ANNUAL REPORT 1980

COMTECH Telecommunications Corp.

milestone

In September of 1980, Comtech successfully completed first article acceptance testing of the first of 21 AN/GSC-39(V) Satellite Communication Terminals to be delivered to the U.S. Government for use in the worldwide Department of Defense (DOD) Satellite Communications System.

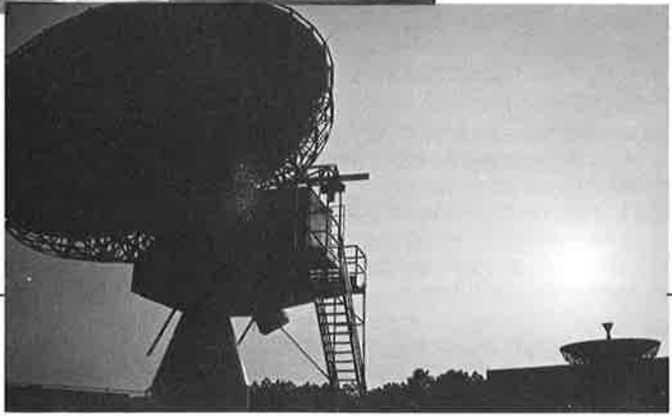
The AN/GSC-39(V), commonly referred to as the MT (medium terminal), is comprised of communications equipment designed for installation in either fixed-site or transportable configurations. The transportable systems are installed in vans and represent a new generation of terminals intended to bring a higher level of mobility to the DOD communication network. When deployed, the MT terminals will be used in conjunction with previously fielded systems to provide point-to-point and multipoint communications between U.S. Defense Commands and other locations throughout the world.

Comtech is manufacturing the MT Terminals for the US Army Satellite Communications Agency (USASATCOMA), an arm of the U.S. Army Communications Research and Development Command (CORADCOM), under a multi-year contract issued in 1978. Acceptance testing of the first terminal, a fixed-site configuration, was conducted in a special test facility constructed in Smithtown, New York. The test facility consists of a building large enough to house the electronics for two complete fixed-site systems; two government furnished antennas designed specifically for the MT terminal; and paved areas to accommodate two complete transportable systems, each of which consists of an operations van, transmitter van, maintenance van and supply van. The test facility will be used for the life of the program to accomplish first article testing of the transportable system, and subsequent acceptance testing of the production models of both the fixed-site and transportable terminals.

Aerial View of AN/GSC-39(V) Test Facility

AN/GSC-39(V) First Article Under Test

AN/GSC-39(V) Transportable and Fixed Site Terminals



TO OUR SHAREHOLDERS AND EMPLOYEES:

Simply put, last year was a difficult one. But even with the brief perspective of the months that have elapsed since our fiscal year ended, we see already that it was not without some gains. Unquestionably, Comtech now has its direction and targets in sharper focus and we should be in a much better position to achieve our goals.

Comtech's financial results underscore the extent of what we encountered last year. The Company reported an after-tax loss of $10,669,546 or $3.06 a share on sales of $25.9 million. In the prior year, earnings were $940,656 or $.26 per share on sales of $32.4 million. Backlog at July 31, 1980, however, increased to $40.8 million as compared to the year earlier $34.6 million.

The largest components of last year's loss relate to increased costs incurred in connection with, and reserves reflecting increased estimates of the cost to complete or resolve, two major contracts. One contract relates to a Libyan troposcatter communications network that has been in the installation phase for some time and, as previously reported, has encountered difficulties in part as a result of uncertainty within Libya and in its relations with the United States. While the Company is continuing to explore ways of reaching a satisfactory resolution with its Libyan customer, reserves were provided to cover the Company's total estimated exposure under this contract.

The second major contract is a multi-year prime contract awarded to Comtech by the U.S. Army in 1978 which calls for Comtech to manufacture 21 satellite communications terminals for the Department of Defense Satellite Communications Network. In September 1980, first article acceptance testing of the first of these terminals was satisfactorily completed. The Company expects that the balance of these terminals will be delivered over a period of 30 months and believes completion of the contract will significantly benefit from recently improved material and production control and reporting systems now in place.

The operations of Comtech's Florida antenna subsidiary continued to be unprofitable in fiscal 1980. Not surprisingly, this business has been the subject of analysis and evaluation by management.

Last year, Comtech Data Corporation, our Arizona subsidiary, increased its volume and backlog and enhanced its presence in the marketplace. However, it did not reach profitability largely as a result of continuing investment in research and development. Our expectation is that Comtech Data will be profitable in fiscal 1981, with record sales and backlog.

A hard look at the Company and its operations—including last year's—makes clear that we can be a successful and profitable high technology enterprise in those areas in which we function as a "product" company rather than as a "turnkey systems" one. We plan to continue to move in that direction, and to create and bring along additional new products, while deemphasizing those that matured some time ago. In short, we believe that our product base is the springboard for our future.

Consistent with this shift in emphasis to creating, manufacturing and marketing our own products, rather than assuming total responsibility for turnkey systems that incorporate the products of others—a move that should in time have favorable profit margin implications—we are consolidating operations at Comtech Laboratories into one of our two facilities in Smithtown. This should also have ongoing overhead benefits.

Against this background, I would like to review with you some of our product-oriented activities since the beginning of fiscal year 1980.

Comtech Data completed development of digitized voice Single-Channel-Per-Carrier (SCPC) equipment and received a first order during the year. This equipment was designed for digitized voice transmission by member nations of the Intelsat Network, particularly for communication within and between countries that have relatively little international traffic.

Significant progress was made in the application of Comtech Data's digital modem capabilities. As applied to satellite communications, we have equipment operational on Defense Communication Agency circuits and the NASA Communications Network. Data rates from 56 kilobits per second to 1.544 megabits per second have been delivered. Similar units have been used for transferring high speed data between central computers and remote computer-aided design graphics terminals via microwave, and for distribution of high speed data (750 Kbps to 1.544 Mbps) throughout coaxial cable networks.

We completed development of a new, highly cost-effective video receiver for the satellite cable television receive-only (TVRO) market. The new unit is achieving rapid acceptance in the marketplace for application to cable systems, hotels, and other video receive-only users.

The design and delivery of a complete low cost digital earth terminal was also completed by Comtech Data. The first terminal has been operational for several months at the U.S. Postal Service Research Center in Maryland as part of a program to test the feasibility of electronic mail distribution via satellite. We were also recently awarded a contract for a voice and digital network of 14 stations to be installed within the next nine months as a result of our acknowledged digital satellite earth terminal capabilities. In the voice mode, these stations provide digital representation of the voice signal, permitting the station to operate without modification for either data, voice, or encrypted voice transmission.

