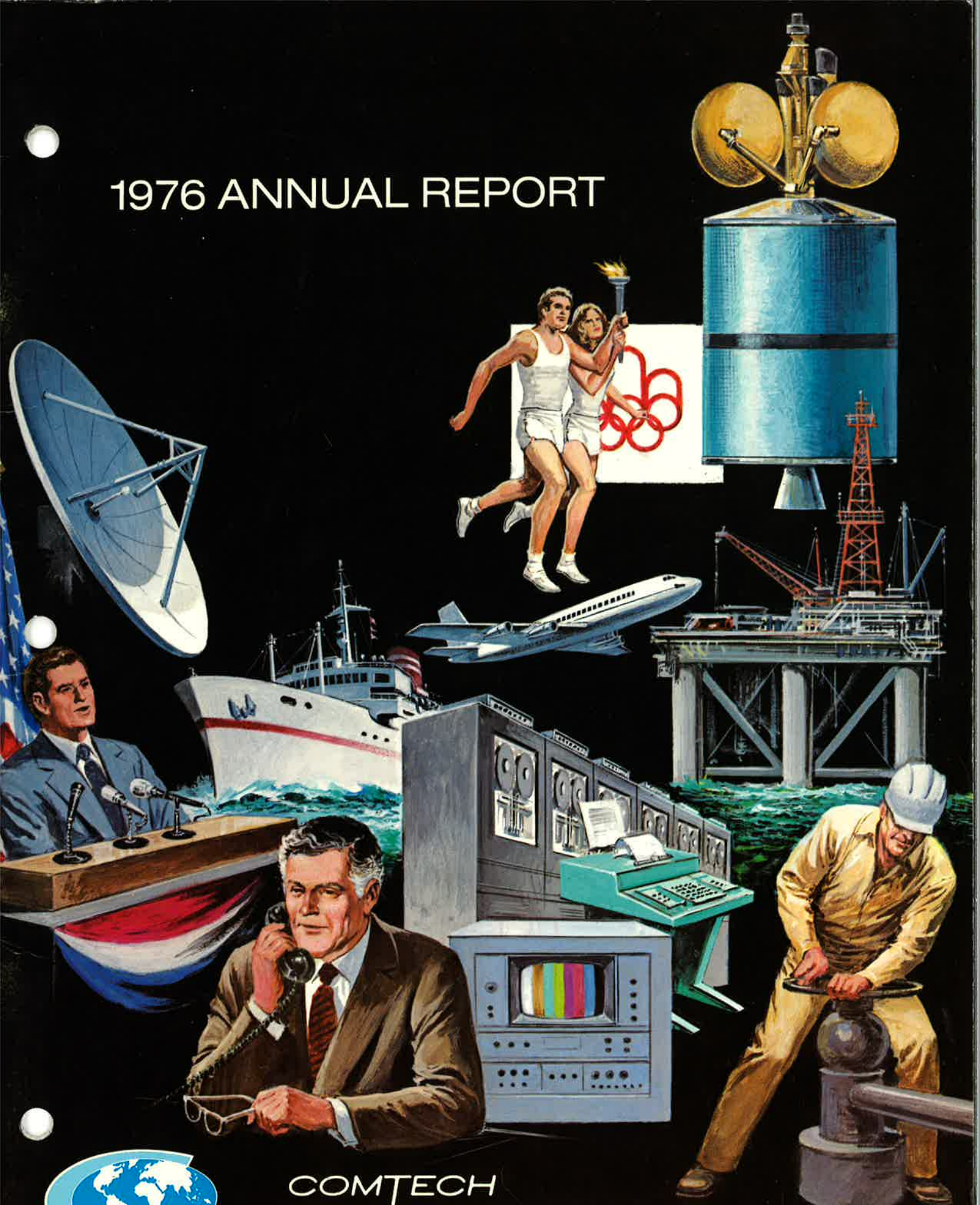


1976 ANNUAL REPORT



COMTECH
LABORATORIES INC.

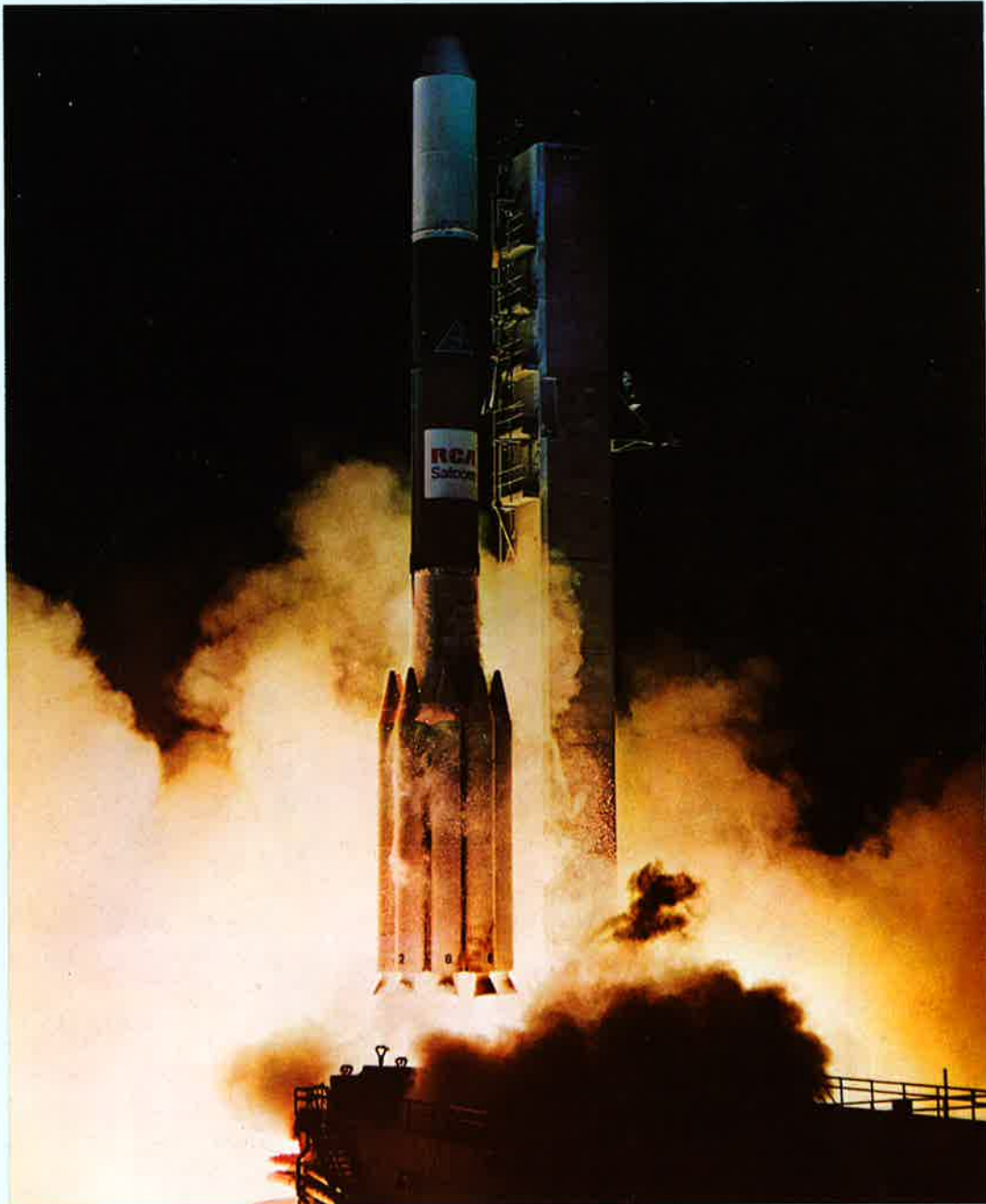


Photo courtesy of RCA

The Thor-Delta 3914 launch vehicle with the RCA Satcom 1 domestic communications satellite was launched in December 1975, at Cape Canaveral, Florida. The satellite was placed into a geostationary orbit 22,300 miles above the equator through a complex series of maneuvers directed from RCA's Vernon Valley, New Jersey, Tracking Telemetry and Control station. The 24-channel spacecraft is designed to provide commercial communications to Alaska, Hawaii and the contiguous 48 states. Each channel can carry 1,000 voice grade circuits, one FM/color video transmission, or 64 million bits per second of data. Comtech designed and installed the communication equipment for the satellite tracking telemetry and command terminals located in Los Angeles and Vernon Valley, as well as the satellite communications equipment in Los Angeles, Vernon Valley, Houston, Chicago, and Point Reyes.

