

# COMTECH INC.

ANNUAL REPORT '84

## ABOUT THE COMPANY

Comtech Inc. was incorporated in 1967 as Comtech Laboratories, Inc. The Company is principally engaged in the design, development, manufacture and installation, for commercial and government applications, of high technology, communications-related equipment. The Company's products are chiefly used in connection with satellite, tropospheric scatter and terrestrial line-of-sight communication systems. The Company designs, manufactures and sells microwave components for electronic systems utilizing microwaves for various military defense and commercial purposes. The Company also is engaged in the manufacture and sale of voice concentrating devices. The Company sells its products directly to end users, as well as to subcontractors and prime contractors which incorporate such products in a full system installation, and also uses its products, along with products of others, to sell and install entire communication systems on a turnkey basis.

The Company's operating units are Premier Microwave Corporation, Comtech Microwave Corp., Comtech Systems International, Inc., Comtech Antenna Corp., and Comtech Communications Corp.

## Corporate Headquarters

Comtech Inc.  
63 Oser Avenue  
Hauppauge, NY 11788  
(516) 435-4646

## Operating Units

Premier Microwave Corporation  
33 New Broad Street  
Port Chester, NY 10573  
(914) 939-8900

Comtech Microwave Corp.  
80 Oser Avenue  
Hauppauge, NY 11788  
(516) 231-5454

Comtech Systems  
International, Inc.  
3100 Communications Road  
St. Cloud, FL 32769  
(305) 892-6111

Comtech Antenna Corp.  
3100 Communications Road  
St. Cloud, FL 32769  
(305) 892-6111

Comtech Communications Corp.  
3400 Industrial Lane  
Broomfield, CO 80020  
(303) 673-8545

## **TO OUR SHAREHOLDERS AND EMPLOYEES:**

Last year was an extraordinarily difficult one for Comtech, and this was certainly reflected in our financial results. The Company reported an after-tax loss of \$27,886,000 or \$5.89 a share on sales of \$40,394,000. In the prior year, earnings were \$1,409,000 or \$.36 per share on sales of \$36,589,000. Backlog (exclusive of the U.S. Army Radio Contract) at July 31, 1984 was \$20,411,000 as compared to the year earlier \$21,627,000.

Comtech's Government Systems Division and the start up voice communication products subsidiary, Comtech Communications Corp., were the focal points of last year's losses. The largest components of these losses related to increased costs incurred in connection with, and reserves reflecting increased estimates of the cost to complete or resolve, two major contracts at the Government Systems Division, continuing operating losses at Comtech Communications, and certain asset write-offs and inventory reserves.

One of the major Government Systems contracts involved the multi-year satellite communications terminal awarded to Comtech by the U.S. Army in 1978, that has been in the production phase for some time and encountered difficulties. At the present time, 19 out of the required 21 terminals have been delivered, system 20 is now in final test, and the present schedule calls for the last terminal to be delivered by the third quarter of fiscal year 1985. The other major Government Systems contract was for the production of AN/GRC-144 microwave radios for the U.S. Army, originally awarded to Comtech during fiscal year 1982. In August 1984, the U.S. Army terminated the contract, assertedly as a result of delay by the Company, and, among other things, demanded repayment of approximately \$1,821,000 of unliquidated progress payments. The Army also asserted the right to assess the Company for procurement costs, if any. Comtech, which contends the Army caused or contributed to delays in performance, has filed an appeal with the Armed Services Board of Contract Appeals as to the nature of the termination. The ultimate loss on this contract cannot be fully determined until the appeal process and vendor negotiations are completed or otherwise resolved.

The operations of Comtech Communications Corp., our voice communications concentrator subsidiary, continued to be unprofitable in fiscal year 1984, and have been the subject of continuing analysis and evaluation by management. Core elements of this business were acquired in July 1983 to provide Comtech with an entry into the digital signal processing and user/subscriber segment of the telecommunications market, and our people set about the job of creating a company. As it turned out, the operation achieved a level of sales volume both less than anticipated and insufficient to absorb committed expenses. Inventory reserves and a net operating loss of this subsidiary aggregated approximately \$5.6 million for fiscal 1984. While budgets for this operation have since been modified to bring estimated expenses more closely in line with anticipated revenue levels, under present circumstances, a sale of this operation seems appropriate and negotiations looking toward a possible disposition are currently in progress. In this connection, provision was made in Comtech's year-end results for an estimated loss on disposal.

During the last many months, Comtech has been undertaking a number of other actions designed to curtail its operating losses, reduce its indebtedness, and meet its liquidity requirements, activities which absorbed substantial amounts of management time and energies.

Among other things, we discontinued certain of the business activities previously engaged in by the Government Systems Division and reassigned to other operating entities the bulk of that Division's remaining activities, thereby eliminating significant facility and other overhead and personnel costs not required for the ongoing activities. In this connection, in October 1984, the Company sold its Hauppauge, Long Island building, which was no longer needed by the Government Systems Division, for \$6,200,000 in cash, resulting in a gain, after expenses of \$2,544,000. The net proceeds of approximately \$5,500,000 were used to reduce indebtedness, including the first mortgage and a major portion of the Company's loan from the Department of the Army, which had been secured by a second mortgage.