Comtech Laboratories developed an intermediate frequency translator which offers an alternate method of increasing signal processing capacity in satellite communications earth terminals currently in use by the U.S. Government. We advanced the state of the art by increasing the signal traffic handling capacities of our commercial satellite receiving and transmitting equipment from 1872 to 2892 voice message channels without enlarging equipment size or significantly affecting selling price. As a result of this effort, the Company received and completed an order to modify Comtech equipment already in operation in the RCA Domestic Satellite Network. This permitted RCA to optimize existing satellite transponder space so that two transponders can now process the voice and message traffic previously carried by three. Both Western Union and Communications Satellite Corporation (COMSAT) have expressed interest in effecting similar modifications to Comtech supplied equipment used in their systems.

Other Company activities included the ongoing manufacture of production quantities of Low Noise Amplifiers for the NATO Satellite Communications Network; the completion of a Western Union program calling for four digital earth stations; the completion of a program for Comsat which provided the first Ku-band (11/14GHz) ground communication equipment at its Etam West Virginia station; the delivery of high power amplifiers for an Intelsat station in Ecuador; the expansion of a transmit uplink in Western Union's domestic system; and the delivery of Low Noise amplifiers for use by customers such as the British Post Office and Telefunken.

The many programs recently initiated or in various stages of completion, demonstrate continued interest in both our satellite and troposcatter product lines. For example, Cable and Wireless chose Comtech Laboratories to supply a 2 GHz quad-diversity 24 voice-channel troposcatter radio system for use in Abu Dhabi. This will provide Amarada Hess with a main communications link between its multi-million dollar complex in the Persian Gulf and its on-shore facility. In addition to voice communications, the link will provide remote monitoring/control capabilities upon which the entire complex will depend.

The Republic of Korea also selected Comtech to supply a major troposcatter communication link for its Air Defense Network. Comtech is to design, manufacture, and install a radio system to provide voice and data communications between predesignated sites. When deployed, this system will incorporate Comtech's latest troposcatter equipment currently under development.

On the satellite side, Comtech was called upon to upgrade an earth station previously manufactured and installed by the Company on Christmas Island. The station will be used for voice and data communications for the Japanese Space Program, and will incorporate Comtech Data's new SCPC equipment as well as Comtech Laboratories ground communication links. Comtech was also recently selected by an overseas customer to provide an X-band station capable of receiving and transmitting high speed data. This station employs a Comtech designed 13-meter antenna capable of operation in winds up to 200 miles per hour.

We believe that growth in the telecommunications industry will be explosive during the 1980's. International voice and data communications systems have been growing at a greater than 20% rate annually over the last five years, benefiting from wider access provided by satellite, troposcatter and terrestrial microwave technology. New technologies applied to both the earth and space segments should ensure a continued growth pattern for the industry.

We see data communications as the most rapidly expanding market segment of the industry. Total expenditures are greater than $4 billion annually and are growing at more than 20% a year. Innovations such as the use of the 11/14 GHz frequency band for satellite and digital microwave transmission should continue to fuel dramatic movement in this exciting industry. An entire range of new products will be needed in order to make these systems work. It is an evolving technology. We see the business offices of the future being connected by digital earth terminals. Present suppliers will continue to produce the office equipment, but we plan to be among those who will interface with that equipment and provide the transmission products to effect communications by satellite. We believe there is going to be more equipment needed to serve this marketplace, and that there is a significant place for Comtech. We are continuing to invest important sums for internal research and development to improve our total share of the component and equipment markets.

Management changes that occurred during the last several months included the resignations, as officers and directors, of John E. Rosenblum, who had been in charge of the Comtech Laboratories' operations, and John A. Tokar, who had been the Company's chief financial officer. Gerard R. Nocita, a founder of the Company, also resigned as a director.

We recently welcomed Frank Marx to the Board of Directors of Comtech. Mr. Marx brings to the Company over forty years of management and business experience in the communications industry. Formerly President of ABTO, a joint venture of American Broadcasting Corp. and Tech-Ops, Inc., he is now serving industry as an independent consultant and a member of the boards of several corporations.

In December, 1980, Comtech refinanced its total short-term bank borrowings of approximately $10.4 million through a new secured term loan, repayable over two years, with interest at 2-1/2% over prime. The new agreement with the Company's three banks also provides for the refinancing on the same basis of the Company's contingent obligations under approximately $5.7 million of outstanding letters of credit, as well as the availability to Comtech, under specified conditions, of up to $1.8 million for additional letters of credit. We are particularly pleased with this response from Comtech's banks. While we have not formulated any specific plans, the Company expects to continue to evaluate opportunities to raise additional capital.

In April, 1980, a two-for-one stock split was effected in the form of a 100% stock distribution, increasing the number of outstanding common shares to 3,492,946.

We have come through a difficult period and, in the process, learned a great deal. The response of our customers, including the U.S. Army, our suppliers, and others on whom we rely, continues to be important to us—and will not be forgotten. Their continuing support is warmly appreciated. Our present family of employees, always Comtech's principal asset, has once again demonstrated qualities of skill, dedication to task—and intense loyalty. This, too, will not be forgotten.

December 5, 1980

Fred Kornberg

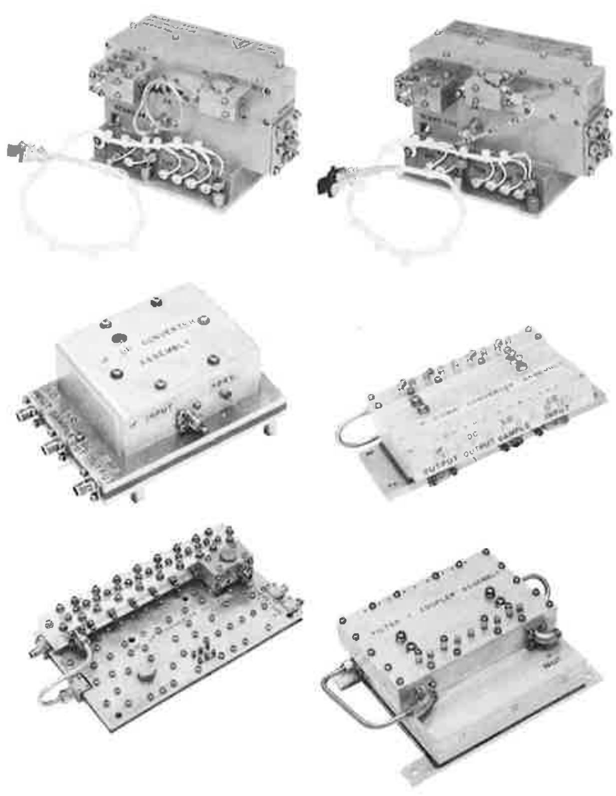
Chairman of the Board
and President

Comtech designs, manufactures, and markets high-technology communications equipment. Over the years, the Company has developed, refined, and expanded its product line to meet two primary objectives:

