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SKYTERRA COMMUNICATIONS INC

Form 10-Q

November 14, 2003

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 period ended September 30, 2003, 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 No

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

Yes No

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

As of November 12, 2003, 6,075,727 shares of the registrant's voting common
stock and 8,990,212 shares of the registrant's non-voting common stock were
outstanding.

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

December
2002

Assets

Current assets:

Cash and cash equivalents

\$ 37,48

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| | |
|---|-----------|
| Short-term investments | 2,00 |
| <hr style="border-top: 1px dashed black;"/> | |
| Total cash, cash equivalents and short-term investments | 39,49 |
| Accounts receivable, net | - |
| Prepaid expenses and other current assets | 1,41 |
| <hr style="border-top: 1px dashed black;"/> | |
| Total current assets | 40,90 |
| | |
| Property and equipment, net | 2 |
| Notes receivable from the Mobile Satellite Venture, L.P. | 56,82 |
| Note receivable from Verestar, Inc. | - |
| Note receivable from Motient Corporation, net | - |
| Investments in affiliates | 2,34 |
| Other assets | 25 |
| <hr style="border-top: 1px dashed black;"/> | |
| Total assets | \$ 100,34 |
| <hr style="border-top: 3px double black;"/> | |
| Liabilities and Stockholders' Equity | |
| Current liabilities: | |
| Accounts payable | \$ 2,10 |
| Accrued liabilities | 5,61 |
| Deferred revenue | - |
| <hr style="border-top: 1px dashed black;"/> | |
| Total current liabilities | 7,71 |
| <hr style="border-top: 1px dashed black;"/> | |
| Series A Convertible Preferred Stock, \$.01 par value, net of unamortized discount of \$41,373 and \$38,078, respectively | 70,49 |
| <hr style="border-top: 1px dashed black;"/> | |
| Minority interest | 11,33 |
| <hr style="border-top: 1px dashed black;"/> | |
| Stockholders' equity: | |
| Preferred stock, \$.01 par value. Authorized 10,000,000 shares; issued 1,118,684 shares as Series A Convertible Preferred Stock at December 31, 2002 and 1,158,150 shares at September 30, 2003 | - |
| Common stock, \$.01 par value. Authorized 200,000,000 shares; issued and outstanding 6,682,615 shares at December 31, 2002 and 6,075,727 shares at September 30, 2003 | 6 |
| Non-voting common stock, \$.01 par value. Authorized 100,000,000 shares; issued and outstanding 8,990,212 shares at December 31, 2002 and September 30, 2003 | 9 |
| Additional paid-in capital | 547,25 |
| Accumulated deficit | (536,43) |
| Treasury stock, at cost, 6,622 shares | (17) |
| <hr style="border-top: 1px dashed black;"/> | |
| Total stockholders' equity | 10,80 |
| <hr style="border-top: 1px dashed black;"/> | |
| Total liabilities and stockholders' equity | \$ 100,34 |
| <hr style="border-top: 3px double black;"/> | |

See accompanying notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except share data)

| | Three Months Ended September 30, | |
|--|----------------------------------|------------|
| | 2002 | 2003 |
| Revenues | \$ -- | \$ 196 |
| Cost of revenues | -- | 219 |
| Gross profit | -- | (23) |
| Expenses: | | |
| Selling, general and administrative | 1,266 | 1,464 |
| Depreciation and amortization | 28 | 13 |
| Total expenses | 1,294 | 1,477 |
| Loss from operations | (1,294) | (1,500) |
| Interest income, net | 1,418 | 1,592 |
| Loss on investments in affiliates | (171) | (67) |
| Other (expense) income, net | (14,813) | 3 |
| Minority interest | (258) | (288) |
| Loss before taxes and discontinued operations | (15,118) | (260) |
| Income tax benefit | -- | -- |
| Loss before discontinued operations | (15,118) | (260) |
| Gain from wind-down of discontinued operations | 413 | 319 |
| Net (loss) income | (14,705) | 59 |
| Cumulative dividends and accretion of convertible preferred stock to liquidation value | (2,370) | (2,429) |
| Net loss attributable to common stockholders | \$ (17,075) | \$ (2,370) |
| Basic and diluted (loss) earnings per share: | | |
| Continuing operations | \$ (1.18) | \$ (0.18) |
| Discontinued operations | 0.03 | 0.02 |
| Net loss per share | \$ (1.15) | \$ (0.16) |
| Weighted average common shares outstanding | 14,800,273 | 15,047,262 |