COMTECH LABORATORIES INC.



Board of Directors

D. R. Campbell
F. Kornberg
J. E. Rosenblum
G. R. Nocita — *Consultant to the Company*
J. A. Tokar — *Vice President, Combustion
Equipment Associates, Inc.*

Officers

F. Kornberg — *President and
Chief Executive Officer*
J. E. Rosenblum — *Vice President*
D. R. Campbell — *Vice President*
M. L. Deever — *Vice President*
J. P. Windus, Jr. — *Secretary/Treasurer*

Bank

Chemical Bank
1064 Old Country Road
Plainview, New York 11803

Legal Counsel

Botein, Hays, Sklar & Herzberg
200 Park Avenue
New York, New York 10017

Registrar and Transfer Agent

Chemical Bank
55 Water Street
New York, New York 10041

Independent Accountants

Arthur Andersen & Co.
1 Huntington Quadrangle
Huntington, Long Island, New York 11746

Stock Traded — OTC

NASDAQ Symbol — CMTL

MESSAGE TO OUR SHAREHOLDERS:

Comtech Laboratories Inc. operating results for the fiscal year ended 31 July 1976 reached record levels. Net income increased by 57% from \$1,525,761, or \$0.94 per share, to \$2,396,024, or \$1.44 per share on a 40% increase in sales from \$16,563,517 to \$23,128,055. These results extended — for the sixth straight year — a continuous earnings growth record.

Our rapid growth has been a direct consequence of two important factors. The first is the dynamic expansion in satellite communication for international, domestic and special-purpose systems; the other is Comtech's ability to respond to these markets with an increasingly comprehensive and technically sophisticated product line and a wide range of systems designs and services.

Comtech's backlog at year end was \$9,867,665 as compared to \$23,096,292 at the end of fiscal year 1975. Although the solicitation of proposals and bids to implement new earth stations for satellite communications systems has flowed at a rapid, planned rate, actual placement of new orders has not always proceeded uniformly. The lower backlog figure, we believe, principally reflects delays in the timing of contract awards.

Over the past several years, the Company has been able to anticipate market trends and maintain a competitive posture through well-defined objectives in product design, manufacturing, and management. To this end, Comtech continues to improve and expand its basic product line. For example, Comtech's new line of compact receivers and transmitters, developed during fiscal year 1975, contributed greatly to the marketability of the majority of satellite earth terminal systems and subsystems the Company sold and delivered in fiscal year 1976.

The Company's development programs were directed toward those areas offering substantial future market return. These efforts included the development of single-chassis redundant frequency conversion equipment particularly suited to single channel-per-carrier applications; a new line of compact X-Band frequency converters for mobile installations and systems with limited space; a redesign of our data-over-voice modem capable of handling data transmission in the unused portion of the voice band

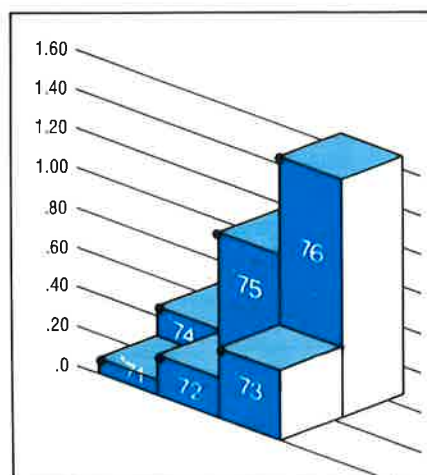
on a terrestrial microwave carrier; high stability phase-locked oscillators of the type required for digital transmission and reception, and communication test equipment adaptable to both field and laboratory use.

In addition to these efforts, the Company has developed a comprehensive line of highly compact terrestrial microwave and troposcatter microwave communication equipment in the frequency bands from 1 to 5 GHz. These modes of communication have been receiving renewed interest over the past several years, particularly in overseas markets for digital communication. The availability of technically advanced and competitive terrestrial microwave and troposcatter microwave systems now allows Comtech to offer a complete national communication network including analysis, system design, and implementation utilizing satellite, terrestrial and troposcatter communication combinations where a high level of secure transmission and reception is desired. Since the majority of existing terrestrial microwave and troposcatter microwave systems have been in operation for as long as 20 years, substantial market potential exists for the upgrading of existing terminals as well as for new systems and network installations utilizing the new, more efficient digital radio techniques.

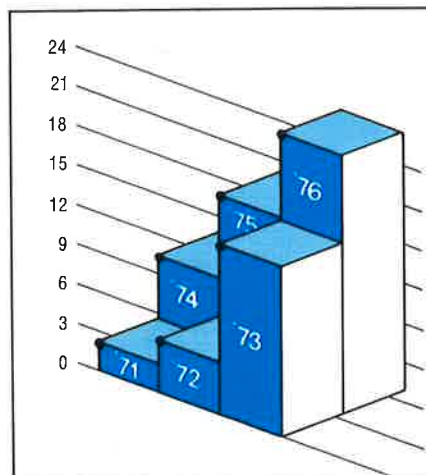
Significant to Comtech's progress has been the continued interest and repeat orders from such customers as RCA, Western Union, Comsat, Cable and Wireless, and the U.S. Army Satellite Communications Agency. Some of the major programs over the past year included the installation of Comtech's receiving and transmitting subsystems at RCA, Comsat and Western Union sites. Similar subsystems were delivered to the government of Mexico, and to Aeronutronic Ford for use in the Indonesian domestic satellite network.

Turn-key projects in 1976 included a transportable earth station installed in the Republic of Nauru under a contract with Cable and Wireless, and several terminals for the RCA domestic satellite communication network. Under a lease agreement with Western Union, Comtech provided a highly mobile terminal for remote video applications. This terminal was delivered in record time and was first used for video coverage of the Republican National Convention in Kansas City.

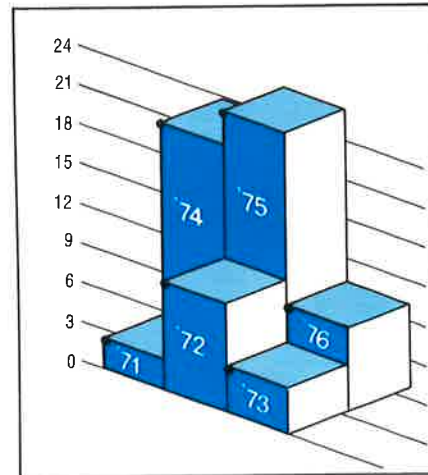
EARNINGS PER SHARE
(in dollars)



SALES AND OTHER INCOME
(in millions of dollars)



BACKLOG
(in millions of dollars)



Fiscal years ended July 31

Toward the close of fiscal 1976, Comtech received a contract award from Satellite Business Systems Incorporated for two satellite communications earth stations capable of digital data reception and transmission in the 4/6 GHz bands. The potential use of these stations for corporate based computer data and image transmission represents a significant step towards the application of satellite communications in the business sector.

Fiscal year 1976 was a year of substantial growth and accomplishment for Comtech. We enter fiscal year 1977 in a strong financial condition, well-positioned to pursue aggressively the many opportunities in the markets we serve. In that connection, the Company is maintaining facility and capability adjustments consistent with our long-range planning and business outlook.

During fiscal year 1976, the Company intensified its effort to augment its human resource complement in the engineering, management and marketing areas. Select disciplines have been added to strengthen the technological base, with emphasis placed on digital, satellite and troposcatter systems. Our management capabilities and marketing activities have been expanded to provide improved coverage of available markets. Particular attention is being given to systems and network sales and new applications for existing products, with a heavy concentration in overseas markets.

Furthermore, Comtech's future business expansion becomes more important as our product line increases in breadth and complexity. It has become increasingly clear that the area of new business development and acquisitions demands a strenuous, full-time effort. To further enhance our effectiveness, Mr. Milton L. Deever, formerly Director of Planning and Management Information Systems for the Government Electronics Division of Motorola, Inc., was appointed in May of this year as Vice President, New Business Development. Mr. Deever will be responsible for acquisitions and for the development of new application markets for Comtech's comprehensive line of advanced communication equipments and systems.