Keenly aware of a continuous need to effect cost efficiencies, we reduced our workforce by about one third and consolidated our Comtech Microwave operations (including certain of the former activities of the Government Systems Division) into two 20,000 square foot facilities on Long Island. Careful attention is being given to this operation with a view to its making an ongoing contribution to the Company's future.

In November 1984, assets of the Company's Comtech Data Corporation subsidiary were sold to a subsidiary of Fairchild Industries, Inc. for an anticipated aggregate purchase price of approximately \$12,000,000. Of the \$11,400,000 received in November, approximately \$8,100,000 was used to repay the Company's entire outstanding secured bank debt and approximately \$1,300,000 was used to repay other indebtedness. The balance of the sales proceeds is to be received in March 1985. It is expected that the sale of Comtech Data Corporation will result in a gain of approximately \$8,000,000.

We note with thanks the contributions to Comtech Data and Comtech made by Milton L. Deever, who had been a founder and moving force behind Comtech Data, and who undertook employment with Fairchild in connection with the Comtech Data sale. Mr. Deever had also served as Comtech's Chief Operating Officer since April 1984, following the resignation of George A. Reed, who held that position since he was employed by the Company in May 1982.

Recently, Comtech reported a net profit of \$1,050,000 or \$.22 per share on sales of \$6,930,000 for the quarter ended October 31, 1984, as compared to a loss of \$850,000 or \$.18 per share on sales of \$8,833,000 for the prior year period. Of course, the financial results for the first quarter were significantly affected by the sale of the Hauppauge, Long Island building, which produced a gain of \$2,544,000. The sales decrease of \$1,903,000, or 22%, from the prior year period primarily reflects reduced revenue due to the phase-out of certain operations of the Government Systems Division, and a lower sales level of Premier Microwave Corporation, partially offset by increased revenues of Comtech Communications Corp., Comtech Systems International, Inc., and Comtech Microwave Corp. Backlog (exclusive of the U.S. Army Radio Contract and Comtech Data Corporation) at October 31, 1984 was \$15,904,000 as compared to \$20,943,000 a year ago.

The balance of this Report deserves your careful attention. As you can see, a great effort will continue to be needed from those many employees of our enterprise who worked with unstinting energy and dedication during this difficult period. The challenges are many and we intend to confront them innovatively and aggressively.

December 21, 1984



Fred Kornberg  
Chairman of the Board  
and President

**FINANCIAL SECTION  
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**Annual Meeting**

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Shareholder's are cordially invited to attend and participate in the Annual Meeting of Shareholders scheduled for Tuesday, January 29, 1985 at 10:00 a.m. at:

Sheraton Hotel  
110 Vanderbilt Motor Parkway  
Smithtown, NY 11787  
(516) 231-1100

**Availability of Form 10-K**

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Shareholders may obtain a copy of Form 10-K, exclusive of exhibits free of charge by writing to:

Secretary  
Comtech Inc.  
63 Oser Avenue  
Hauppauge, NY 11788

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The Company also will furnish exhibits to the Form 10-K to shareholders who request same upon payment to the company of a \$25 fee.

COMTECH INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
JULY 31, 1984 AND 1983 (NOTE 1)

<u>ASSETS</u>	1984 <u>Pro Forma</u> (Note 16) (Unaudited)	1984 <u>Historical</u>	<u>1983</u>
CURRENT ASSETS:			
Cash	\$ 4,117,000	\$ 320,000	\$ 2,780,000
Accounts receivable - net (Notes 2, 5 and 15)	8,461,000	10,526,000	11,666,000
Inventories (Notes 2, 6 and 15)	7,526,000	10,229,000	14,760,000
Assets subsequently sold - net (Note 16)		1,035,000	
Other	<u>397,000</u>	<u>438,000</u>	<u>825,000</u>
Total current assets	20,501,000	22,548,000	30,031,000
PROPERTY, PLANT AND EQUIP- MENT - net (Notes 2 and 7)	6,222,000	7,284,000	10,394,000
OTHER ASSETS (Notes 2 and 4)	2,019,000	2,019,000	1,738,000
TOTAL (Note 8)	<u>\$28,742,000</u>	<u>\$31,851,000</u>	<u>\$42,163,000</u>

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

COMTECH INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
JULY 31, 1984 AND 1983 (NOTE 1)