See accompanying notes to unaudited consolidated financial statements.

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

Nine Months

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| | ----- 2002 ----- |
|--|------------------------|
| Cash flows from operating activities: | |
| Net loss | \$ (4,424) |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| Gain from discontinued operations | (11,871) |
| Depreciation and amortization | 87 |
| Loss on investments in affiliates | 228 |
| Loss on sale of XM Satellite Radio common stock | 14,864 |
| Non-cash compensation (contra-expense) expense | (228) |
| Non-cash charge for issuance of warrant by consolidated subsidiary | -- |
| Changes in assets and liabilities: | |
| Accounts receivable | -- |
| Prepaid expenses, interest receivable and other assets | (3,086) |
| Accounts payable and accrued expenses | (167) |
| Deferred revenue | -- |
| | ----- |
| Net cash used in continuing operations | (4,597) |
| Net cash used in discontinued operations | (1,546) |
| | ----- |
| Net cash used in operating activities | (6,143) |
| | ----- |
| Cash flows from investing activities: | |
| Cash paid for investments in affiliates | (400) |
| Cash received from investment in affiliates | 300 |
| Cash received from the sale of XM Satellite Radio common stock | 3,944 |
| Cash acquired from acquisitions, net of purchase price and acquisition costs | -- |
| Purchases of notes receivable | (1,118) |
| Purchases of short-term investments | (5,176) |
| Sales and maturities of short-term investments | 11,309 |
| Purchases of property and equipment | -- |
| | ----- |
| Net cash provided by (used in) continuing operations | 8,859 |
| Net cash provided by discontinued operations | 500 |
| | ----- |
| Net cash provided by (used in) investing activities | 9,359 |
| | ----- |
| Cash flows from financing activities: | |
| Proceeds from issuance of common stock, net of costs | 18,112 |
| Proceeds from issuance of common stock in connection with the exercise of warrants and options | 3 |
| Cash paid in connection with tender offer | -- |
| Proceeds from contributions to a consolidated subsidiary | 177 |
| | ----- |
| Net cash provided by (used in) financing activities | 18,292 |
| | ----- |
| Net increase (decrease) in cash and cash equivalents | 21,508 |
| Cash and cash equivalents, beginning of period | 7,061 |
| | ----- |
| Cash and cash equivalents, end of period | \$ 28,569 |
| | ===== |

See accompanying notes to unaudited consolidated financial statements.

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(1) Description of the Business

SkyTerra Communications, Inc. (the "Company"), formerly known as Rare Medium Group, Inc., operates its business through a group of complementary subsidiaries in the telecommunications industry, including the Mobile Satellite Venture, L.P. joint venture ("MSV Joint Venture"), Electronic System Products, Inc. ("ESP"), and Miraxis, LLC ("Miraxis"). Consistent with this strategy, in August 2003, the Company signed an agreement to acquire control of Verestar, Inc., a global provider of integrated satellite and fiber services to government organizations, multi-national corporations, broadcasters and communications companies. Closing of the purchase agreement is subject to Verestar achieving certain concessions from its satellite and terrestrial vendors, approval by the FCC, and other customary closing conditions.

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 an 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. The MSV Joint Venture cannot expand its mobile satellite services business using ATC base stations into Canada until this application pending before Industry Canada is approved. With the FCC's issuance of the ATC order, the Company expects the MSV Joint Venture to enter a new stage of development which requires significant future funding requirements and/or a need for one or more strategic partners.