Our facility expansion program is well under way. A 5,000 square-foot extension to the Engineers Road plant

has increased its size to 65,000 square feet. Final arrangements were completed for the lease of a 123,000 square-foot manufacturing facility on seven acres of land adjoining our Engineers Road plant. The facility should be ready for occupancy during the second quarter of fiscal year 1977. At that time, we will relinquish our present 37,500 square-foot leased plant on Oser Avenue and relocate those activities to the new building. The new building will permit the consolidation and expansion of all Comtech manufacturing operations, as well as the allocation of additional space for systems engineering, development and program management.

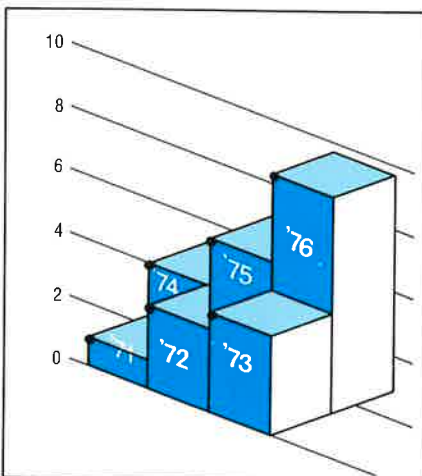
Last February, Comtech's bank line of credit, which is subject to annual renewal, was increased to \$12,000,000. However, for the last 16 months the Company has not found it necessary to draw on this line of credit. This is a result of our ability to obtain milestone and progress payments from our military and most of our domestic and international customers.

Comtech's position in the communications industry is a tribute to the caliber of our personnel. We wish to thank all of our employees* for their high level of performance and active interest in meeting the goals of the Company. In recognition of their contributions, and as a result of the record operating results for fiscal year 1976, Comtech has contributed \$250,000 to the Employees Profit Sharing Retirement Plan, as compared to \$150,000 for fiscal year 1975. Company contributions to the plan in future years will depend on, among other things, Comtech's overall performance and profitability.

In order to attract and retain key personnel, we instituted a Key Employee Incentive Compensation Plan, commencing with fiscal year ended July 31, 1976, which sets aside 5% of the Company's pre-tax income for distribution to selected employees.

We also wish to thank our growing number of shareholders for their continued encouragement and support. Their demonstrations of confidence are important factors in maintaining a solid financial base from which the Company can sustain its growth.

SHAREHOLDERS' EQUITY (in millions of dollars)



Fred Kornberg
President and
Chief Executive Officer

October 16, 1976

*It is the policy of Comtech to provide equal opportunity to all employees and applicants for employment without regard to race, sex, religion, color or national origin, and affirmative action is taken to ensure the implementation of this policy.

GENERAL DESCRIPTION OF SATELLITE COMMUNICATIONS MARKETS

Long before communications-relaying space vehicles became a reality, scientists eyed the natural satellite of the earth — the moon. Early in 1946, Project Diana scientists detected the first radar signals reflected off the moon. Thirty years later, artificial satellites circle the globe. The first man-produced "beeps" directly from space were heard on October 4, 1957 from Sputnik 1. The USA entered the space age on January 31, 1958 with Explorer 1.

Today, in addition to the spectacular manned exploration of moon and space, commercial and military satellites stretch telephone, digital data and television signals across oceans and continents by means of global communications established through the International Telecommunications Satellite Consortium (INTELSAT) and the Defense Satellite Communications System (DSCS). Probably more important are the new markets satellites have created for intra-national or domestic satellite (DOMSAT) communications. Present DOMSAT systems provide communications between regions via satellite, and within regions via terrestrial microwave, troposcatter microwave or cable facilities. In the near future, satellites operating economically with demand-assignment multiple-access techniques, and smaller, inexpensive earth stations at higher frequencies will allow communications within regions via satellite.

During the past year, the pace of communication satellite systems development has accelerated. Satellite communications systems offer lower costs and special capabilities to communication users. Many of these users have found that the best and most cost-effective way to meet their communication needs is to relay radio signals off geostationary satellites 22,300 miles in space, enabling messages to travel over continents or hemispheres. No land-based system is needed except one to take the signal from the user to the earth station transmitter and from the earth station receiver to the end user.

Until the present time, satellite channels have been used almost exclusively as replacements or substitutes for earthbound ones such as terrestrial microwave, troposcatter microwave, or cable channels. This situation is changing as the special capabilities of satellite channels become more widely recognized. Some important communications satellite capabilities are beginning to be exploited. For example, commercial satellite channels are usually employed as point-to-point links between two earth stations just as if

these stations were linked by a direct connection. But a satellite can provide for more than a point-to-point direct connection. A single satellite channel can transmit and receive signals from any earth station located within its beamwidth or its antenna pattern which can encompass as much as a third of the globe. This point-to-multipoint communications capability renders the satellite communication channel particularly useful in a network composed of a large number of small earth stations. If a destination number, such as an address or telephone number, is attached to each message transmitted by an earth station in such a system, then it is no longer necessary to devote a separate direct channel between each pair of earth stations wishing to communicate.

Satellite communications systems are composed of two basic products — satellites and earth stations. The overall market is projected to generate a total of about \$3 billion in new business between now and 1980.* Earth stations account for approximately 65% of the investment in satellite communications hardware. The estimated market for satellite communication earth stations and subsystems during 1975 and the projected 1980 market is comprised of major segments as follows:

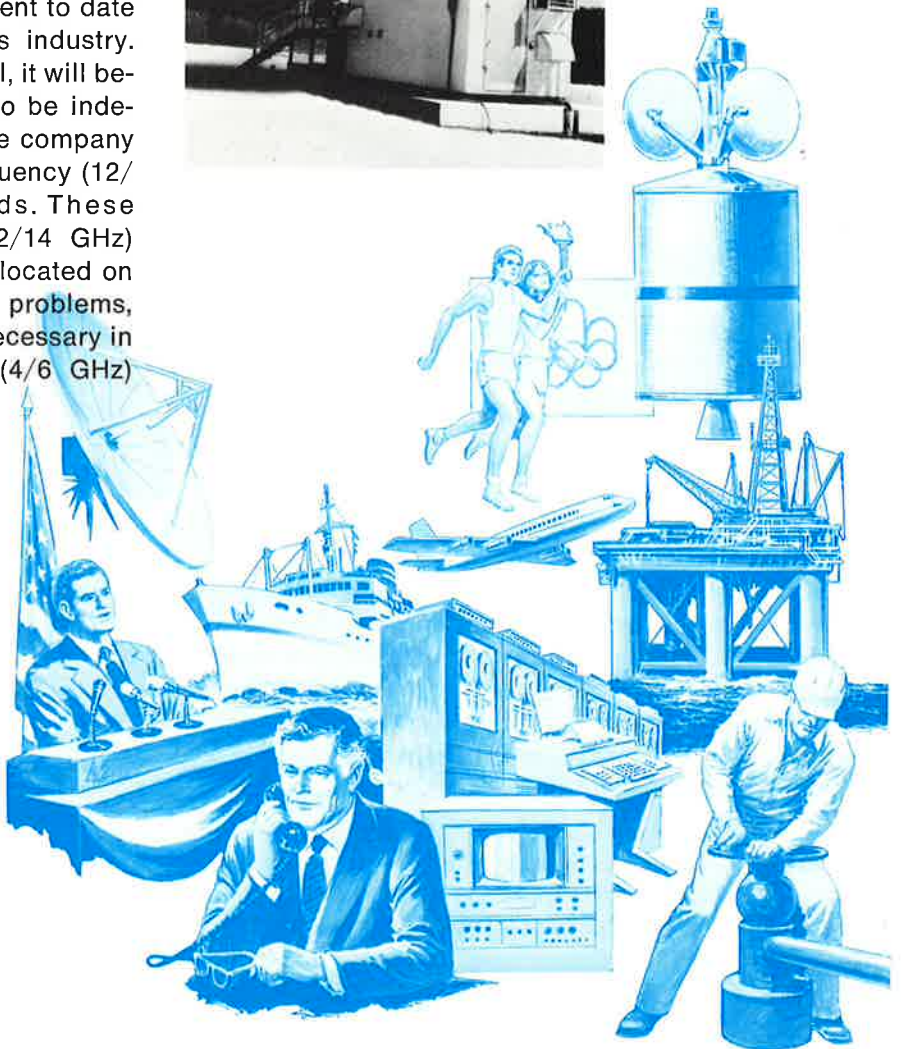
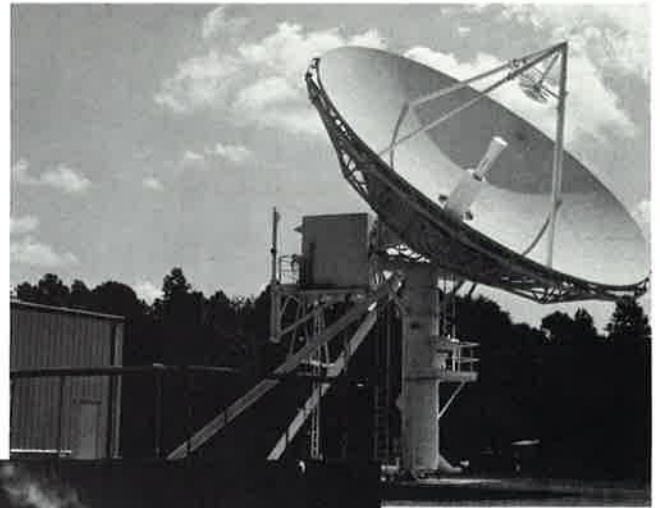
ESTIMATED AND PROJECTED SATELLITE EARTH STATION MARKETS