<u>LIABILITIES AND SHAREHOLDERS'</u> <u>EQUITY (DEFICIENCY)</u>	1984 <u>Pro Forma</u> (Note 16) (Unaudited)	1984 <u>Historical</u>	<u>1983</u>
<b>CURRENT LIABILITIES:</b>			
Notes payable and current maturities of long-term debt (Note 8)	\$ 1,729,000	\$13,373,000	\$ 1,285,000
Accounts payable	4,037,000	5,144,000	2,570,000
Accrued expenses	4,077,000	4,930,000	5,506,000
Allowance for estimated losses on contracts (Notes, 2, 3, 11 and 15)	2,742,000	2,742,000	2,307,000
Reserve for loss on sale of assets (Note 15)	4,700,000	4,700,000	
Advance contract payments received	283,000	283,000	204,000
Total current liabilities	<u>17,568,000</u>	<u>31,172,000</u>	<u>11,872,000</u>
LONG-TERM DEBT (Note 8)	11,801,000	11,801,000	19,687,000
OTHER LIABILITIES	<u>915,000</u>	<u>915,000</u>	<u>562,000</u>
COMMITMENTS AND CONTINGENCIES (Notes 3 and 11)			
<b>SHAREHOLDERS' EQUITY (DEFICIENCY)</b> (Notes 4, 8 and 10):			
Preferred stock, \$.10 par value: Authorized - 2,000,000 shares; Issued - none			
Common stock, \$.10 par value: Authorized - 1984, 20,000,000 shares; 1983, 10,000,000 shares			
Issued - 1984, 4,681,646 shares; 1983, 3,844,465 shares	469,000	469,000	385,000
Additional paid-in capital	12,632,000	12,632,000	6,729,000
Retained earnings (accumulated deficit)	<u>(14,463,000)</u> <u>(1,362,000)</u>	<u>(24,958,000)</u> <u>(11,857,000)</u>	<u>2,928,000</u> <u>10,042,000</u>
Treasury stock - 75,000 shares in 1984 - at cost	<u>(180,000)</u>	<u>(180,000)</u>	
Shareholders' equity (deficiency)	<u>(1,542,000)</u>	<u>(12,037,000)</u>	<u>10,042,000</u>
<b>TOTAL</b>	<u>\$28,742,000</u>	<u>\$31,851,000</u>	<u>\$42,163,000</u>

COMTECH INC. AND SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)  
FOR THE FISCAL YEARS ENDED JULY 31, 1984 AND 1982 (NOTES 1 AND 10)

	<u>COMMON STOCK</u>	<u>ADDITIONAL</u>	<u>RETAINED</u>	<u>TREASURY STOCK</u>	<u>SHAREHOLDERS'</u>
	<u>SHARES</u>	<u>PAID-IN</u>	<u>EARNINGS</u>		<u>EQUITY</u>
	<u>ISSUED</u>	<u>CAPITAL</u>	<u>(DEFICIT)</u>		<u>(DEFICIENCY)</u>
	<u>AMOUNT</u>				
BALANCE, AUGUST 1, 1981	3,557,066	\$ 3,359,000	\$ (861,000)		\$ 2,854,000
Net income			2,380,000		2,380,000
Shares issued in connection with stock option, warrant, purchase and employment agreements	178,166	373,000			391,000
BALANCE, JULY 31, 1982	3,735,232	3,732,000	1,519,000		5,625,000
Net income			1,409,000		1,409,000
Shares issued in connection with stock option, warrant, purchase and employment agreements	109,233	611,000			622,000
Proceeds from stock purchase warrants (Note 8)		2,386,000			2,386,000
BALANCE, JULY 31, 1983	3,844,465	6,729,000	2,928,000		10,042,000
Net loss			(27,886,000)		(27,886,000)
Shares issued in public offering of common stock	750,000	5,556,000			5,631,000
Shares issued in connection with stock option, warrant, purchase and employment agreements	87,181	347,000			356,000
Shares purchased from former officer				\$(180,000)	(180,000)
BALANCE, JULY 31, 1984	4,681,646	\$12,632,000	\$ (24,958,000)	\$(180,000)	\$ (12,037,000)

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



COMTECH INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE FISCAL YEARS ENDED JULY 31, 1984, 1983 AND 1982 (NOTE 1)

	<u>1984</u>	<u>1983</u>	<u>1982</u>
Net sales (Notes 2, 3 and 13)	<u>\$40,394,000</u>	<u>\$36,589,000</u>	<u>\$33,487,000</u>
Costs and expenses (Note 14):			
Cost of sales (Note 2)	44,578,000	24,658,000	23,232,000
Selling, general and administrative	14,709,000	7,125,000	5,270,000
Research and development (Note 2)	2,227,000	1,638,000	1,258,000
Interest - net	2,623,000	1,122,000	1,312,000
Total costs and expenses	<u>64,137,000</u>	<u>34,543,000</u>	<u>31,072,000</u>
Income (loss) from continuing operations before gain on sale of assets and income taxes	(23,743,000)	2,046,000	2,415,000
Gain (loss) on sale of assets - net (Notes 7 and 15)	<u>(4,700,000)</u>		<u>248,000</u>
Income (loss) from continuing operations before income taxes	(28,443,000)	2,046,000	2,663,000
Provision (benefit) for income taxes (Notes 2 and 9)	(557,000)	680,000	1,164,000
Income (loss) from continuing operations	<u>(27,886,000)</u>	<u>1,366,000</u>	<u>1,499,000</u>
Estimated gain (loss) on disposal of discontinued operations, including provision for operating losses during phase-out period, net of tax benefits (expense) of \$(36,000) in 1983 and \$122,000 in 1982 (Note 12)		43,000	(143,000)
Income (loss) before extraordinary credit	(27,886,000)	1,409,000	1,356,000
Extraordinary credit - Reduction of income taxes resulting from the utilization of net operating loss carryforwards (Note 9)			<u>1,024,000</u>
Net income (loss)	<u><u>\$ (27,886,000)</u></u>	<u><u>\$ 1,409,000</u></u>	<u><u>\$ 2,380,000</u></u>
Earnings (loss) per share (Note 2):			
Continuing operations	\$(5.89)	\$.35	\$.40
Disposal of discontinued operations		.01	(.04)
Income (loss) before extraordinary credit	(5.89)	.36	.36
Extraordinary credit			<u>.28</u>
Earnings (loss) per share	<u><u>\$(5.89)</u></u>	<u><u>\$.36</u></u>	<u><u>\$.64</u></u>
Weighted average number of common and common equivalent shares outstanding	<u><u>4,730,528</u></u>	<u><u>3,967,110</u></u>	<u><u>3,712,703</u></u>