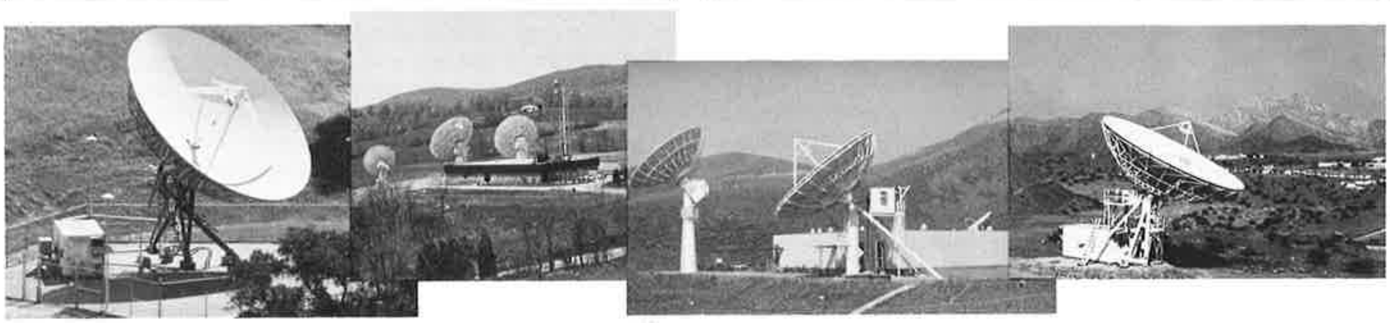
- The creation of a product mix, uniform in performance, designed for rapid and cost effective integration into Comtech supplied satellite and troposcatter terminals.
- The design and manufacture of products responsive to industry needs and fully marketable as individual components independent of Comtech's integration capabilities.

These objectives are complementary—offering a potential balance between the less frequent large volume contracts, and the more frequent opportunities possible through equipment sales. The quality of our equipment is key to sustaining a competitive posture in both the terminal and equipment markets, but sales potential is tempered by the variables of cost, delivery time, technical performance, customer demand, and, of course, our ability to maintain if not lead the state of the art. Today, more than ever Comtech is placing emphasis on the quality, timing and potential applications of the products bearing our logo.