On August 25, 2003, the Company purchased 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. Through the purchase of ESP, the Company acquired an additional 16.1% of IQStat, Inc. ("IQStat"), raising the Company's total stake to 21.3%. IQStat is a privately held company with technology that will enable it to measure radio listening habits and transmit the data over a national wireless communications network to IQStat's operations center. IQStat intends to market the aggregated data to broadcasters and advertisers to allow real-time tracking of consumer behavior.

On May 28, 2002, the Company became affiliated with Miraxis, a development stage 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.

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 solutions. As a result of the weakening of general economic conditions that

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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 such, the results of Rare Medium, Inc. and LiveMarket are reflected as discontinued operations.

From 1999 through the first quarter of 2001, the Company made venture investments by taking strategic minority equity positions in other independently managed companies. Additionally, during that period, the Company developed, managed and operated companies in selected Internet-focused market segments ("Start-up Companies"). During the first quarter of 2001, the Company reduced its focus on these businesses and substantially ceased providing funding to its Start-up Companies.

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, 2002 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 and nine months ended September 30, 2003 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 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

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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 at 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. This new option will expire either December 31, 2003 or March 31, 2004, depending on when certain regulatory appeals are decided. 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 additional equity investments 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. Such additional equity investments must total \$41.6 million if made by December 31, 2003 and will need to increase thereafter by an amount equal to the additional interest accrued on the MSV Joint Venture's outstanding debt. Currently, the MSV Investors Subsidiary owns, upon conversion, approximately 30.3% of the equity interests in the MSV Joint Venture. If the Other MSV Investors exercise their option, the MSV Investors Subsidiary would own, upon conversion, approximately 27.4% of the equity interests.

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

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 seven 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. Subsequent to June 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. Currently, the Company holds approximately 40.1% of the ownership interests of Miraxis.

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The Company's President and Chief Executive Officer currently holds an approximate 1.0% interest in Miraxis. Miraxis License Holdings, LLC ("MLH"), an entity unaffiliated with Miraxis, other than as described below, holds the rights to certain orbital slots that Miraxis has acquired access to in order to implement its business plan. Miraxis is in the process of issuing 10% of its outstanding common equity on a fully diluted basis to MLH in exchange for access to those slots. Prior to becoming affiliated with the Company, its Chief Executive Officer and President acquired a 2.0% interest in MLH. In addition, an affiliate of the Company's preferred stockholders holds an approximate 70.0% interest in MLH.

In May 2003, the Company acquired Series B Preferred Shares from IQStat for approximately \$0.3 million, representing an ownership interest of approximately 5.2%. IQStat is a privately held company with technology that will enable it to measure radio listening habits and transmit the data over a national wireless communications network to IQStat's operations center. IQStat intends to market the aggregated data to broadcasters and advertisers to allow real-time tracking of consumer behavior.

In August 2003, the Company signed an agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Verestar is a global provider of integrated satellite and fiber services to government organizations, multi-national corporations, broadcasters, and communications companies. Concurrent with the signing of the definitive 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. Closing of the purchase agreement is subject to Verestar achieving certain concessions from its satellite and terrestrial vendors, approval by the FCC, and other customary closing conditions. At closing, if it occurs, the Company will provide nominal consideration to the existing owner of Verestar in exchange for its equity interest. Furthermore, at closing, assuming it occurs, the Company will, subject to certain terms and conditions, purchase up to an additional \$7.0 million in principal of senior secured notes from Verestar.

In August 2003, for nominal consideration, the Company 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, the Company 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 September 30, 2003, the Company has purchased approximately \$0.2 million in principal of these senior secured notes. ESP is expected to make restricted stock grants to its employees representing an aggregate of 30% of ESP's outstanding equity, diluting the Company's ownership to 70%.