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

COMTECH INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION  
FOR THE FISCAL YEARS ENDED JULY 31, 1984, 1983 AND 1982 (NOTE 1)

	<u>1984</u>	<u>1983</u>	<u>1982</u>
FINANCIAL RESOURCES WERE PROVIDED (USED BY):			
Continuing operations:			
Income (loss) from continuing operations	\$(27,886,000)	\$ 1,366,000	\$ 1,499,000
Charges not affecting working capital:			
Depreciation and amortization of property, plant and equipment	2,020,000	937,000	693,000
Deferred Federal income taxes	(557,000)	552,000	
Charge equivalent to the utilization of income tax loss carryforward			1,146,000
Other - net	<u>(100,000)</u>	<u>535,000</u>	
Funds provided from (used by) continuing operations	(26,523,000)	3,390,000	3,338,000
Funds provided from (used by) discontinued operations - net		79,000	<u>(265,000)</u>
Total from operations*	<u>(26,523,000)</u>	<u>3,469,000</u>	<u>3,073,000</u>
Increase in long-term debt	3,500,000	17,603,000	
Issuance of stock purchase warrants		2,386,000	
Issuance of common shares	5,987,000	622,000	391,000
Increase in other liabilities	821,000		
Disposal and reclassification of property, plant and equipment - net	<u>4,319,000</u>	<u>158,000</u>	<u>63,000</u>
Total	<u>(11,896,000)</u>	<u>24,238,000</u>	<u>3,527,000</u>
FINANCIAL RESOURCES WERE USED FOR:			
Purchase of businesses, less working capital acquired		4,625,000	
Purchase of property, plant and equipment	3,229,000	1,701,000	749,000
Reduction in long-term debt	11,386,000	4,302,000	4,157,000
Increase in other assets - net	92,000	1,071,000	261,000
Purchase of treasury stock	180,000		
Total	<u>14,887,000</u>	<u>11,699,000</u>	<u>5,167,000</u>
INCREASE (DECREASE) IN WORKING CAPITAL	<u>\$(26,783,000)</u>	<u>\$12,539,000**</u>	<u>\$(1,640,000)</u>

(Continued)

	<u>1984</u>	<u>1983</u>	<u>1982</u>
CHANGES IN COMPONENTS OF WORKING CAPITAL:			
Increase (decrease) in current assets:			
Cash	\$ (2,460,000)	\$(1,536,000)	\$ 2,765,000
Accounts receivable - net	(1,140,000)	6,004,000	(4,169,000)
Inventories	(4,531,000)	11,244,000	(1,884,000)
Assets subsequently sold - net	1,035,000		(1,767,000)
Other	(387,000)	612,000	(363,000)
Total	<u>(7,483,000)</u>	<u>16,324,000</u>	<u>(5,418,000)</u>
(Increase) decrease in current liabilities:			
Notes payable and current maturities of long-term debt	(12,088,000)	(929,000)	1,696,000
Accounts payable	(2,574,000)	(1,337,000)	898,000
Accrued expenses	576,000	(2,215,000)	(1,726,000)
Allowance for estimated losses on contracts	(435,000)	210,000	1,133,000
Advance contract payments received	(79,000)	486,000	1,777,000
Reserve for loss on sale of assets	(4,700,000)		
Total	<u>(19,300,000)</u>	<u>(3,785,000)</u>	<u>3,778,000</u>
INCREASE (DECREASE) IN WORKING CAPITAL	<u>\$(26,783,000)</u>	<u>\$12,539,000**</u>	<u>\$(1,640,000)</u>

\* The extraordinary credit had no impact on working capital in 1982.

\*\* Includes \$9,182,000 of working capital relating to businesses acquired (see Note 4).

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

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COMTECH INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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1. RECENT OPERATIONS AND FUTURE PLANS

The accompanying consolidated financial statements have been prepared on a going-concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the financial statements, Comtech Inc. (formerly Comtech Telecommunications Corp.) and its subsidiaries (the Company) incurred a net loss of \$27,886,000 during fiscal 1984 which was attributable, in part, to the termination of a significant contract as discussed in Note 3. The net loss resulted in the Company having a net shareholders' deficiency of \$12,037,000 at July 31, 1984. These factors, among others, indicate that the Company may be unable to continue as a going-concern.

The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount and classification of liabilities that might be necessary should the Company be unable to continue as a going-concern. The Company's continuation as a going-concern is dependent, among other things, upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to maintain acceptable relationships with vendors to enable the Company to complete satisfactorily its contractual obligations, to comply with the terms and covenants of its financing agreements, to obtain additional financing or other sources of funds as may be required and ultimately to attain profitable operations.

Management is assessing the Company's operations and future and anticipates selling certain of its operations (see Notes 15 and 16). The proceeds from such sales will be used to repay debt and provide working capital. At July 31, 1984, it was not certain which operations would be sold. Therefore, all subsidiaries are included in continuing operations at July 31, 1984 for the purposes of these financial statements.