| | (in \$ millions) | |
|---|------------------|------|
| | 1975 | 1980 |
| INTELSAT | | |
| — New Earth Stations | 75 | 55 |
| — Retrofit and Expansion of Existing Earth Stations | 5 | 5 |
| US DOMSAT | | |
| — New Systems | 20 | 75 |
| — Retrofit and Expansion of Existing Systems | 5 | 15 |
| FOREIGN DOMSAT | | |
| — Dedicated Satellite Type | 60 | 200 |
| — Intelsat Transponder Type | 10 | 60 |
| SPECIAL PURPOSE | | |
| — Off-Shore Platform-Pipeline-Monitoring | 3 | 18 |
| — PBS-HEW-etc. | 2 | 12 |
| — Broadcast — CATV | 4 | 10 |
| — Inmarsat/Aerosat | 6 | 20 |
| MILITARY | 120 | 180 |
| ESTIMATED AND PROJECTED TOTALS | 310 | 650 |

*The estimates and projections in this section are based upon Comtech's evaluation of current market information.

As shown, the market for earth stations is projected to grow from the estimated \$310 million in 1975 to about \$650 million in 1980. The INTELSAT market is expected to decline as fewer new stations are added each year to the already mature global system. However, after 1980, when the next generation of satellites — INTELSAT V — becomes operational, employing some transponders at higher frequencies (12/14 GHz) and using digital modulation communication techniques such as time division multiple access (TDMA), many stations will have to be rebuilt or replaced. This should create an upturn in this part of the market in the early 1980's.

At present, four separate US domestic systems (WU-RCA-AMSAT-ATT/GTE) are in operation. The recent restructuring of the former CML Satellite Corporation into Satellite Business Systems, Inc. (SBS) may well be the most significant development to date in the domestic satellite communications industry. When the SBS system becomes operational, it will become the first domestic satellite system to be independent of terrestrial microwave telephone company links and the first to utilize the higher frequency (12/14 GHz) satellite communication bands. These sparsely populated higher frequency (12/14 GHz) bands will allow the earth terminals to be located on rooftops inside cities, without interference problems, rather than a number of miles away as is necessary in the presently used crowded frequency (4/6 GHz) bands.



GENERAL DESCRIPTION OF SATELLITE COMMUNICATIONS MARKETS (continued)



SBS will bring together the financial, technological and marketing strengths of three major companies, IBM, Comsat, and Aetna, to produce an innovative satellite service that could effectively unify data processing and communications. The SBS concept involving direct high-speed digital satellite transmission via small earth stations located on customer premises has the potential to revolutionize present day satellite communications. Digital transmission and TDMA are expected to be used, with demand assigned channels to serve a wide variety of large corporate user requirements for data, voice and image transmission. The SBS system is scheduled to become operational in 1979, so the greatest number of earth stations, predicted at 7900 by 1986, provides the potential for continued market growth well into the 1980's.

As the preceding table also shows, the greatest projected growth area is in foreign domestic satellite communications. The foreign domsat area has become one of major concentration, particularly within those countries spread over large geographical areas. The nations of the world have started to establish domestic satellite communications systems, compatible with, and readily linked to, existing international networks.

This foreign domsat market is expected to explode from an estimated 1975 level of \$70 million to a predicted level of \$260 million by 1980. By far the largest increase is expected to be in developing countries, where satellite communications systems offer a quickly established relatively inexpensive national telecommunications network where little or no communications capability presently exists.

Along with demand for regional or domestic systems, a move toward special-purpose satellite communications systems appears to have begun. These would interconnect small communities or individual users rather than carrier-oriented systems that interconnect regional areas or national terrestrial carrier networks. These users can be cities, islands, buildings, ships or airplanes. In this area, many sophisticated applications predicted in recent years have reached, or are about to reach, implementation. These include public service broadcasting, cable television, electronic mail interconnection, public safety, health services, data platform relay, oil and gas pipeline monitoring, space vehicle transmissions, mobile communications and verification, time and frequency dissemination, maritime vessel and commercial airline communications, and computer-to-computer transactions servicing the business sector.

As reflected in the foregoing table, these special-purpose systems have very limited markets today. However, a strong projected growth potential is shown in all areas extending into the 1980's. Of particular interest is the Aeronautical Communications Satellite (AEROSAT) and International Maritime Satellite Organization (INMARSAT). Since the early 1960's, much discussion has centered on improving aeronautical and maritime communications over the



oceans. There is now general agreement that satellite communications technology offers the most promising answers. Beyond purely technical problems, however, several obstacles remain in implementing operational systems. The most formidable for the Aerosat system appears to be the marked lack of enthusiasm of the airlines, which seem to believe that the system will be too costly and may not be needed for a long time. In the Inmarsat system, the greatest obstacle appears to be a dispute over the selection of the Comsat General-sponsored Marisat program versus the European Space Agency Marots program.

The Public Broadcasting Service (PBS) is proceeding with plans to interconnect 165 local television stations by satellite. Home Box Office has established a satellite network for distribution of video to CATV systems. The US Department of Health, Education and Welfare (HEW) has contracted for an interactive video experimental satellite communication system that may be the forerunner of future health service systems. Several oil companies are interested in small earth stations on off-shore drilling platforms. Although such special-purpose system purchases thus far have been less than \$10 million per year, the market is projected to grow rapidly in the next decade.



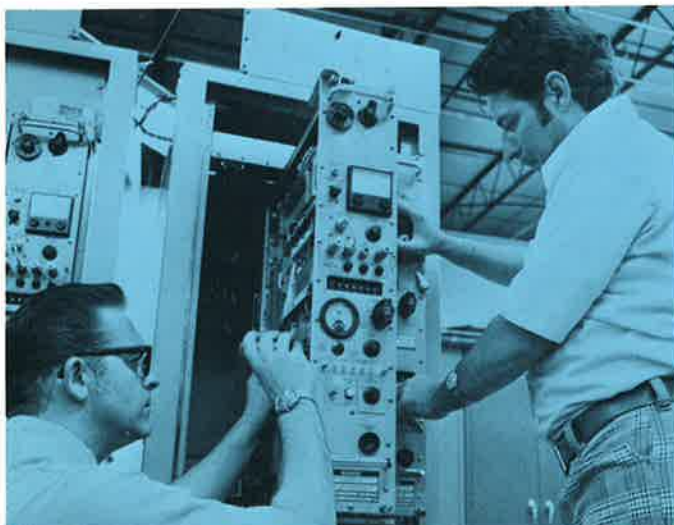
An early satellite communication market participant, the Department of Defense continues to be a very large communications earth station purchaser for the DSCS network. Military satellite communications earth station sales, the second largest market segment, are expected to continue to grow at a moderate rate of approximately 10% per year to a level of \$180 million in 1980.