The investments in Miraxis and IQStat are included in "Investments in Affiliates" on the accompanying consolidated balance sheets. The investments are being accounted for under the equity method with the Company's share of Miraxis' and IQStat's loss being recorded in "Loss on Investments in Affiliates" on the accompanying consolidated statements of operations.

(5) 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 Financial Accounting Standards Board ("FASB") Interpretation No. 44, "Accounting For Certain Transactions Involving Stock Compensation," and

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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 in 2001, for the three and nine months ended September 30, 2002, the Company recognized compensation contra-expense of approximately \$13,000 and \$0.2 million, respectively, resulting from the decrease in the price of the Company's common stock from December 31, 2001 to September 30, 2002. For the three and nine months ended September 30, 2003, the Company recognized compensation expense of approximately \$0.3 million and \$0.4 million, respectively, relating to the re-pricing of certain stock options in 2001 and 2002.

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 September 30, | | Nine Mon |
|--|----------------------------------|----------|----------|
| | 2002 | 2003 | 2002 |
| Net (loss) income, as reported | \$(14,705) | \$59 | \$(4,4 |
| (Deduct) Add: Stock-based compensation (contra-expense) expense, as reported | (13) | 297 | (2 |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards | (140) | (68) | (6 |
| Pro forma net (loss) income | \$(14,858) | \$288 | \$(5,2 |
| Basic and diluted net loss attributable to common stockholders per share: | | | |
| As reported | \$(1.15) | \$(0.16) | \$(1. |
| Pro forma | \$(1.16) | \$(0.14) | \$(1. |

For the three and nine months ended September 30, 2002, the Company issued options to purchase 25,000 shares of common stock at a weighted average fair value of \$1.22 using the Black-Scholes option pricing model. For the three months ended September 30, 2003, the Company issued options to purchase 40,000 shares of common stock at a weighted average fair value of \$1.26 using the Black-Scholes option pricing model. For the nine months ended September 30, 2003, the Company issued options to purchase 235,000 shares of common stock at a weighted average fair value of \$0.83 using the Black-Scholes option pricing model.

(6) 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

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of their performance and prospects. As of September 30, 2003, cash of approximately \$0.1 million (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 \$2.8 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 \$3.2 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 and nine months ended September 30, 2002, the Company recognized a gain of approximately \$0.4 million and \$11.9 million, respectively, as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts. For the three and nine months ended September 30, 2003, the Company recognized a gain of approximately \$0.3 million and \$0.9 million, respectively, as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts.

(7) Contingencies

Motient Notes

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. As a result of the uncertainty with respect to the ultimate collection on the New Motient Note, a reserve continues to be maintained for the entire amount of the note. If the Company recovers any amount on the New Motient Note, adjustments to the reserve would be reflected in the accompanying consolidated statements of operations.

Litigation

On November 19, 2001, five of the Company's shareholders filed a complaint against the Company, certain of its subsidiaries and certain of their 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 intends to continue to dispute

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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, 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 12, 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. The Company intends to vigorously oppose any efforts by the plaintiffs should they appeal the decision or refile the matter in a different jurisdiction.

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 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.

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

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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 subsidiaries in the telecommunications industry, including the MSV Joint Venture, ESP, and Miraxis. Consistent with this strategy, in August 2003, we signed an agreement to acquire control of Verestar, a global provider of integrated satellite and fiber services to government organizations, multi-national corporations, broadcasters and communications companies. Closing of the purchase agreement is subject to Verestar achieving certain concessions from its satellite and terrestrial vendors, approval by the FCC, and other customary closing conditions.

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. We have designated three members of the 12-member board of directors of the MSV Joint Venture's corporate general partner.

On February 10, 2003, 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 into its mobile satellite network. A similar application is pending before Industry Canada, the FCC's counterpart in Canada. The MSV Joint Venture cannot expand its mobile satellite services business using ATC base stations into Canada until this application pending before Industry Canada is approved. With the FCC's issuance of the ATC order, we expect the MSV Joint Venture to enter a new stage of development which requires significant future funding requirements and/or a need for one or more strategic partners.