On November 7, 1984, the Company sold the net assets of Comtech Data Corporation (CDC) to Fairchild Industries, Inc. for a price equivalent to \$7,880,000 in excess of the net carrying value of such assets. The proceeds of the sale were used to repay debt (see Note 8) and replenish working capital.

The following table summarizes CDC's results of operations and financial condition which are included in the accompanying consolidated financial statements.

Financial Condition

	July 31,	
	1984	1983
Current assets	\$4,809,000	\$4,454,000
Total assets	5,870,000	5,139,000
Current liabilities, excluding intercompany payables	1,821,000	981,000

Results of Operations

	Fiscal Year Ended July 31,		
	1984	1983	1982
Net sales to unrelated cus- tomers	\$11,277,000	\$8,281,000	\$6,420,000
Total costs and expenses	10,726,000	6,899,000	5,635,000
Other income - net	90,000	26,000	204,000

The Company is continuing to consider possible sales of other assets and subsidiaries.

2. SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Comtech Inc. and its subsidiaries, all of which are wholly owned. All significant intercompany transactions have been eliminated.

Sales Recognition

Sales are generally recognized under the unit-of-delivery method of accounting, except for large multi-year funded programs which are accounted for under the percentage-of-completion method of accounting. Progress payment retainages and estimated earnings on such multi-year programs are reflected as unbilled receivables.

Revenues derived from the sale or lease of telephone voice multiplexors and concentrators (see Note 4) are generally recorded at the time of shipment and in no event prior to thirty days before customer acceptance. Service revenues are recognized as such revenues become payable by customers.

## Costs and Expenses

Cost of sales is based on 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 other direct costs.

Since contracts may extend over periods in excess of one year, 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. When estimates indicate a future loss on a contract is probable, a provision for the full amount thereof is charged to current operations. To the extent the charge exceeds the inventory balance related to the "loss" contract, the excess is credited to the allowance for estimated losses on contracts.

## Inventories

Raw materials and components are stated at the lower of cost (using the first-in, first-out cost flow assumption) or market. Work-in-process is valued at the total material, direct labor, manufacturing overhead and other direct costs incurred under each contract, less amounts charged to cost of sales pursuant to the application of the unit-of-delivery method of revenue recognition.

## Property, Plant and Equipment

Property, plant and equipment (including major renewals and betterments) are recorded at cost. When property is retired, sold or scrapped, the cost and accumulated depreciation or amortization of such property are eliminated from the accounts, and the resultant gain or loss is reflected in current operations.

Annual depreciation is provided utilizing the straight-line method over the estimated useful service lives of the related assets (buildings and improvements - 40 years, equipment - 3 to 8 years). Leasehold improvements are amortized over the remaining terms of the leases or the useful lives of the improvements, whichever is less.

### Goodwill

The unamortized excess of cost over the purchase value of assets acquired, which amounted to \$557,000 and \$571,000 at July 31, 1984 and 1983, respectively, is included in the balance sheet caption, "Other Assets," and is being amortized on a straight-line basis over 40 years.

### 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.

### Income Taxes

Where appropriate, the Company provides deferred income taxes for transactions reported in different periods for financial and income tax reporting purposes (see Note 9). At July 31, 1984, no deferred taxes are recorded because of the existence of net operating loss carryforwards.

If applicable, research and development and investment tax credits are accounted for as reductions of income taxes in the year in which the research expenses are incurred or the related asset is placed in service.

### Earnings (Loss) Per Share

Earnings (loss) per share are based on the weighted average common and common equivalent shares outstanding during the year. Fully diluted earnings per share are not presented because the impact of assumed full dilution was antidilutive in all years presented.

### Reclassifications

Certain amounts relating to fiscal 1983 and 1982 have been reclassified to conform with the fiscal 1984 presentation.



### 3. UNITED STATES ARMY CONTRACTS

#### Radio Contract

In fiscal 1983, the Company commenced a multi-year contract with the United States Army to produce 221 transportable microwave radios for an amended contract price of \$12,100,000. Following discussions, the Army terminated this contract for default in August 1984. As part of the termination notice, the Army demanded return of certain Government-furnished equipment and repayment of unliquidated progress payments of \$1,821,000 and asserted its right to assess the Company for reprocurement costs, if any. The Company has commenced discussions with the Army intended to permit it to substitute inventory relating to this contract in lieu of a refund of the progress payments. In November 1984, the Company, which contends the Army caused or contributed to delays in contract performance, filed an appeal as to the nature of the termination with the Armed Services Board of Contract Appeals. The Company also is negotiating cancellation settlements with vendors who were to supply materials and services for the contract. The ultimate loss on this contract cannot be fully determined until the appeal process with the Army and vendor negotiations are completed or otherwise resolved.

During the year ended July 31, 1984, the Company recognized losses of \$6,542,000 on this contract, including the estimated costs associated with the termination.

The balance in the allowance for estimated losses on contracts principally relates to this contract at July 31, 1984. No provision for possible reprocurement assessments has been made because management does not believe the Army will reprocure this particular radio. However, the Army has not officially indicated its intentions in this matter and, therefore, the ultimate outcome is in doubt.

For the fiscal year ended July 31, 1983, the Company recognized sales and cost of sales of \$2,090,000 and \$1,818,000, respectively, on this contract.