Complementing the relatively new strength in the market for fixed, transportable and tactical satellite communications networks is the continued expansion and upgrading of existing military satellite communications terminals. Within these existing networks, the need for equipment restoration, replacement and general expansion represents a substantial portion of the available market. With the increased use of new communication techniques, particularly digital modulation, this area should offer substantial market potential well into the future.

The trend to digital modulation techniques is expected to continue in all communications areas. Base-band equipment will be required to signal and switch, compress and code, multiplex and modulate at speeds from 100 b/s for systems using slow speed data, to 100 Mb/s for multiple-channel video or computer data communications systems. Minicomputers and micro-processors will be needed to perform monitoring functions, switching and signaling.

In short, terminals for satellite communication are expected to be matched to user needs and to the service provided. They most likely will be automated as much as possible, and convey a high volume of digital traffic, thereby effectively unifying data processing and communications. Rapidly growing new services are predicted to be digital, particularly computer-interconnect and high-speed data and facsimile.

Satellite communication can provide in a very cost competitive manner a level of quality and efficiency unmatched by other techniques. The major advantage of satellite communication systems is the ability to communicate from a single point to many points directly, over long or short distances to a continental network or to individual users who may be big or small, fixed or mobile.



CONSOLIDATED BALANCE SHEETS

| | <u>ASSETS</u> | |
|---|---------------------|--------------------------------|
| | <u>1976</u> | <u>July 31,</u> <u>1975</u> |
| Current Assets: | | |
| Cash | \$ 764,200 | \$ 792,999 |
| Accounts receivable (Notes 1 and 2) | 2,387,449 | 3,196,457 |
| Inventories, less progress payments (Notes 1 and 3) | 5,787,618 | 4,228,865 |
| Other current assets | 52,593 | 79,929 |
| | <u>8,991,860</u> | <u>8,298,250</u> |
| Property, plant and equipment less accumulated depreciation and amortization (Notes 1, 4 and 5) | 3,342,118 | 2,791,180 |
| Other assets | 104,431 | 21,492 |
| | <u>\$12,438,409</u> | <u>\$11,110,922</u> |
| <u>LIABILITIES AND SHAREHOLDERS' EQUITY</u> | | |
| Current Liabilities: | | |
| Accounts payable | \$ 1,109,533 | \$ 2,849,688 |
| Accrued expenses and taxes withheld | 1,011,840 | 637,991 |
| Income taxes currently payable (Note 6) | 787,383 | 746,877 |
| Advance contract payments received | — | 245,848 |
| Current maturities of mortgage notes | 54,000 | 50,000 |
| | <u>2,962,756</u> | <u>4,530,404</u> |
| Mortgage notes due after one year (Note 5) | 659,720 | 714,144 |
| Deferred income taxes (Note 6) | 481,300 | 317,300 |
| Shareholders' equity (Notes 7 and 8): — | | |
| Common stock, \$.10 par value: | | |
| Authorized — 3,000,000 shares | | |
| Outstanding — 1976 — 1,664,950 | 166,495 | 159,884 |
| 1975 — 1,598,840 | 2,656,134 | 2,273,210 |
| Additional paid-in capital | 5,512,004 | 3,115,980 |
| Retained earnings | 8,334,633 | 5,549,074 |
| | <u>\$12,438,409</u> | <u>\$11,110,922</u> |
| Commitments and Contingencies (Note 11) | | |



CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

| | Year ended July 31, | |
|---|---------------------|---------------------|
| | 1976 | 1975 |
| Net sales | \$23,128,055 | \$16,563,517 |
| Costs and expenses: | | |
| Cost of sales | 16,302,911 | 12,212,825 |
| Selling, general and administrative | 1,645,840 | 979,218 |
| Depreciation and amortization | 373,952 | 293,649 |
| Interest | 62,328 | 145,064 |
| | <u>18,385,031</u> | <u>13,630,756</u> |
| Income before income taxes | 4,743,024 | 2,932,761 |
| Provision for income taxes (Note 6): | | |
| Current | 2,183,000 | 1,327,000 |
| Deferred | 164,000 | 80,000 |
| | <u>2,347,000</u> | <u>1,407,000</u> |
| Net income | <u>2,396,024</u> | <u>1,525,761</u> |
| Retained earnings at beginning of year: | | |
| As previously reported | 3,115,980 | 1,603,919 |
| Adjustment to reflect retroactive change in accounting method (Note 1) | | (13,700) |
| Retained earnings at beginning of year as restated | <u>3,115,980</u> | <u>1,590,219</u> |
| Retained earnings at end of year | <u>\$ 5,512,004</u> | <u>\$ 3,115,980</u> |
| Earnings per share (Note 1) | <u>\$1.44</u> | <u>\$.94</u> |

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

| | Year ended July 31, | |
|--|---------------------|--------------------|
| | 1976 | 1975 |
| Financial resources were provided by: — | | |
| From Operations: | | |
| Net income | \$2,396,024 | \$1,525,761 |
| Add income charges not affecting working capital: | | |
| Depreciation and amortization | 373,952 | 293,649 |
| Deferred income taxes | 164,000 | 80,000 |
| Total from operations | 2,933,976 | 1,899,410 |
| Net proceeds from exercise of stock options | 257,535 | 45,100 |
| Tax benefit from disqualifying disposition of option stock | 132,000 | 46,000 |
| | <u>3,323,511</u> | <u>1,990,510</u> |
| Financial resources were used for: | | |
| Purchases of equipment — net | 924,890 | 564,205 |
| Reduction in long-term debt | 54,424 | 49,985 |
| Other | 82,939 | 16,607 |
| | <u>1,062,253</u> | <u>630,797</u> |
| Increase in working capital | <u>\$2,261,258</u> | <u>\$1,359,713</u> |

Analysis of changes in working capital

| | | |
|---|--------------------|--------------------|
| Increases (decreases) in current assets: | | |
| Cash | (\$ 28,799) | \$ 219,684 |
| Accounts receivable | (809,008) | 1,483,024 |
| Inventories | 1,558,753 | 1,410,631 |
| Other current assets | (27,336) | 32,964 |
| | <u>693,610</u> | <u>3,146,303</u> |
| (Increases) decreases in current liabilities: | | |
| Notes payable to banks | — | 850,000 |
| Accounts payable | 1,740,155 | (1,763,955) |
| Accrued expenses and taxes withheld | (373,849) | (306,990) |
| Income taxes currently payable | (40,506) | (381,287) |
| Advance contract payments received | 245,848 | (181,358) |
| Current maturities of mortgage notes | (4,000) | (3,000) |
| | <u>1,567,648</u> | <u>(1,786,590)</u> |
| Increase in working capital | <u>\$2,261,258</u> | <u>\$1,359,713</u> |



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

July 31, 1976 and 1975

NOTE 1 — ACCOUNTING POLICIES:

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Comtech International, Inc. All significant intercompany transactions have been eliminated.

Contract Accounting

Sales are recorded when specific contract terms are fulfilled, usually by delivery and acceptance (the unit of delivery method of accounting). Cost of sales, which is applied to units delivered, is based upon the actual contract costs incurred and, in the case of partial shipments, estimated final contract costs. Contract costs include material, direct labor and manufacturing overhead. All selling, general and administrative expenses are charged to operations as incurred. Under all contracts, when estimates indicate a probable future loss, an immediate provision for the full amount thereof is charged to cost of sales.

Inventories

Raw materials and components are stated at first-in, first-out cost, which is not in excess of market. Work in process has been valued at the total material, direct labor and manufacturing overhead incurred under each contract.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost; expenditures for maintenance and repairs are charged to operations as incurred; and renewals and betterments, which extend the useful life of the assets, are capitalized. At the time property is retired or otherwise disposed of, the cost of the asset and the accumulated depreciation or amortization is removed from the account and the gain or loss on disposition is taken into income. Annual depreciation is provided utilizing the straight-line method over the estimated useful lives.

Product Development Costs

In 1975, the Company changed its method of accounting for product development costs to conform with The Statement of Financial Accounting Standards No. 2, "Accounting for Research and Development Costs". Under the new method, which has been applied retroactively, certain costs which were previously deferred and amortized over five years are charged to expense as incurred. The effect of this change on the results of operations for fiscal 1975 was immaterial.

The Company is continually involved in research and development of new products and technology. A significant portion of this effort is related to specific contracts and is recoverable under the terms of the contracts. Research and development costs not relating to specific contracts are charged to cost of sales as incurred and amounted to \$230,883 in 1976 and \$148,389 in 1975.