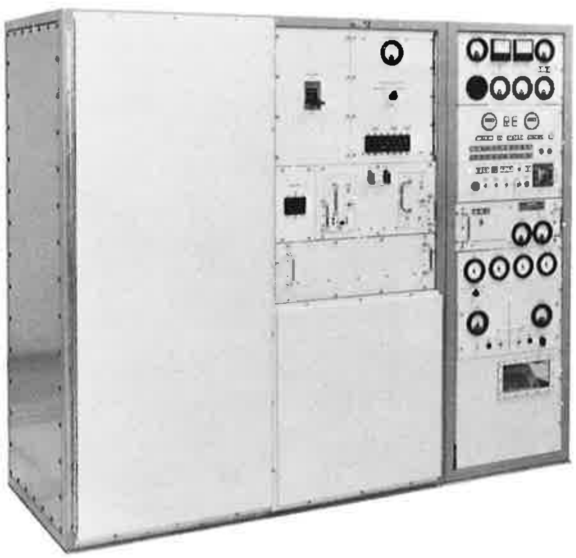
FREQUENCY SOURCES AND STRIPLINE COMPONENTS FOR MICROWAVE EQUIPMENT



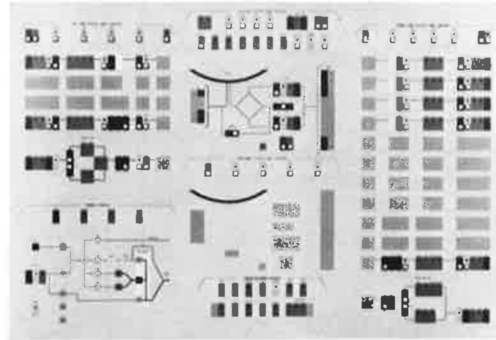
LOW NOISE AMPLIFIERS FOR COMMERCIAL AND DEFENSE APPLICATIONS



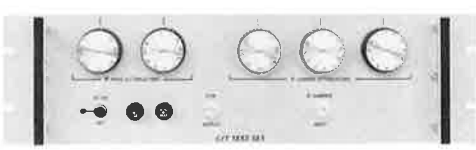
HIGH POWER AMPLIFIERS FOR SATELLITE AND TROPOSCATTER SYSTEMS

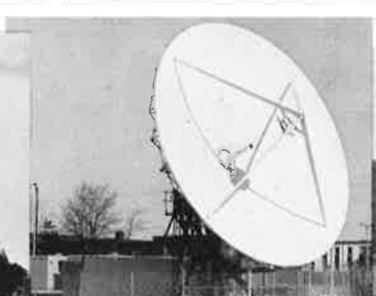


REMOTE CONTROL/MONITORING FOR SATELLITE EARTH STATIONS

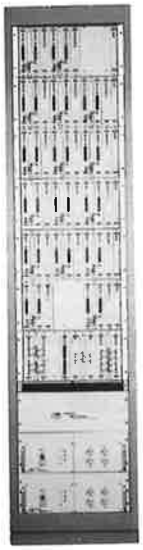


SPECIAL PURPOSE TEST INSTRUMENTATION

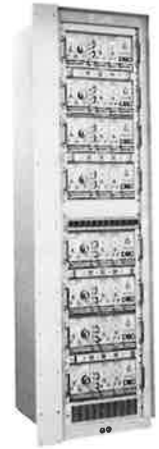


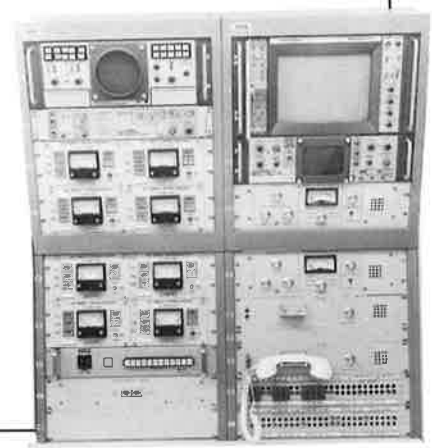


SINGLE CHANNEL PER CARRIER EQUIPMENT FOR INTELSAT SATELLITE SYSTEMS

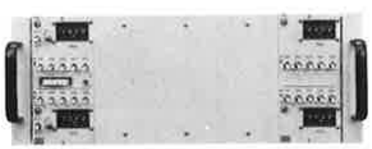


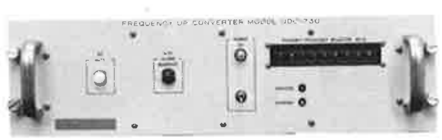
GROUND COMMUNICATION AND CONTROL EQUIPMENT FOR COMMERCIAL SATELLITE SYSTEMS

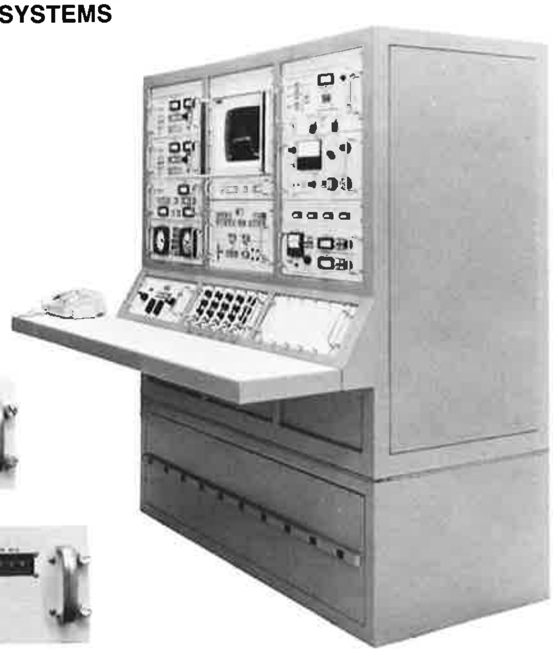


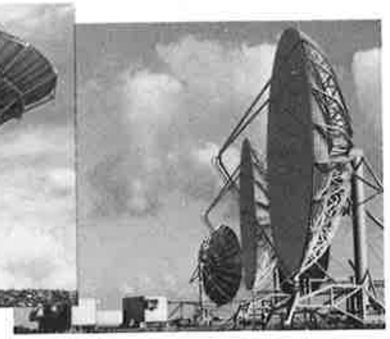


GROUND COMMUNICATION AND CONTROL EQUIPMENT FOR DEFENSE SATELLITE SYSTEMS

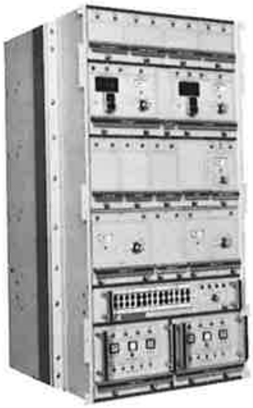


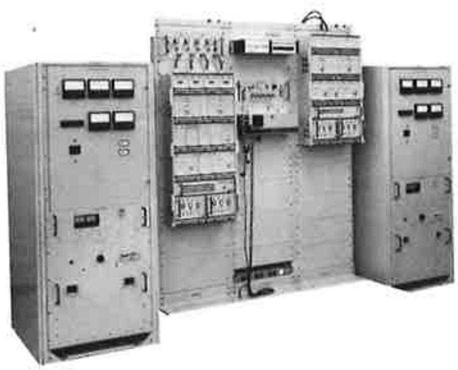




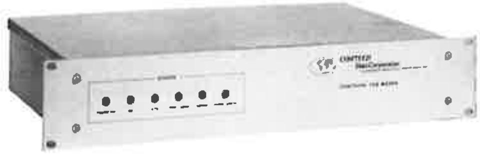


RECEIVING AND TRANSMITTING EQUIPMENT FOR TROPOSCATTER SYSTEMS

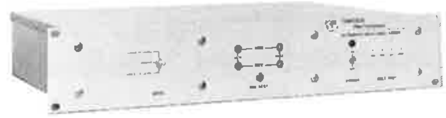




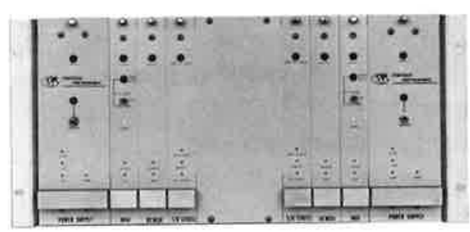
HIGH SPEED DIGITAL MODEMS FOR COAXIAL CABLE



ALTERNATE DATA/VOICE CODEC



DIGITAL MODULATION/DEMODULATION EQUIPMENT FOR SATELLITE SYSTEMS



RECEIVING AND SWITCHING EQUIPMENT FOR VIDEO RECEIVE-ONLY SATELLITE EARTH STATIONS

Consolidated Balance Sheets

ASSETS

	July 31, 1980	July 31, 1979
Current assets:		
Cash and short term investments (Notes 5 and 9)	$ 1,846,616	$ 230,349
Accounts receivable net of allowance for doubtful accounts of $1,068,637 in 1980 (Notes 1, 2 and 5)	8,919,939	10,357,880
Income taxes receivable (Notes 5 and 6)	1,110,191	1,821,000
Inventories (Notes 1 and 3)	5,088,863	6,621,653
Other current assets	426,712	257,670
	17,392,321	19,288,552
Property, plant and equipment less accumulated depreciation and amortization (Notes 1, 4 and 5)	7,789,297	7,793,743
Non-current receivables (Notes 1, 2 and 5)	1,487,783	3,223,038
Other assets	405,323	52,153
	$27,074,724	$30,357,486

LIABILITIES AND SHAREHOLDERS' EQUITY

	1980	1979
Current liabilities:		
Notes payable (Note 9)	$ 30,000	$ 6,150,000
Accounts payable	4,167,219	2,157,005
Accrued expenses and taxes withheld	1,963,643	1,590,218
Deferred income taxes	—	129,000
Advance contract payments received	972,432	1,251,691
Allowance for estimated loss on contracts (Note 1)	5,566,000	—
Current maturities of long term debt (Note 5)	1,074,360	523,000
	13,773,654	11,800,914
Long term debt (Note 5)	12,059,419	2,283,985
Deferred income taxes (Notes 1 and 6)	—	4,502,064
Commitments and contingencies (Note 11)		
Shareholders' equity (Notes 7 and 8):		
Common stock, $.10 par value:		
Authorized—5,000,000 shares Outstanding—1980—3,492,946 1979—3,478,746	349,295	347,874
Additional paid-in capital	2,946,949	2,807,696
Retained earnings (deficit)	(2,054,593)	8,614,953
	1,241,651	11,770,523
	$27,074,724	$30,357,486

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Income (Loss) and Retained Earnings (Deficit)

	Year ended July 31, 1980	Year ended July 31, 1979
Net sales	$25,920,360	$32,465,184
Costs and expenses:		
Cost of sales	33,893,932	26,413,927
Selling, general and administrative	5,325,731	3,265,899
Depreciation and amortization	778,611	653,565
Interest	1,522,696	491,137
	41,520,970	30,824,528
Income (loss) from operations before income taxes	(15,600,610)	1,640,656
Provision (credit) for income taxes (Note 6)	(4,931,064)	700,000
Net income (loss)	(10,669,546)	940,656
Retained earnings at beginning of year	8,614,953	7,674,297
Retained earnings (deficit) at end of year	($ 2,054,593)	$ 8,614,953
Net earnings (loss) per share (Note 1)	($3.06)	$ .26

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Changes in Financial Position