On August 25, 2003, for nominal consideration, we purchased all of the outstanding common stock of ESP, a product development firm that creates products for and provides consulting and engineering services targeted toward the telecommunications, broadband, satellite communications, and wireless industries. Through the purchase of ESP, we acquired an additional 16.1% of IQStat, raising our total stake to 21.3%. IQStat is a privately held company that measures radio listening habits and transmits the data over a national wireless communications network to IQStat's operations center. IQStat intends to market the aggregated data to broadcasters and advertisers to allow real-time tracking of consumer behavior.

On May 28, 2002, we became affiliated with Miraxis, a development stage 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.

On August 29, 2003, the Company signed an agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Closing of the definitive purchase agreement is subject to Verestar achieving certain concessions from its satellite and terrestrial vendors, approval by the FCC, and other customary closing conditions. If the transaction closes as expected in the fourth quarter of 2003, we expect to consolidate the operating results of Verestar after the date of closing. To the extent we are

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not permitted to consolidate Verestar's operating results due to FIN No. 46 (as defined and discussed below), we expect to provide supplemental disclosure of the items required by this Item 2.

From 1998 through the third quarter of 2001, our 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 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 LiveMarket, was made at the end of the third quarter of 2001. As such, the results of Rare Medium, Inc. and LiveMarket are reflected as discontinued operations.

From 1999 through the first quarter of 2001, we made venture investments by taking strategic minority equity positions in other independently managed companies. Additionally, during that period, we developed, managed and operated Start-up Companies. During the first quarter of 2001, we reduced our focus on these businesses and substantially ceased providing funding to our Start-up Companies.

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 also 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 certain of our Start-up Companies up to their respective dates of dissolution.

Results of Operations for the Three Months Ended September 30, 2003 Compared to the Three Months Ended September 30, 2002

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 ending September 30, 2003 increased to \$0.2 million from nil for the three months ended September 30, 2002, an increase of \$0.2 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 from services performed by ESP, as a full three months of ESP's operating results will be included.

Cost of Revenues

Cost of revenues includes the salaries and related employee benefits for ESP employees that provide billable product development, consulting and

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engineering services, as well as the cost of reimbursable expenses. Cost of revenues for the three months ending September 30, 2003 increased to \$0.2 million from nil for the three months ended September 30, 2002, an increase of \$0.2 million. This increase was due to the acquisition of ESP on August 25, 2003. In future periods, we expect cost of revenues from services performed by ESP to increase, as a full three months of ESP's operating results will be included.

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 ending September 30, 2003 increased to \$1.5 million from \$1.3 million for the three months ended September 30, 2002, an increase of \$0.2 million. This increase was primarily related to the \$0.2 million of expenses incurred by ESP after the August 25, 2003 acquisition and the recognition of a \$0.3 million non-cash compensation expense in the three months ended September 30, 2003 relating to the re-pricing of certain stock options which occurred in 2001 and 2002, partially offset by a \$0.3 million insurance claim payment related to the class action lawsuit settled in January 2003. As these costs relate to our current operations, including ESP, 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 a full three month of ESP's operating results will be included.

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 September 30, 2003 decreased to approximately \$13,000 from \$28,000 for the three months ended September 30, 2002, a decrease of approximately \$15,000. This decrease is primarily the result of the reduction in property and equipment used in our continuing operations, partially offset by the depreciation of ESP's property and equipment after the August 2003 acquisition. As our capital expenditures remain nominal, we expect depreciation and amortization expense to remain at this level in future periods.

Interest Income, Net

Interest income, net for the three months ended September 30, 2003 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 and Verestar.