Earnings Per Share

Earnings per share are based upon the weighted average common shares and common share equivalents outstanding during the year. The number of common shares and common share equivalents used in computing earnings per share was 1,663,359 and 1,628,970 in 1976 and 1975 respectively.

NOTE 2 — ACCOUNTS RECEIVABLE:

| | 1976 | July 31, 1975 |
|--|--------------------|--------------------|
| Amounts receivable from the United States Government | \$ 431,192 | \$1,504,037 |
| Amounts receivable from others | 1,956,257 | 1,692,420 |
| | <u>\$2,387,449</u> | <u>\$3,196,457</u> |

During the fiscal years ended July 31, 1976 and 1975, approximately 42% and 62%, respectively, of the Company's revenues resulted from contracts with government agencies and government contractors.

NOTE 3 — INVENTORIES:

| | 1976 | July 31, 1975 |
|------------------------------|--------------------|--------------------|
| Raw materials and components | \$1,124,286 | \$1,238,829 |
| Work in process | 4,814,056 | 5,709,587 |
| | <u>5,938,342</u> | <u>6,948,416</u> |
| Less—progress payments | 150,724 | 2,719,551 |
| | <u>\$5,787,618</u> | <u>\$4,228,865</u> |

Work in process relating to contracts is expected to be delivered over a period of less than twelve months. Approximately 78% in 1976 and 90% in 1975 of the Company's work in process represents work performed pursuant to contracts. The remainder represents parts and components being manufactured for stock.

Title to work in process is vested in the customer on contracts which provide for progress, partial, or advance payments to the extent of such payments received.

NOTES (continued)

NOTE 4 — PROPERTY, PLANT AND EQUIPMENT:

| | Estimated useful lives | July 31, | |
|--|------------------------|--------------------|--------------------|
| | | 1976 | 1975 |
| Land | — | \$ 180,000 | \$ 180,000 |
| Building | 40 Years | 1,348,493 | 1,184,669 |
| Leasehold improvements | Lease Term | 82,930 | 81,764 |
| Equipment | 8 Years | 2,883,094 | 2,123,194 |
| | | <u>4,494,517</u> | <u>3,569,627</u> |
| Less — accumulated depreciation and amortization | | 1,152,399 | 778,447 |
| | | <u>\$3,342,118</u> | <u>\$2,791,180</u> |

NOTE 5 — MORTGAGE NOTES:

| | July 31, | |
|---|------------------|------------------|
| | 1976 | 1975 |
| 9.4% First mortgage indebtedness to a bank payable monthly, maturing in 1980 | \$482,890 | \$493,177 |
| 6.5% Second mortgage indebtedness to the New York State Job Development Authority payable monthly, maturing in 1981 | 230,830 | 270,967 |
| | <u>713,720</u> | <u>764,144</u> |
| Less — portion due within one year | 54,000 | 50,000 |
| | <u>\$659,720</u> | <u>\$714,144</u> |

At July 31, 1976, the aggregate principal amount

maturing annually during each of the five fiscal years ending July 1981 is as follows: 1977 — \$54,000; 1978 — \$58,000; 1979 — \$62,000; 1980 — \$498,000; 1981 — \$42,000. These mortgages are secured by the land and building referred to in Note 4.

NOTE 6 — INCOME TAXES:

The Company has a Domestic International Sales Corporation subsidiary (DISC) which acts as a sales agent for the Company's international sales. As a DISC, 50% of the income on export sales is considered earned by the DISC and one-half of this amount is exempt from current federal taxation as long as the DISC complies with certain requirements and retains its tax status. It is the intention of management to reinvest all undistributed earnings (\$898,000) of the DISC and accordingly no provision has been made on the portion not subject to current taxation. In addition, since the DISC has a fiscal year ending August 31, the taxes on the taxable portion of the undistributed earnings of the DISC will not be payable until the subsequent fiscal year and, therefore, have been included in the deferred tax provision.

As permitted by the Internal Revenue Code, depreciation expenses are recognized in different periods for financial and income tax accounting purposes.

The following tabulation sets forth the difference between the statutory and effective income tax rates for the years ended July 31, 1976 and 1975.

| | July 31, | | July 31, | |
|---|--------------------|------------|--------------------|------------|
| | 1976 | | 1975 | |
| | Amount | Percent | Amount | Percent |
| Federal statutory income tax rate | \$2,290,000 | 48% | \$1,401,000 | 48% |
| State income taxes, net of federal tax benefit | 281,000 | 6 | 132,000 | 5 |
| Tax exempt DISC income | (151,000) | (3) | (80,000) | (3) |
| Investment credit | (73,000) | (2) | (46,000) | (2) |
| Effective income tax rate | <u>\$2,347,000</u> | <u>49%</u> | <u>\$1,407,000</u> | <u>48%</u> |
| Deferred taxes attributable to timing differences consist of: | | | | |
| Depreciation | \$ 57,000 | | \$ 60,000 | |
| Taxable DISC income | 107,000 | | 20,000 | |
| | <u>\$ 164,000</u> | | <u>\$ 80,000</u> | |

The company records investment tax credits in the year in which the related property is placed in service.



NOTE 7 — COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL:

Changes in the common stock and additional paid-in capital accounts during the years ended July 31, 1976 and 1975 are as follows:

| | No. of shares | Common stock | Additional paid-in capital |
|--|------------------|------------------|----------------------------------|
| Balance July 31, 1974 | 1,564,640 | \$156,464 | \$2,206,019 |
| Exercise of stock options | 34,200 | 3,420 | 41,680 |
| Tax benefits resulting from disqualifying disposition by employees of stock purchased under stock option plans | | | 46,000 |
| Costs associated with the registration of underwriter stock and stock option plans | | | (20,489) |
| Balance July 31, 1975 | <u>1,598,840</u> | <u>159,884</u> | <u>2,273,210</u> |
| Exercise of stock options | 66,110 | 6,611 | 250,924 |
| Tax benefits resulting from disqualifying disposition by employees of stock purchased under stock option plans | | | 132,000 |
| Balance July 31, 1976 | <u>1,664,950</u> | <u>\$166,495</u> | <u>\$2,656,134</u> |

NOTE 8 — QUALIFIED STOCK OPTION PLANS:

Under the Company's qualified stock option plans adopted by the shareholders in 1968 and 1970, as amended, options may be granted to officers and key personnel holding less than 5% of the Company's common stock for the purchase of common stock of the Company at not less than 100% of the fair market

value of the stock on the date of the grant. Options become exercisable over a period of not more than five years from the date granted.

The following tabulation sets forth the activity in stock options for the years ended July 31, 1976 and 1975.

| | July 31, | | | |
|--------------------------------|------------------------|-----------------|------------------------|-----------------|
| | 1976 | Option price | 1975 | Option price |
| | Number of shares | per share | Number of shares | per share |
| Outstanding, beginning of year | 93,160 | \$1.25-18.13 | 115,160 | \$1.25-18.13 |
| Granted | 50,750 | 9.25-24.75 | 16,000 | 2.25- 7.00 |
| Exercised | (66,110) | 1.25-18.13 | (34,200) | 1.25- 5.50 |
| Cancelled | (5,350) | 4.25-18.13 | (3,800) | 1.25-10.75 |
| Outstanding, end of year | <u>72,450</u> | 1.25-18.13 | <u>93,160</u> | 1.25-18.13 |
| Exercisable, end of year | <u>15,400</u> | 1.25-18.13 | <u>50,700</u> | 1.25-18.13 |

At July 31, 1976 and 1975, 7,600 and 53,000 shares were available for grant, respectively.

NOTES (continued)

NOTE 9 — LINE OF CREDIT:

The Company has an agreement with the Chemical Bank of New York which provides a short term \$12,000,000 line of credit. Under the terms of the agreement, the Company may borrow up to \$5,500,000 on a short-term unsecured basis, at an interest rate of ½% above prime, with additional short-term borrowings up to \$6,500,000, to be secured by certain accounts receivable and inventory. No compensating balances are required by the agreement. The maximum amount borrowed under the agreement during 1975 was \$1,175,000 at average rates of 10.3%. The approximate average borrowings outstanding during 1975 was \$743,000 at average interest rates of 10.6%. There were no borrowings under the line of credit in fiscal 1976.