United States Army Satellite Communications Terminal Contract

In February 1982, the Company was granted a significant price adjustment to its largest contract by the Army Contract Adjustment Board (ACAB) in response to the Company's petition for extraordinary relief under the provisions of Public Law 85-804. The terms of the award included, among other things, (i) an increase in the maximum contract price from \$52,128,000 to \$69,703,000 and (ii) the granting of the loan described in Note 8. The award also contains certain restrictions which, among other things, prohibit the Company from paying cash dividends and limit its ability to increase certain officer and executive compensation levels.

As of July 31, 1984, 18 of the 21 units covered by the contract had been shipped and accepted by the Army. The nineteenth unit was shipped in October 1984. Specific shipment dates are not yet available for the remaining two units.

4. ACQUISITIONS

During fiscal 1983, the Company made two acquisitions, both of which were accounted for under the purchase method of accounting. The operations of the acquired businesses, which are described below, are included in the accompanying consolidated financial statements from the dates of their respective acquisitions.

On January 28, 1983, the Company acquired the outstanding common stock of Premier Microwave Corporation (Premier) for an aggregate consideration, including expenses, of \$3,873,000. Premier designs and manufactures a broad line of microwave components for various radar, missile, communications, telemetry and submarine systems. The total purchase price exceeded the net purchase value of Premier by \$578,000, which amount was recorded as goodwill (see Note 2).

On July 1, 1983, the Company's subsidiary, Comtech Communications Corporation (CCC), acquired the operating assets relating to the COM 2 Product Line from a subsidiary of Storage Technology Corporation (STC) for an aggregate consideration, including expenses of \$250,000, of \$9,933,000, comprised of \$5,311,000 in cash, \$3,314,000 in notes (see Note 8), and a five-year warrant to purchase 450,000 shares of the Company's common stock which, for accounting purposes, was valued at \$1,058,000 (see Note 10). CCC is engaged in the manufacture and marketing of microprocessor-controlled telephone voice multiplexors and concentrators. The total purchase price was considered equivalent to the net purchase value of the assets acquired.

5. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	<u>July 31,</u>	
	<u>1984</u>	<u>1983</u>
Amount receivable from the United States Government	\$ 1,973,000	\$ 1,243,000
Unbilled receivables (including retainages) on contracts in progress	1,666,000	5,874,000
Accounts receivable from other customers	<u>7,009,000</u>	<u>4,857,000</u>
Total	10,648,000	11,974,000
Less - Allowance for doubtful accounts (Note 15)	<u>(122,000)</u>	<u>(308,000)</u>
Accounts receivable - net	<u>\$10,526,000</u>	<u>\$11,666,000</u>

Unbilled receivables relate to contracts accounted for on the percentage-of-completion basis and are billable upon the completion of performance tests and acceptance by the customer.

6. INVENTORIES

Inventories consist of the following:

	<u>July 31,</u>	
	<u>1984</u>	<u>1983</u>
Raw materials and components	\$10,494,000	\$ 3,350,000
Work-in-process	7,147,000	11,783,000
Finished goods	653,000	4,009,000
Gross inventories	<u>18,294,000</u>	<u>19,142,000</u>
Less:		
Progress payments not in excess of costs included in work-in-process	(1,140,000)	(896,000)
Inventory reserves (Note 15)	<u>(6,925,000)</u>	<u>(3,486,000)</u>
Inventories - net	<u>\$10,229,000</u>	<u>\$14,760,000</u>

7. PROPERTY, PLANT AND EQUIPMENT

Changes in property, plant and equipment were as follows:

	<u>Balance at Beginning of Year</u>	<u>Additions at cost</u>	<u>Transfers, Retirements or Sales</u>	<u>Balance at End of Year</u>
<u>Year ended July 31,</u> <u>1984</u>				
Land	\$ 708,000		\$ (650,000) (b)	\$ 58,000
Buildings and improvements	3,442,000	\$ 47,000	(2,590,000) (b)	899,000
Equipment	10,750,000	3,139,000	(1,688,000) (e)	12,201,000
Leasehold improve- ments	<u>570,000</u>	<u>43,000</u>	<u>(85,000)</u>	<u>528,000</u>
Total	<u>\$15,470,000</u>	<u>\$3,229,000</u>	<u>\$(5,013,000)</u>	<u>\$13,686,000</u>
<u>Year ended July 31,</u> <u>1983</u>				
Land	\$ 698,000		\$ 10,000 (c)	\$ 708,000
Buildings and improvements	2,905,000	\$ 288,000	249,000 (c)	3,442,000
Equipment	5,685,000	5,119,000 (a)	(54,000) (c)	10,750,000
Leasehold improve- ments	<u>86,000</u>	<u>205,000 (a)</u>	<u>279,000</u>	<u>570,000</u>
Total	<u>\$ 9,374,000</u>	<u>\$5,612,000</u>	<u>\$ 484,000</u>	<u>\$15,470,000</u>
<u>Year ended July 31,</u> <u>1982</u>				
Land	\$ 650,000		\$ 48,000 (d)	\$ 698,000
Buildings and improvements	2,286,000	\$ 300,000	319,000 (d)	2,905,000
Equipment	5,398,000	358,000	(71,000)	5,685,000
Leasehold improve- ments	<u>54,000</u>	<u>91,000</u>	<u>(59,000)</u>	<u>86,000</u>
Total	<u>\$ 8,388,000</u>	<u>\$ 749,000</u>	<u>\$ 237,000</u>	<u>\$ 9,374,000</u>

- (a) Includes assets of \$3,911,000 acquired as part of the business acquisitions described in Note 4.
- (b) Reclassified to "Assets Subsequently Sold - net" (except for \$33,000 of building improvements) (see Note 16).
- (c) Reclassification from "Other Assets."
- (d) Includes reclassification from "Net Assets of Discontinued Operations" aggregating \$724,000 (see Note 12), comprised of Land (\$10,000), Building (\$549,000) and Equipment (\$165,000).
- (e) Includes \$814,000 transferred to various accounts.