Loss on Investment in Affiliates

For the three months ended September 30, 2003, we recorded a loss on investments in affiliates of approximately \$0.1 million relating primarily to the reserve for the promissory note issued by Miraxis and for our proportionate share of IQStat's operating loss. For the three months ending September 30, 2002, we recorded a loss on investments in affiliates of approximately \$0.2 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

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For the three months ended September 30, 2003 and 2002, 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 September 30, 2003 and 2002, we recognized a gain of approximately \$0.3 million and \$0.4 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 September 30, 2003, we recorded a net loss attributable to common stockholders of approximately \$2.4 million. The loss was due to the approximate \$0.1 million net income and the \$2.4 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.

Results of Operations for the Nine Months Ended September 30, 2003 Compared to the Nine Months Ended September 30, 2002

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 nine months ending September 30, 2003 increased to \$0.2 million from nil for the nine months ended September 30, 2002, an increase of \$0.2 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 from services performed by ESP, as a full period of ESP's operating results will be included.

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 nine months ending September 30, 2003 increased to \$0.2 million from nil for the nine months ended September 30, 2002, an increase of

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\$0.2 million. This increase was due to the acquisition of ESP on August 25, 2003. In future periods, we expect cost of revenues from services performed by ESP to increase, as a full period of ESP's operating results will be included.

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 nine months ending September 30, 2003 decreased to \$4.8 million from \$4.9 million for the nine months ended September 30, 2002, a decrease of \$0.1 million. This decrease was primarily related to the \$1.1 million charge recognized in the nine months ended September 30, 2002 related to the settlement of the class action lawsuit and the reduced legal and advisory fees after the settlement of the class action lawsuit and the \$0.3 million insurance claim payment related to the costs associated with the class action lawsuit, partially offset by the \$0.2 million of expenses incurred by ESP after the August 25, 2003 acquisition, the approximately \$0.4 million charge recognized in the nine months ended September 30, 2003 relating to the severance for the Company's former Controller and former Treasurer and the \$0.2 million compensation contra-expense and \$0.4 million compensation expense recognized in the nine months ended September 30, 2002 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, 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 a full period of ESP's operating results will be included.

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 nine months ended September 30, 2003 decreased to approximately \$26,000 from \$0.1 million for the nine months ended September 30, 2002, a decrease of approximately \$0.1 million. This decrease is primarily the result of the reduction in property and equipment used in our continuing operations, partially offset by the depreciation of ESP's property and equipment after the August 2003 acquisition. As our capital expenditures remain nominal, we expect depreciation and amortization expense to remain at this level in future periods.

Interest Income, Net

Interest income, net for the nine months ended September 30, 2003 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 and Verestar.

Loss on Investment in Affiliates

For the nine months ended September 30, 2003, we recorded a loss on investments in affiliates of approximately \$0.3 million relating primarily to the reserve for the promissory note issued by Miraxis and for our proportionate share of Miraxis' and IQStat's operating loss. For the nine months ending September 30, 2002, we recorded a loss on investments in affiliates of approximately \$0.2 million for our proportionate share of Miraxis' operating loss. We will continue to monitor the carrying value of our remaining investments in affiliates.

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Minority Interest

For the nine months ended September 30, 2003 and 2002, we recorded minority interest of approximately \$0.8 million and \$0.7 million, respectively, 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 nine months ended September 30, 2003 and 2002, we recognized a gain of approximately \$0.9 million and \$11.9 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 nine months ended September 30, 2003, we recorded a net loss attributable to common stockholders of approximately \$7.6 million. The loss was due to the \$0.4 million net loss and the \$7.2 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 \$31.6 million in cash, cash equivalents and short-term investments as of September 30, 2003. Cash used in operating activities from continuing operations was \$3.5 million for the nine months ended September 30, 2003 and resulted primarily from cash used for general corporate overhead including payroll and professional fees. We expect cash used in continuing operations to remain at approximately this level in future periods. Cash used by discontinued operations was \$0.4 million for the nine months ended September 30, 2003 and resulted from cash used for settlement of vendor liabilities and legal and advisory fees.