	Year ended July 31,	
	1980	1979
Financial resources were provided (used) by:		
Operations:		
Net income (loss) from operations	($10,669,546)	$ 940,656
Charges (credits) not affecting working capital:		
Depreciation and amortization	778,611	653,565
Deferred income taxes	(4,502,064)	700,000
Total from operations	(14,392,999)	2,294,221
Increase in long term debt	9,870,000	—
Increase in deferred income taxes	—	1,716,764
Net proceeds from exercise of stock options and warrants	46,601	64,688
Retirement of fixed assets, net	295,918	7,311
Reduction of non-current receivables	1,735,255	—
Increase in additional paid-in-capital related to shares issuable under stock purchase agreement	94,073	70,438
	(2,351,152)	4,153,422
Financial resources were used for:		
Purchase of building and equipment	1,070,083	1,656,209
Reduction in long term debt	94,566	519,240
Increase in non-current receivables	—	2,957,623
Stock repurchases in connection with the organization of a subsidiary	—	5,626
Increase in other assets	353,170	11,870
	1,517,819	5,150,568
Increase (decrease) in working capital	($ 3,868,971)	($ 997,146)

Analysis of changes in working capital

	Year ended July 31,	
	1980	1979
Increases (decreases) in current assets:		
Cash and short term investments	$ 1,616,267	($ 2,020,797)
Accounts receivable	(1,437,941)	4,876,044
Income taxes receivable	(710,809)	(128,335)
Inventories	(1,532,790)	3,346,996
Other current assets	169,042	133,750
	(1,896,231)	6,207,658
(Increases) decreases in current liabilities:		
Notes payable	6,120,000	(4,446,000)
Accounts payable	(2,010,214)	(1,039,175)
Accrued expenses and taxes withheld	(373,425)	(478,029)
Deferred income taxes	129,000	254,000
Advance contract payments received	279,259	(1,058,600)
Current maturities of long term debt	(551,360)	(437,000)
Allowance for estimated loss on contracts	(5,566,000)	—
	(1,972,740)	(7,204,804)
Increase (decrease) in working capital	($ 3,868,971)	($ 997,146)

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Notes to Consolidated Financial Statements

NOTE 1–ACCOUNTING POLICIES:

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated.

Contract Accounting

Sales Recognition

Sales are generally recorded under the unit of delivery method of accounting except for a large multi-year funded military program which utilizes the percentage of completion method of accounting. Progress payment retainage and estimated earnings are reflected as unbilled receivables.

Costs and Expenses

Cost of sales 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, manufacturing overhead and certain selling and finance costs associated with contracts. All other selling, general and administrative expenses are charged to operations as incurred. Since contracts can extend over one or more years, revisions in costs and earnings estimates during the course of the work are reflected during the accounting period in which the facts which require the revision become known. Under all contracts, when estimates indicate a probable future loss, including applicable selling, general and administrative expenses, an immediate provision for the full amount thereof, is charged to operations. To the extent the charge exceeds the related inventory balance, the excess is credited to allowance for estimated loss on contracts.

Inventories

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

Property, Plant and Equipment

Property, plant and equipment (including major renewals and betterments) are recorded at cost; expenditures for maintenance and repairs are charged to operations as incurred. At the time property is retired or otherwise disposed of, the cost and accumulated depreciation or amortization of such property is eliminated and the gain or loss on disposition is reflected in operations. Annual depreciation is provided utilizing the straight-line method over the estimated useful life of the asset.

Research and Development Costs

The Company charges research and product development costs to operations as incurred except where such costs are reimbursable under customer-funded contracts. Research and development costs not relating to customer-funded contracts amounted to approximately $800,000 in 1980 and approximately $520,000 in 1979.

Income Taxes

The Company provides deferred income taxes for transactions reported in different periods for financial and income tax reporting purposes. Investment tax credits are accounted for as a reduction of income taxes in the year the related asset is placed in service.

Earnings Per Share

Earnings per share is based upon the weighted average common shares and common share equivalents outstanding during the year after giving retroactive effect to a two for one stock distribution declared March 4, 1980. The number of common shares and common share equivalents used in computing earnings per share were 3,487,131 and 3,604,814 in 1980 and 1979, respectively. In 1980 the outstanding stock options and warrants have not been included since the effect would be anti-dilutive. In 1979 the effect of full dilution was immaterial.

NOTE 2—ACCOUNTS RECEIVABLE:

	July 31, 1980	July 31, 1979
Amounts receivable from the United States Government	$ 3,246,248	$ 415,611
Unbilled costs and accrued profits on contracts in progress	4,986,453	5,443,450
Amounts receivable from others	3,243,658	7,721,857
	11,476,359	13,580,918
Less:		
Unbilled costs and other amounts receivable in excess of one year	1,487,783	3,223,038
Allowance for doubtful accounts	1,068,637	—
	$ 8,919,939	$10,357,880

At July 31, 1980 and 1979, $4,440,000 and $2,029,000, respectively, represented retainages under a large contract with the U.S. Government of which approximately $1,393,000 and $1,422,000, respectively, are expected to be collected in excess of one year. Unbilled accounts receivable are billable upon completion of performance tests and acceptance by the customer. The allowance for doubtful accounts primarily reflects the uncertainty of collection of approximately $995,000 under a contract with a major foreign customer.

NOTE 3—INVENTORIES:

	July 31, 1980	July 31, 1979
Raw materials and components	$1,440,670	$1,452,016
Work in process	7,921,880	6,220,900
	9,362,550	7,672,916
Less—progress payments	4,273,687	1,051,263
	$5,088,863	$6,621,653

Work in process relating to contracts is expected to be delivered over a period of less than twelve months. Approximately 79% in 1980 and 71% in 1979 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.

NOTE 4—PROPERTY, PLANT AND EQUIPMENT:

	Estimated Useful Lives	July 31, 1980	July 31, 1979
Land		$ 1,177,806	$1,030,982
Buildings and improvements	40 years	4,433,511	4,268,469
Leasehold improvements	Lease Term	54,239	24,081
Equipment	3-8 years	5,591,804	5,273,518
		11,257,360	10,597,050
Less—accumulated depreciation and amortization		3,468,063	2,803,307
		$ 7,789,297	$7,793,743

NOTE 5—LONG TERM DEBT:

	July 31, 1980	July 31, 1979
Term loan maturing 1982	$10,420,000	$ —
9.4% First mortgage indebtedness to a bank payable monthly, maturing in 1980	430,328	445,288
6.5% Second mortgage indebtedness to the New York State Job Development Authority payable monthly, maturing in 1981	41,456	93,559
9% First mortgage indebtedness to a bank payable monthly, maturing in 1983	345,948	353,691
9.5% First mortgage indebtedness to an insurance company payable monthly, maturing in 1992	1,896,047	1,914,447
	13,133,779	2,806,985
Less—portion due within one year	1,074,360	523,000
	$12,059,419	$2,283,985

The 9.4% First Mortgage Note was due on July 31, 1980. The Company is presently negotiating a refinancing arrangement with the bank.

The 9% First Mortgage agreement contains an option to refinance the balance, approximately $321,000 at the completion of the initial term, for three successive five year periods at the initial interest rate.