Changes in accumulated depreciation of property, plant and equipment were as follows:

	<u>Balance at Beginning of Year</u>	<u>Charged to Profit and Loss</u>	<u>Transfers, Retirements, Renewals or Replacements</u>	<u>Balance at End of Year</u>
<u>Year ended July 31,</u> <u>1984</u>				
Buildings and improve- ments	\$ 415,000	\$ 119,000	\$(370,000) (a)	\$ 164,000
Equipment	4,581,000	1,807,000	(296,000)	6,092,000
Leasehold improvements	<u>80,000</u>	<u>94,000</u>	<u>(28,000)</u>	<u>146,000</u>
Total	<u>\$5,076,000</u>	<u>\$2,020,000</u>	<u>\$(694,000)</u>	<u>\$6,402,000</u>
<u>Year ended July 31,</u> <u>1983</u>				
Buildings and improve- ments	\$ 239,000	\$ 105,000	\$ 71,000 (b)	\$ 415,000
Equipment	3,825,000	765,000	(9,000) (b)	4,581,000
Leasehold improvements	<u>32,000</u>	<u>67,000</u>	<u>(19,000)</u>	<u>80,000</u>
Total	<u>\$4,096,000</u>	<u>\$ 937,000</u>	<u>\$ 43,000</u>	<u>\$5,076,000</u>
<u>Year ended July 31,</u> <u>1982</u>				
Buildings and improve- ments	\$ 162,000	\$ 77,000		\$ 239,000
Equipment	3,283,000	584,000	\$ (42,000)	3,825,000
Leasehold improvements	<u>25,000</u>	<u>32,000</u>	<u>(25,000)</u>	<u>32,000</u>
Total	<u>\$3,470,000</u>	<u>\$ 693,000</u>	<u>\$ (67,000)</u>	<u>\$4,096,000</u>

(a) Reclassification to "Assets Subsequently Sold - net" (see Note 16).

(b) Includes accumulated depreciation of assets transferred from "Net Assets of Discontinued Operations" (see Note 12) aggregating \$125,000, comprised of Building (\$69,000) and Equipment (\$56,000).

A building and two undeveloped tracts of land, having an aggregate carrying value of \$1,719,000 at the time of sale, were sold for cash during fiscal 1982. The related gain of \$248,000, net of expenses, is included in the accompanying Consolidated Statements of Operations.

8. LONG-TERM DEBT AND NOTES PAYABLE

Secured Notes Payable to Banks

In July 1984, the Company entered into a credit agreement which provided that it could borrow up to \$2,000,000 in demand loans which bore interest at two percentage points above the prime lending rate. These loans were collateralized by a pledge agreement signed in July 1984 under which the Company pledged substantially all of its assets to secure the loans outstanding under this agreement and the revolving credit agreement described below. At July 31, 1984, demand loans of \$1,000,000 were outstanding. Such borrowings, which reached a maximum of \$2,000,000, were repaid in November 1984 from the proceeds of the sale of CDC's net assets (see Note 1). The Company, having paid its entire outstanding bank debt, does not currently have a bank credit facility.

Any new letters of credit will be issued on a secured basis subject to prior bank approval.

Long-Term Debt

Long-term debt consists of the following:

	<u>July 31,</u>	
	<u>1984</u>	<u>1983</u>
Revolving credit agreement with three banks	\$ 6,000,000	\$ 2,500,000
13% Subordinated Notes due 1991 (net of an unamortized discount of \$1,079,000 and \$1,245,000)	8,921,000	8,755,000
Purchase note payable to STC	3,314,000	3,314,000
Loan payable to the United States Army (including accrued interest of \$867,000 and \$433,000)	4,739,000	4,573,000
Mortgage and other	96,000	1,830,000
Obligations under capital leases	1,104,000	
Total long-term debt	<u>24,174,000</u>	<u>20,972,000</u>
Less - Current maturities	<u>(12,373,000)</u>	<u>(1,285,000)</u>
Long-term portion	<u>\$ 11,801,000</u>	<u>\$19,687,000</u>

### Revolving Credit Agreement

In January 1983, the Company entered into a loan agreement with three banks providing the Company with a revolving line of credit of \$6,000,000. Borrowings under this line were to be payable on January 1, 1985 with interest payable quarterly at a rate of 1/2 percentage point above prime (such prime rate being 13 percent at July 31, 1984). The agreement, among other things, contained certain affirmative and negative covenants and limited the Company's ability to pay dividends, make capital expenditures and enter into lease agreements.

All borrowings under this agreement were repaid in November 1984 from the proceeds of the sale of the net assets of CDC. Having repaid such borrowings, the Company does not currently have a bank credit facility.