For the nine months ended September 30, 2003, cash used in investing activities from continuing operations, excluding purchases and sales of short-term investments, was approximately \$2.8 million and primarily consisted of \$2.5 million used to purchase the senior secured promissory note from Verestar and \$0.4 million used to purchase investments in IQStat and Miraxis. Other than our agreements with ESP and Verestar 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 IQStat 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.

For the nine months ended September 30, 2003, cash used in financing activities was approximately \$1.2 million and resulted primarily from the repurchase of shares of common stock in the tender offer as described below.

Motient Promissory Notes

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

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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. As a result of the uncertainty with respect to the ultimate collection on the New Motient Note, a reserve continues to be maintained for the entire amount of the note. If we recover any amount on the New Motient Note, adjustments to the reserve would be reflected in the accompanying consolidated statements of operations. Furthermore, we have been conducting periodic discussions with Motient concerning alternatives related to the New Motient Note including the exchange of such note, or a portion thereof, into an additional equity interest in the MSV Joint Venture.

MSV Joint Venture Convertible Note 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, Rare Medium Group 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 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 at 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. This new option will expire either December 31, 2003 or March 31, 2004, depending on when certain regulatory appeals are decided. 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 additional equity investments at a valuation of the MSV Joint Venture equal to or greater than the valuation at the time the MSV Investors Subsidiary

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purchased the notes. Such additional equity investments must total \$41.6 million if made by December 31, 2003 and will need to increase thereafter by an amount equal to the additional interest accrued on the MSV Joint Venture's outstanding debt. Currently, our MSV Investors Subsidiary owns, upon conversion, approximately 30.3% of the equity interests in the MSV Joint Venture. If the Other MSV Investors exercise their option, our MSV Investors Subsidiary would own, upon conversion, approximately 27.4% of the equity interests.

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 Senior Secured Promissory Notes

In August 2003, we signed an agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Verestar is a global provider of integrated satellite and fiber services to government organizations, multi-national corporations, broadcasters, and communications companies. Concurrent with the signing of the purchase agreement, we purchased a 10% senior secured note with a principal balance of \$2.5 million and a due date of August 2007. Closing of the definitive purchase agreement is subject to Verestar achieving certain concessions from its satellite and terrestrial vendors, approval by the FCC, and other customary closing conditions. At closing, if it occurs, we will provide nominal consideration to the existing owner of Verestar in exchange for its equity interest. Furthermore, at closing, assuming it occurs, we will, subject to certain terms and conditions, purchase up to an additional \$7.0 million in principal of senior secured notes from Verestar.

ESP Senior Secured Promissory Notes

In August 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 September 30, 2003, we purchased approximately \$0.2 million in principal of these senior secured notes.

Other Transactions

As part of our regular on-going evaluation of business opportunities, we are currently engaged in a number of separate and unrelated preliminary discussions concerning possible joint ventures and other transactions (collectively, the "Transactions"). We are in the early stages of such discussions and have not entered into any agreement in principle with respect to any of the Transactions. 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. We cannot predict if any such Transaction will be consummated or, if consummated, will result in a financial or other benefit to us.

Tender Offer

On March 13, 2003, we commenced a cash tender offer at a price of \$1.00 per share for up to 2,500,000 shares of our outstanding voting common stock.

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The tender offer expired on April 23, 2003 with 968,398 shares purchased by us for an aggregate cost, including all fees and expenses applicable to the tender offer, of approximately \$1.2 million. The primary purpose of the tender offer was to provide our public stockholders with additional liquidity for their shares of common stock, particularly in light of decreased liquidity arising from the decision of Nasdaq to delist our common stock, and to do so at a premium over the stock price before the tender offer and without the usual transaction costs associated with open market sales. Our preferred stockholders did not sell any shares of common stock in the tender offer.