On December 4, 1980, the Company borrowed $10,420,000 pursuant to a Term Loan and Security Agreement with three banks. Interest on this loan is at 2½% above the prime rate and is payable monthly. The proceeds were used to repay $10,420,000 of demand notes payable to banks. The agreement also provides that the banks will provide the Company with a facility in the amount of approximately $5,700,000, the aggregate approximate amount of presently outstanding letters of credit opened by the banks for the account of the Company, which facility may be used solely for the purpose of refinancing payments under such letters of credit. The amount of any borrowings under this facility will increase the principal amount of the term loan. In addition, the agreement provides for a $1,800,000 credit line for future contract guarantee letters of credit, subject to certain conditions.

Upon the occurrence of an event of default the banks may declare payable all obligations of the Company to the banks, including contingent obligations under outstanding letters of credit. Under certain circumstances, the banks would thereafter be required to return to the Company amounts paid with respect to contingent obligations which are no longer outstanding.

The agreement requires minimum installments as follows:

March 31, 1981	$ 550,000
August 1, 1981	800,000
March 31, 1982	800,000
August 1, 1982	800,000
December 4, 1982	7,470,000
	$10,420,000

Further, fifty percent of the net proceeds from the disposition of certain assets by the Company will be paid to the banks as a credit against installments under the Term Note in the order in which they become due. Fifty percent of the net proceeds of any sale of securities by the Company will be paid to the banks as a credit against the final installment.

As collateral for the loan, the Company has pledged substantially all assets, except inventory, and has agreed to maintain minimum levels of working capital, net worth and a quick ratio as defined.

In addition, the agreement contains certain restrictive covenants as to payment of dividends and acquisitions of capital equipment.

As a result of this refinancing, $9,870,000 of demand notes payable have been reclassified as long term debt in the accompanying balance sheet. At July 31, 1980 the aggregate principal amount of mortgages and term debt maturing annually during each of the four fiscal years ending July 1985 is as follows: 1982—$1,625,000, 1983—$8,622,000, 1984—$27,000 and 1985—$30,000. Mortgages are secured by the land and buildings referred to in Note 4.

NOTE 6—INCOME TAXES:

Income taxes had not been provided on the undistributed earnings recorded as of July 31, 1978 (cumulatively $1,479,000) by the Company's Domestic International Sales Corporation (DISC) subsidiary since the Company intended to permanently reinvest these earnings in export related activities. In 1979 the Company evaluated the appropriateness of the continuance of the deferral of taxes on the current year's DISC income, and decided to discontinue further deferrals at that time. During fiscal 1980, the amount of foreign revenues declined from those recorded in 1979. Maintenance of a qualified DISC requires compliance with stringent IRS tests and ratios relative to foreign business. The Company therefore decided to provide for taxes on such previously untaxed DISC earnings.

NOTE 6—INCOME TAXES (con't):

Of the Company's $15,600,610 operating loss, approximately $4,239,000 has been carried back to the prior years resulting in tax credits. Approximately $7,853,000 has been applied to the deferred income taxes remaining after giving effect to the tax credit. The effect of such transactions is to generate a net operating loss carryforward for financial statement purposes of approximately $3,508,000 which will expire in fiscal 1987. At July 31, 1980, the Company had net operating loss carryforwards for tax purposes of approximately $3,808,000 resulting primarily from use of the completed contract method of accounting for long term contracts. Deferred income taxes for 1979 of $700,000 for financial statement reporting purposes resulted primarily from the completed contract method.

The following tabulation sets forth the difference between the statutory and effective income tax rates for the years ended July 31, 1980 and 1979.

	July 31, 1980	July 31, 1979
Federal statutory income tax (credit) rate	(46%)	47%
Tax provided on undistributed DISC earnings	5	—
Net operating loss carryforward	9	—
State income taxes, net of federal tax benefit	—	5
Investment credit	—	(6)
New jobs credit	—	(3)
Effective income tax (credit) rate	(32%)	43%

NOTE 7—SHAREHOLDERS' EQUITY:

Changes in Shareholders' Equity during the years ended July 31, 1980 and 1979 are as follows:

	No. of Shares	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)
Balance July 31, 1978	1,730,373	$ 173,037	$2,853,033	$7,674,297
Exercise of stock options and warrants	10,100	1,010	63,678	—
Net income for the period	—	—	—	940,656
Shares repurchased and retired in connection with the resignation of a Comtech Data Corporation employee	(1,100)	(110)	(5,516)	—
Excess of market value over proceeds on shares issuable in connection with the organization of Comtech Data Corp.	—	—	70,438	—
Balance July 31, 1979	1,739,373	$ 173,937	$2,981,633	$8,614,953
Shares issued in connection with a two for one stock distribution	1,739,373	173,937	(173,937)	—
Exercise of stock options	14,200	1,421	45,180	—
Net (loss) for the period	—	—	—	(10,669,546)
Excess of market value over proceeds on shares issuable in connection with the organization of Comtech Data Corp.	—	—	94,073	—
Balance July 31, 1980	3,492,946	$ 349,295	$2,946,949	($2,054,593)

On March 4, 1980, the Board of Directors approved a two for one stock distribution in the form of a stock dividend which was distributed April 15, 1980. For comparative purposes the accompanying balance sheet, earnings (loss) per share and notes to the financial statements have been restated to give retroactive effect to the distribution.

NOTE 8—STOCK OPTION PLANS:

Options to purchase common stock of the Company have been granted under various plans to officers and other key employees. Options granted under the Company's 1970 qualified option plan are at prices equal to the fair market value of such stock on the date of grant and are exercisable over a period of not more than five years. Options granted under the Company's 1976 Incentive Stock Option Plan are at prices which may not be less than 85% of the fair market value of such stock on the date of grant and are exercisable over a period determined by the Board of Directors at the time of grant.

In connection with options issued under the 1976 Incentive Stock Option Plan, the difference between the option price and the fair market value on the date of grant is compensation expense and is charged to operations over the period during which the options become exercisable. The amount charged to expense in 1980 and 1979 was $52,000 and $10,803, respectively.

In December 1978 the shareholders approved an amendment to the Company's 1976 Incentive Stock Option Plan. The amendment, after giving effect to the stock distribution in April, 1980, increased the number of shares available for future grants under the Plan by 300,000 and authorized the grant of stock appreciation rights ("SAR's") which will be related to options previously or subsequently granted under the Plan. The SAR's, in general, would entitle the optionee to receive, upon exercise, cash, shares of Common Stock of the Company or a combination of both (as determined by the Committee administering the Plan) equal to the difference between the exercise price of the related option and the market price of the Company's stock on the date of exercise of the SAR. Upon exercise of the SAR's, the related options must be surrendered.

Under the Company's Incentive Warrant Plan for directors of the Company who are neither officers nor employees of the Company or its subsidiaries, a maximum of 50,000 shares of common stock were available for grant under provisions to be established at the discretion of a committee of the Board of Directors. Warrants which have been granted under the Plan become exercisable over a period of ten years.