NOTE 10 — PROFIT SHARING AND INCENTIVE COMPENSATION PLANS:

Effective August 1, 1974, the Company adopted a profit sharing plan covering all eligible employees. The plan, which is subject to the approval of the IRS, provides for the Company to contribute such amounts as the Board of Directors determines. During the fourth quarter of fiscal 1976 and 1975, the Board approved contributions of \$250,000 and \$150,000 respectively, which were charged to income.

Effective August 1, 1975, the Company adopted an incentive compensation plan for officers and other key employees. Under the plan, an amount equal to 5% of income before income taxes without taking into consideration extraordinary items and before amounts allocated hereunder shall be payable to selected key employees of the Company. A provision of \$249,600 was charged against income in fiscal 1976 for incentive compensation.

NOTE 11 — COMMITMENTS AND CONTINGENCIES:

In June 1976, the Company entered into a 20 year lease agreement for a new manufacturing facility with annual rentals of approximately \$277,000 plus property taxes and other specific costs. The agreement also includes an option to purchase the facility after one year for approximately \$2,574,000. Coincident with the completion of the new facility during the second quarter of fiscal 1977, the Company's existing lease for its Oser Avenue facility (\$78,000 per annum) will be terminated without cost to the Company.

Certain sales of the Company are subject to the Renegotiation Act of 1951, as amended. Clearance has been received through fiscal year 1974. In the opinion of management, no refunds are anticipated for sales subject to renegotiation in 1975 and 1976.



REPORTS OF INDEPENDENT ACCOUNTANTS

To the Board of Directors
and Shareholders of
Comtech Laboratories Inc.

We have examined the consolidated balance sheet of Comtech Laboratories Inc. (a New York corporation) and subsidiary as of July 31, 1976 and the consolidated statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements for the year ended July 31, 1975 were examined and reported on by other independent public accountants.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Comtech Laboratories Inc. and subsidiary as of July 31, 1976 and the results of their operations and changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ARTHUR ANDERSEN & CO.

Huntington, N. Y.
October 5, 1976

To the Board of Directors
and Shareholders of
Comtech Laboratories Inc.

We have examined the consolidated balance sheet of Comtech Laboratories Inc. and its subsidiary as of July 31, 1975 and the related consolidated statements of income and retained earnings and of changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In accordance with Statement of Financial Accounting Standards No. 2, the method of accounting for product development costs was changed in 1975 as described in Note 1 to the financial statements.

In our opinion, the consolidated financial statements examined by us present fairly the financial position of Comtech Laboratories Inc. and its subsidiary at July 31, 1975, the results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year after restatement for the change, with which we concur, referred to in the preceding paragraph.

PRICE WATERHOUSE & CO.

Huntington Station,
New York
October 10, 1975

Five Year Summary of Operations

| | Year Ended 31 July | | | | |
|---|--------------------|-------------------|-------------------|---------------------|---------------------|
| | 1972 (A) | 1973 (A) | 1974 (A) | 1975 | 1976 |
| Net sales | \$3,971,363 | \$12,995,511 | \$10,368,282 | \$16,563,517 | \$23,128,055 |
| Costs and expenses: | | | | | |
| Cost of sales | 3,124,147 | 11,294,814 | 7,922,584 | 12,212,825 | 16,302,911 |
| Selling, general and administrative | 375,092 | 631,112 | 752,158 | 979,218 | 1,645,840 |
| Depreciation and amortization | 66,548 | 143,640 | 213,194 | 293,649 | 373,952 |
| Interest | 34,714 | 84,027 | 119,521 | 145,064 | 62,328 |
| | <u>3,600,501</u> | <u>12,153,593</u> | <u>9,007,457</u> | <u>13,630,756</u> | <u>18,385,031</u> |
| Income before income taxes | 370,862 | 841,918 | 1,360,825 | 2,932,761 | 4,743,024 |
| Provision for income taxes | 116,400 | 310,300 | 623,700 | 1,407,000 | 2,347,000 |
| Net Income | <u>\$ 254,462</u> | <u>\$ 531,618</u> | <u>\$ 737,125</u> | <u>\$ 1,525,761</u> | <u>\$ 2,396,024</u> |
| Earnings per share (B) | <u>\$.20</u> | <u>\$.33</u> | <u>\$.45</u> | <u>\$.94</u> | <u>\$ 1.44</u> |

(A) Restated as described in Note 1 of the financial statements. The effect of the change was to increase income as follows: 1972-\$3,600, \$.01 per share; 1973-\$22,500, \$.02 per share; 1974-\$13,700, \$.01 per share.

(B) Based upon the weighted average common shares and common share equivalents outstanding during the year.

Management Discussion and Analysis of Summary of Operations

During fiscal year 1976 as compared to 1975 and fiscal year 1975 to 1974, sales increased by approximately 40% and 60%, respectively. During these periods there was a rapid growth in the satellite communications market for which the Company supplies a comprehensive and technically sophisticated product line.

Cost of sales in fiscal year 1976 as compared to 1975 and fiscal year 1975 to 1974 as a percentage of net sales, decreased by approximately 3% in each period, as a result of a favorable mix of products, efficiencies associated with higher production volume, and increases in customer funded research and development.

Selling, general and administrative expenses in fis-

cal year 1976 compared to 1975 and 1975 to 1974 increased approximately 68% and 30%, respectively, principally due to increased levels of employment, and higher costs of compensation, employee benefits, selling and marketing expenses and professional fees.

Depreciation and amortization in fiscal years 1976 compared to 1975 and 1975 to 1974 increased by 27% and 38%, respectively, due principally to the addition of new equipment.

Interest expense in fiscal year 1976 decreased by 58% as compared to 1975 since the Company did not borrow against its line of credit. Interest expense in 1975 increased compared to 1974 by 22% due principally to higher average annual borrowings under the Company's line of credit.



Sales By Major Product Area

| | Year Ended 31 July | | | | |
|---|--------------------|------|------|------|------|
| | 1972 | 1973 | 1974 | 1975 | 1976 |
| The percentage of annual dollar sales for each major class of products sold was as follows: | | | | | |
| Receiving, Transmitting, and Digital Equipment | 100% | 85% | 66% | 75% | 56% |
| Systems and Major Subsystems | | 15% | 34% | 25% | 44% |

Stock Prices

The common stock of Comtech Laboratories Inc. is traded in the Over-The-Counter market, NASDAQ Symbol CMTL. The table below sets forth the high and low bid and asked prices for the Company's common stock during each quarter of fiscal years 1976

| | STOCK PRICES | | | |
|---------------------|------------------|------------------|------------------|------------------|
| | Bid Price | | Asked Price | |
| | High | Low | High | Low |
| Fiscal Year 1976 | | | | |
| First Quarter | 13 | 8 $\frac{1}{4}$ | 14 | 9 $\frac{1}{4}$ |
| Second Quarter .. | 17 | 11 $\frac{1}{2}$ | 18 | 12 $\frac{1}{2}$ |
| Third Quarter | 24 $\frac{1}{2}$ | 16 $\frac{1}{2}$ | 25 $\frac{1}{2}$ | 17 $\frac{1}{2}$ |
| Fourth Quarter | 24 $\frac{1}{4}$ | 14 $\frac{3}{4}$ | 25 $\frac{1}{4}$ | 15 $\frac{3}{4}$ |

and 1975. The prices shown are representative quotations supplied by the National Association of Securities Dealers, Inc. through NASDAQ and do not include retail mark-up, mark-down or commissions and do not necessarily reflect actual transactions.

| | STOCK PRICES | | | |
|---------------------|------------------|-----------------|------------------|-----------------|
| | Bid Price | | Asked Price | |
| | High | Low | High | Low |
| Fiscal Year 1975 | | | | |
| First Quarter | 4 $\frac{3}{4}$ | 2 $\frac{1}{2}$ | 5 $\frac{3}{4}$ | 3 $\frac{1}{2}$ |
| Second Quarter .. | 4 $\frac{1}{2}$ | 1 $\frac{3}{4}$ | 5 $\frac{1}{2}$ | 2 $\frac{3}{4}$ |
| Third Quarter | 8 | 3 $\frac{3}{4}$ | 9 | 4 $\frac{3}{4}$ |
| Fourth Quarter | 13 $\frac{1}{2}$ | 6 $\frac{1}{4}$ | 14 $\frac{1}{2}$ | 7 $\frac{1}{4}$ |

Dividends

No dividends have been paid on the Company's common stock.