Recently Issued Accounting Standards

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN No. 46"). FIN No. 46 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. 46 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. We are currently reviewing our investments and other arrangements to determine whether any of our investee companies are VIEs.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS No. 150"). SFAS No. 150 establishes standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires the classification of certain financial instruments as a liability (or in certain circumstances an asset) because that instrument embodies an obligation of the company. SFAS No. 150 is effective immediately for instruments entered into or modified after May 31, 2003 and in the first interim period beginning after June 15, 2003 for all instruments entered into before May 31, 2003. The adoption of SFAS No. 150 did not have a material impact on our financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2003, we had \$31.6 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 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.

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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 our shareholders filed a complaint against us, certain of our subsidiaries and certain of their 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 stock when they sold the company that they owned to us. 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, we 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, we filed a motion to dismiss on behalf of our self and our current and former officers and directors. On March 7, 2003, the Court denied the motion to dismiss, and discovery has commenced. We intend to continue to dispute this matter vigorously.

We and certain of our 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., our former name, and the Engelhard/ICC ("E/ICC") joint venture arising from the desiccant air conditioning business that we and our subsidiaries sold in 1998. The claimant has sought \$8.5 million for (a) its alleged out of pocket losses in investing in certain of E/ICC's technology, (b) unjust enrichment resulting from the reorganization of E/ICC in 1998, and (c) 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. We intend 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, us, certain of our current and former officers, our 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 us and certain of our 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. On October 11, 2002, the plaintiffs sought to have the matter remanded to state

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court. On May 7, 2003, the Federal District Court denied the plaintiffs request to remand the matter as it related to us, our defendants and an additional defendant. On June 9, 2003, we and our defendants filed a motion to dismiss. On August 4, 2003, the plaintiffs responded. On October 12, 2003, the Federal District Court dismissed the action, holding that it lacked personal jurisdiction over us and our defendants and, accordingly, found it unnecessary to rule upon our other bases for dismissal. We intend to vigorously oppose any efforts by the plaintiffs should they appeal the decision or refile the matter in a different jurisdiction.

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

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 |

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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 September 3, 2003, the Company filed a report on Form 8-K (i) announcing the acquisition of all of the outstanding equity of Electronic System Products, Inc.; (ii) announcing the signing of a definitive purchase agreement to acquire approximately 67% (on a fully diluted basis) of the outstanding equity of Verestar, Inc.; (iii) announcing the purchase of a \$2.5 million of senior secured note from Verestar, Inc.; and (iv) announcing that the Board of Directors had approved the change of the Company's name to SkyTerra Communications, 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: November 14, 2003

By: /s/ JEFFREY A. LEDDY

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

Date: November 14, 2003

By: /s/ CRAIG J. KAUFMANN

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

Exhibit 31.1

CERTIFICATIONS

I, Jeffrey A. Leddy, certify that:

1. I have reviewed this Form 10-Q of SkyTerra Communications, 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

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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 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)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls 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) 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
 - c) 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 (the registrant's fourth quarter in the case of an annual report) 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 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 registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls 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 14, 2003

By: /s/ JEFFREY A. LEDDY

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

CERTIFICATIONS

I, Craig J. Kaufmann, certify that:

1. I have reviewed this Form 10-Q of SkyTerra Communications, 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 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)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls 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) 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
 - c) 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 (the registrant's fourth quarter in the case of an annual report) 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 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 registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls 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.

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Date: November 14, 2003

By: /s/ CRAIG J. KAUFMANN

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

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Jeffrey A. Leddy, Chief Executive Officer and President of SkyTerra Communications, Inc. (the "Company"), hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) 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.

By: /s/ JEFFREY A. LEDDY

Name: Jeffrey A. Leddy
Title: Chief Executive Officer and President
(Principal Executive Officer and
Principal Financial Officer)
Date: November 14, 2003

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Craig J. Kaufmann, Controller and Treasurer of SkyTerra Communications, Inc. (the "Company"), hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) 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.

By: /s/ CRAIG J. KAUFMANN

Name: Craig J. Kaufmann
Title: Controller and Treasurer
(Principal Accounting Officer)
Date: November 14, 2003

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.