Under an agreement related to the establishment of a subsidiary, 192,200 shares of common stock are reserved for sale at par value to certain individuals upon the achievement by that subsidiary of certain earnings levels defined in the agreement. As of July 31, 1980 such earnings levels have not been achieved.

The greater of the excess of market value over the proceeds for such shares on the date of the agreement or upon the achievement of the earnings milestone will be charged to compensation expense over the estimated period of earnings achievement.

NOTE 8—STOCK OPTION PLANS (con't):

The following tabulations set forth the activity in stock options and warrants for the years ended July 31, 1980 and 1979.

	July 31,			
	1980		1979	
	Number of Shares	Option Price Per Share	Number of Shares	Option Price Per Share
Qualified stock options:				
Outstanding, beginning of the year	71,600	$3.25-6.32	130,600	$2.25-6.32
Granted	—	—	—	—
Exercised	(4,800)	3.25	(15,000)	2.25-3.75
Cancelled	(41,200)	3.25-6.32	(44,000)	3.25-6.32
Outstanding, end of year	25,600	3.25-6.32	71,600	3.25-6.32
Incentive stock options:				
Outstanding, beginning of the year	304,860	2.77-5.37	207,060	2.77-4.84
Granted	254,000	2.71-4.41	109,000	3.67-5.37
Exercised	(9,400)	2.77-3.67	(5,200)	2.77-3.67
Cancelled	(103,800)	2.77-5.37	(6,000)	3.67-3.88
Outstanding, end of the year	445,660	2.71-5.37	304,860	2.77-5.37
Incentive warrants:				
Outstanding, beginning of the year	29,500	3.25-3.88	29,500	3.25-3.88
Granted	10,000	3.82	—	—
Exercised	—	—	—	—
Cancelled	(1,000)	3.25	—	—
Outstanding, end of the year	38,500	3.25-3.88	29,500	3.25-3.88
Total options and warrants outstanding, end of the year	509,760	2.71-6.32	405,960	2.77-6.32
Warrants and options which became exercisable during the year	137,240	2.77-6.32	45,740	2.76-6.32
Available for grant, end of year	247,200		365,100	

NOTE 9—LINES OF CREDIT:

During the current year the Company had agreements with three banks which provided $30,000,000 of credit lines for working capital and letters of credit. The weighted average interest rates for such debt were 11.5% and 12.25% as of July 31, 1980 and 1979 respectively.

Borrowing under these arrangements averaged $8,235,000 during 1980 at an average rate of 15.4% and averaged $2,154,000 during 1979 at an average interest rate of 11%. The maximum amounts borrowed under the agreements in 1980 and 1979 were $10,450,000 and $6,400,000.

Borrowing at July 31, 1980 amounted to $10,450,000. Subsequent to July 31, 1980, $30,000 was paid out of operations and $10,420,000 was paid from the proceeds of the refinancing described in Note 5.

NOTE 10—PROFIT SHARING AND INCENTIVE COMPENSATION PLANS:

The Company has a profit sharing plan covering all eligible employees. The plan, which has been approved by the IRS, provides for the Company to contribute such amounts as the Board of Directors determines. During the year ended July 31, 1979, the Board approved contributions of $100,000 which were charged to income. There was no contribution for the year ended July 31, 1980.

The Company has 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 thereunder is payable to selected key employees of the Company. A provision of $87,000 was charged against income in fiscal 1979. There was no provision for the year ended July 31, 1980.

NOTE 11—COMMITMENTS AND CONTINGENCIES:

The Company and its subsidiaries have entered into leasing agreements for manufacturing facilities for periods ranging from 3 to 5 years. The annual rentals under these agreements aggregate approximately $210,000. In addition, the Company has entered into computer equipment leases for periods not exceeding 5 years at an average annual rental of $204,000.

In connection with a contract with the Government of Libya, as amended, for $26,700,000, the Company was required to establish customary standby letters of credit for 20% of the contract value (which represents an amount equal to the down payment received under the contract). Under the terms of the contract, the letter of credit for the advance payment is reduced as shipments are made against the contract. As of July 31, 1980 and 1979, such reductions amounted to approximately $3,800,000 and $3,170,000 respectively. As of July 31, 1980 approximately $1,600,000 of letters of credit have not been reduced in accordance with the initial terms of this contract pending settlement of disputed work. In addition, the Company was required to establish performance guarantees of approximately $3,400,000. There are additional performance guarantees of approximately $650,000 outstanding on other contracts.

NOTE 12—QUARTERLY DATA (UNAUDITED):

Quarter	Net Sales	Gross Profit (Loss)	Net Income (Loss)	Earnings (Loss) Per Share
Fiscal 1980				
First	$4,761,565	$ 718,531	($382,470)	($.11)
Second ..	5,612,798	780,663	(377,235)	(.11)
Third.....	7,887,416	320,210	(664,729)	(.19)
Fourth....	7,658,581	(9,792,976)	(9,245,112)	(2.65)
Fiscal 1979				
First	$4,227,178	$ 597,976	($121,955)	($.04)
Second ..	6,533,051	1,115,123	103,953	.03
Third.....	8,707,154	1,897,793	330,997	.09
Fourth....	12,997,801	2,440,365	627,661	.17

The Third and Fourth quarters of Fiscal 1980 reflect charges to operations of approximately $1,000,000 and $12,600,000 primarily from difficulties and delays encountered in the ongoing installation plans for a troposcatter network in Libya (approximately $7,200,000) and the cumulative effect (approximately $5,100,000) of higher than anticipated costs relating to a major contract with the U.S. Government. Additional charges to operations (approximately $1,300,000) were made in the fourth quarter of fiscal 1980 to reflect cost overruns on other contracts.

NOTE 13—SEGMENT INFORMATION:

For the purpose of segment reporting, management considers the Company to operate in one industry, the Communications Equipment industry.

During the Fiscal years ended July 31, 1980 and 1979, approximately 60% and 54% respectively of the Company's revenues resulted from contracts with U.S. Government agencies and prime contractors of government agencies and approximately 14% and 31% respectively, resulted from export sales. In 1979 sales to the government of Libya accounted for approximately 24% of the Company's revenues.

Report of Independent Accountants

To the Board of Directors and Shareholders of
Comtech Telecommunications Corp.:

We have examined the consolidated balance sheets of Comtech Telecommunications Corp. (a New York corporation) and subsidiaries as of July 31, 1980 and July 31, 1979, and the related consolidated statements of income (loss) and retained earnings (deficit) and changes in financial position for the years then ended. Our examinations were 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.

As reflected in the accompanying consolidated financial statements, the Company incurred a net loss of $10,669,546 in 1980. Realization of the amount at which assets included in the accompanying consolidated balance sheets are carried is subject to the success of future operations.