Form 10-K

A copy of the Company's Annual Report on Form 10-K for fiscal year 1976 as filed with the Securities and Exchange Commission (excluding exhibits) will be furnished, without charge, to any owner of common

stock of the Company entitled to vote at its Annual Meeting, upon written request to J. P. Windus, Jr., Secretary-Treasurer, Comtech Laboratories Inc., 135 Engineers Road, Smithtown, New York 11787.

Quarterly Operating Results — Unaudited

The quarterly operating results for fiscal 1976 and 1975 are summarized below.

| Fiscal 1976 | Net Sales | Net Income | Earnings per Share |
|---------------------|-------------|------------|--------------------|
| First Quarter | \$5,747,570 | \$571,070 | \$.35 |
| Second Quarter .. | 6,547,338 | 687,865 | .41 |
| Third Quarter | 4,709,909 | 540,009 | .32 |
| Fourth Quarter | 6,123,238 | 597,080 | .36 |

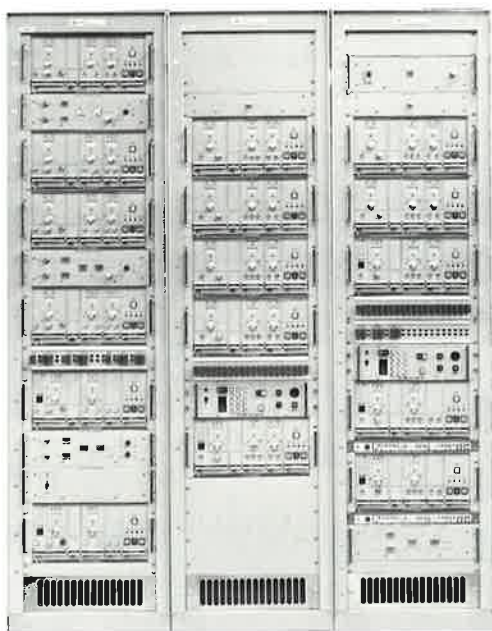
| Fiscal 1975 | Net Sales | Net Income | Earnings per Share |
|---------------------|-------------|------------|--------------------|
| First Quarter | \$1,144,600 | \$ 21,868 | \$.01 |
| Second Quarter .. | 4,686,937 | 392,334 | .24 |
| Third Quarter | 2,146,816 | 158,467 | .10 |
| Fourth Quarter | 8,585,164 | 953,092 | .59 |

The quarterly operating results for 1975 and 1976 have not been audited by independent public accountants in accordance with generally accepted auditing standards. Furthermore, procedures for limited reviews

of quarterly operating results as established by the American Institute of Certified Public Accountants were not required nor performed with respect to either 1975 or 1976.

NEW DEVELOPMENTS AND ACCOMPLISHMENTS

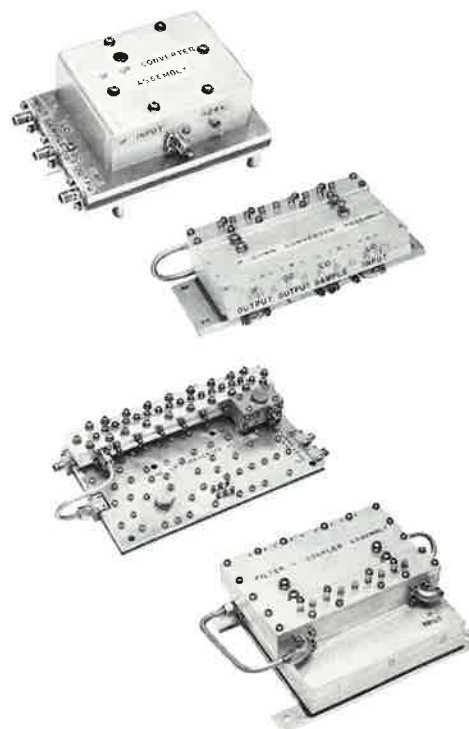
**Highly Compact Receiving
And Transmitting Subsystems**



**Frequency Sources For
Digital Applications**



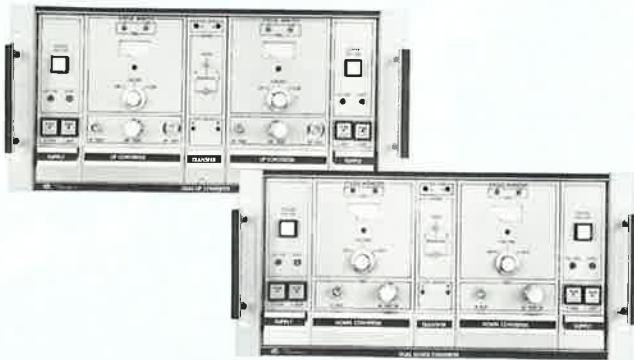
**State Of The Art Integrated
Microwave Circuits**



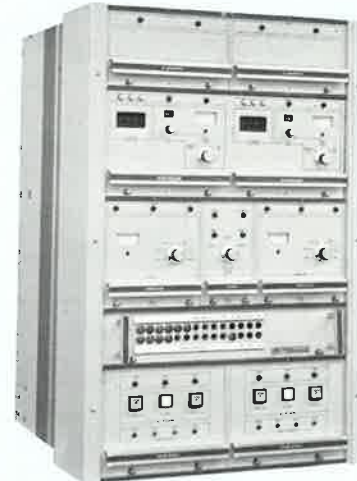
Data Over Voice Modem



Redundant Frequency Conversion Subsystems For SCPC Application



Highly Compact Microwave Troposcatter Subsystems



Transmitter

Field And Laboratory Test Instruments



Group Delay Test Set



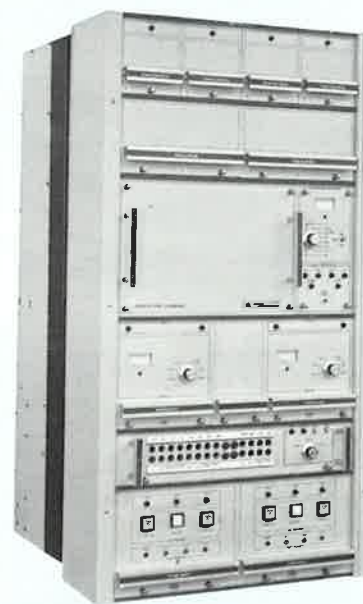
Wideband Phase Noise Test Set



Phase Noise Test Set



C/T Test Set



Receiver

COMTECH AT WORK



Comtech's fully transportable satellite communications earth station, currently on lease to Western Union, is designed to provide television transmission for remote applications. The station was initially used by Western Union to provide television coverage of the Republican National Convention in August of 1976. The station incorporates Comtech's new line of advanced television transmit and receive equipment. The complete station consists of a 10-meter parabolic antenna and a 20 by 8 by 8-foot shelter which houses the ground communications equipment.





The year 1976 has been an eventful year for the United States. We have celebrated the completion of our second century as an independent Republic, participated with a large degree of success in the XXI

Olympiad, and weathered yet another election year. As a nation, we have developed and maintained a level of maturity that sustains us as a major influence on the technological and economic growth of the world.

In recent years, the phenomenal advance of satellite communications has exemplified the type of contribution the United States has consistently put forth for the benefit of all nations. With the advent of the satellite as a means of communication, the expanse of the earth has truly shrunk to bring the peoples of all nations another step closer to the ideal of mutual understanding and unity.

It is with this thought that Comtech commissioned the cover painting for our 1976 Annual Report. In a small way, the cover depicts the state-of-the-art today as well as the future. We can predict the rapid and continued expansion of global television and telephone services, and the increased use of the satellite for special applications such as communications for off-shore oil rigs, maritime vessels, commercial airlines, oil and gas pipelines, scientific installations, and remote construction sites. In the near-term future, sophisticated digital applications will increase traffic handling capacities within the allocated bands, as well as provide for direct computer-to-computer transactions. In much the same way as special applications are an outgrowth of the initial concept of satellite communications, they will additionally serve as the springboard for those new communication innovations yet to be developed for the benefit of all the peoples of the world.



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