In our opinion, subject to the realization of the amount at which assets are carried as discussed in the preceding paragraph, the consolidated financial statements referred to above present fairly the financial position of Comtech Telecommunications Corp. and subsidiaries as of July 31, 1980 and July 31, 1979, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Huntington, N.Y.
December 4, 1980

Five-Year Summary of Operations

	Year Ended July 31,				
	1976(A)	1977	1978	1979	1980
Net sales and other income	$25,492,915	$19,042,473	$27,788,367	$32,465,184	$25,920,360
Costs and expenses:					
Cost of sales	18,095,121	14,328,056	21,961,682	26,413,927	33,893,932
Selling, general and administrative	1,983,210	2,564,604	2,983,985	3,265,899	5,325,731
Depreciation and amortization	403,509	435,210	510,557	653,565	778,611
Interest	92,027	80,737	170,868	491,137	1,522,696
	20,573,867	17,408,607	25,627,092	30,824,528	41,520,970
Income (loss) from continuing operations before income taxes	4,919,048	1,633,866	2,161,275	1,640,656	(15,600,610)
Provision (credit) for income taxes (B)	2,426,500	790,000	805,000	700,000	(4,931,064)
Income (loss) from continuing operations	2,492,548	843,866	1,356,275	940,656	(10,669,546)
Loss from operation of discontinued subsidiary, net of income taxes of $200,000 in 1978; $70,000 in 1977 (C)	—	(63,829)	(211,384)	—	—
Net income (loss)	$ 2,492,548	$ 780,037	$ 1,144,891	$ 940,656	($10,669,546)
Earnings (loss) per share (D), (E):					
Continuing Operations	$ .73	$ .24	$ .38	$ .26	($3.06)
Discontinued Operations	—	(.02)	(.06)	—	—
Net earnings (loss) per share	$ .73	$ .22	$ .32	$ .26	($3.06)
Average common shares and common share equivalents	3,429,424	3,481,270	3,562,084	3,604,814	3,487,131

(A) Restated to reflect the acquisition of Comtech Antenna Corp. (formerly R.F. Systems, Inc.) which has been accounted for as a pooling of interests.

(B) See Note 6 of the Notes to Consolidated Financial Statements.

(C) In April 1978, the Company discontinued operations of its wholly-owned subsidiary, Comtech Advanced Systems, Inc. and terminated agreements with a group of individuals. The subsidiary had sales in fiscal 1978 of $53,000 and losses from operations, net of applicable income taxes, of approximately $211,000.

(D) Earnings per share is based upon the weighted average common shares and common share equivalents outstanding during the year. Retroactive effect has been given to the shares issued in connection with the acquisition of Comtech Antenna Corp. (formerly R.F. Systems, Inc.). The effect of full dilution is immaterial.

(E) A split of the Company's common stock outstanding was effected in the form of a 100% stock dividend on April 15, 1980. All prior period comparative figures based on shares outstanding have been restated to reflect the 2 for 1 stock distribution.

Management Discussion and Analysis of Summary of Operations

Sales

During the Fiscal Year 1980, as compared to 1979, sales decreased by approximately 20%. This decrease principally reflected the level of shipments and certain delivery delays. Sales for the Fiscal Year 1979, as compared to 1978, increased by approximately 17%. This increase was principally due to a higher level of sales on a major contract with the U.S. Government.

Costs and Expenses

Cost of sales as a percentage of sales for Fiscal 1980 compared to Fiscal 1979, increased by approximately 49%. This increase, which resulted in a negative gross profit for the year, reflects the cumulative impact of realizing higher than anticipated costs on several fixed price contracts and reserves taken for letters of credit. For Fiscal 1979, as compared to 1978, cost of sales increased by approximately 2%. This increase was due to changes in the cumulative effect of higher than anticipated costs on a major contract.

Selling, General and Administrative expenses in Fiscal 1980, compared to 1979, and in 1979 compared to 1978, increased by approximately 63% and 9% respectively. The increase in 1980 reflects mainly the impact of a major provision for bad debt on Accounts Receivable, and significant charges for professional fees. The increase in 1979 is attributable to the reflection of a complete year of expenses associated with the Company's Arizona subsidiary, Comtech Data Corp., as compared to a portion of the year (four months) during Fiscal 1978.

Depreciation and amortization in Fiscal 1980 as compared to 1979, and in 1979 compared to 1978, increased by 19% and 28%, respectively, due to the addition of new facilities and equipment.

Interest expense in Fiscal 1980, as compared to 1979, and in 1979 as compared to 1978, increased by 210% and 187%, respectively. These increases reflect higher levels of borrowing and higher prevailing interest rates.

Income Taxes

The effective tax rate for 1979 was 43%, while the Fiscal 1980 net operating loss resulted in a tax credit.

The 1980 tax credit results from the carryback of the current year's loss to the book earnings recorded during Fiscal Years 1977, 1978 and 1979. The balance of the credit results from an offset of the deferred taxes recorded in Fiscal Years 1978 and 1979. These deferred taxes were the result of the tax refunds generated by the Company's 1978 adoption of the completed contract method for tax reporting.

Stock Prices

The common stock of Comtech Telecommunications Corp. is traded in the Over-The-Counter market. 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.

	Fiscal Year 1980*		Fiscal Year 1979*	
Quarter	Bid, Low-High	Asked, Low-High	Bid, Low-High	Asked, Low-High
First	3⅜-5¾	3¾-6⅛	3⅝-7⅞	4-8¼
Second	3⅜-6	3¾-6⅜	3⅝-5⅛	4-5½
Third	3-5¼	3⅜-5⅝	4⅜-5⅞	4¾-6¼
Fourth	2⅞-4	3⅜-4½	4⅞-5⅞	5¼-6¼

*Stock prices for first, second and third quarters of fiscal 1980 and all quarters of fiscal 1979 adjusted to reflect 100% stock distribution effective April 15, 1980.

Dividends

No cash 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 1980 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 Secretary, Comtech Telecommunications Corp., 45 Oser Ave., Smithtown, NY 11787.

Board of Directors

F. Kornberg—Chairman
B. Adler—Business and Engineering Consultant
G. Bugliarello—President, Polytechnic Institute of New York
F. Marx—Telecommunications Consultant

Officers

F. Kornberg—President and Chief Executive Officer
M. L. Deever—Vice President
G. Birutis—Vice President
B. A. Nathan—Secretary

Banks

Chemical Bank
125 Jericho Turnpike
Jericho, N.Y. 11753

The Chase Manhattan Bank, N.A.
1 Chase Manhattan Plaza
New York, N.Y. 10015

Manufacturers Hanover Trust Company
7600 Jericho Turnpike
Woodbury, N.Y. 11797

Legal Counsel

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200 Park Avenue
New York, New York 10017

Registrar and Transfer Agent

Chemical Bank
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New York, New York 10041

Independent Accountants

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1 Huntington Quadrangle
Huntington, Long Island, New York 11746

Stock Traded—OTC **NASDAQ Symbol—CMTL**

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Telecommunications Corp.

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