### 13% Subordinated Notes

In February 1983, in a public offering, the Company sold \$10,000,000 principal amount of 13% Subordinated Notes due February 1, 1991 and 800,000 warrants (see Note 10). The net proceeds of the offering of approximately \$9,300,000 were used, in part, to repay indebtedness incurred and replenish working capital expended to acquire Premier (see Note 4), with the remainder used for general corporate purposes. The Company is required to redeem \$2,500,000 principal amount of the notes on both February 1, 1989 and 1990 and the remaining \$5,000,000 on February 1, 1991. Interest is payable semiannually on February 1 and August 1. The indenture underlying these notes specifies, among other things, that a technical default of any other loan agreement constitutes an event of default of it as well.

### Purchase Note

The purchase note, which was issued to STC as partial consideration for the purchase of the COM 2 Product Line (see Note 4), is payable in three equal annual instalments, scheduled to commence on July 1, 1984. Interest is payable on a quarterly basis at the prime lending rate.

The 1984 principal payment was not made when due, and interest was accrued but not paid from March until November 1984. The Company paid past due interest and principal in November 1984 from the proceeds of the sale of CDC's net assets.

In addition, it is currently negotiating with STC to reach a settlement on certain disputed amounts between STC and CCC. These negotiations have been disrupted because STC filed for bankruptcy in November 1984.

### Army Loan

In September 1982, the Company and the Office of the Comptroller of the Department of the Army executed a \$4,140,000 loan agreement pursuant to the award by the ACAB described in Note 3, the proceeds from which were used in October 1982 to repay the entire outstanding balance of a former term loan. The Army Loan, which was secured by a second mortgage on the Company's Hauppauge, New York manufacturing facility (see Note 16), was repayable in sixty equal monthly instalments commencing June 1, 1984, together with interest at a rate set, effective prospectively every six months, by the Secretary of Treasury pursuant to the Contracts Dispute Act of 1978. Such rate is 14.375 percent for the period July 1 to December 31, 1984. Interest accrued, on an un compounded basis, through June 1, 1984 was scheduled to be paid, without further interest, in equal monthly installments during such sixty-month period.

In November 1984, the Company prepaid \$3,539,000 of this loan from the proceeds of the sale of the Hauppauge facility (see Note 16) and reached an agreement to repay the remaining balance outstanding over a period of 48 months.

### Mortgage

The mortgage bore interest at the rate of 9.5 percent, was scheduled to be payable in monthly instalments through 1992 and was secured by the Company's land and building in Hauppauge, New York. Such property was sold in October 1984, at which time the mortgage was paid in full. At July 31, 1984, the mortgage is classified within "Assets Subsequently Sold - net" in the accompanying Consolidated Balance Sheet (see Note 16).



### Capital Leases

The obligations under capital leases relate to certain equipment leased by the Company having a net carrying value of \$1,067,000 at July 31, 1984.

### Defaults

At July 31, 1984, the Company was in default of most of its long-term debt agreements because it was not in compliance with certain covenants and was delinquent in making certain scheduled loan and interest payments. In addition, certain of the agreements contain cross-default clauses. Subsequent to July 31, 1984, these defaults were cured when the related debt was either repaid in full or delinquent payments made current.

### Debt Maturities

Long-term debt is scheduled to mature as follows:

<u>Fiscal Year Ending</u> <u>July 31,</u>	<u>Amount</u>
1985*	\$12,373,000
1986	1,651,000
1987	569,000
1988	577,000
1989	2,583,000
Thereafter	<u>6,421,000</u>
Total	<u>\$24,174,000</u>

\*Includes the entire amounts outstanding under the revolving credit line and \$3,539,000 prepayment of the Army loan.

## 9. INCOME TAXES

For financial reporting purposes the Company has available tax loss carryforwards of approximately \$28,500,000. It expects that its Federal income tax return for the fiscal year ended July 31, 1984 will include a net operating loss carryforward of approximately \$24,000,000 expiring principally in the period 1996 to 1999. The difference between these two amounts is principally a result of the Company's policy to account for long-term contracts on the percentage-of-completion or unit-of-delivery method for financial reporting purposes and the completed contract method for income tax purposes. It also has investment, foreign and research and development tax credit carryforwards of approximately \$900,000.

In fiscal 1982 the Company utilized, for financial reporting purposes, the last remaining portion of the \$15,600,000 operating loss (prior to reclassification of discontinued operations) incurred in fiscal 1980. Federal taxes on income for the year ended July 31, 1983, which would normally be currently payable, were accounted for as the restoration of net deferred tax credits previously eliminated or not previously recorded because of the existence of the net operating loss carryforwards for financial reporting purposes.

The following table reconciles the Company's effective tax rate for continuing operations to the Federal statutory rate:

	<u>Year Ended July 31,</u>	
	<u>1983</u>	<u>1982</u>
Federal statutory income tax rate	46 %	46 %
State income taxes, net of Federal tax benefit	3	1
Investment tax credits	(6)	(3)
Research and development credits	(10)	
Foreign tax credits	(3)	
Other-net	3	
Effective rate	<u>33 %</u>	<u>44 %</u>

The principal causes for timing differences are (i) the accounting for all contracts on the completed contract method for tax purposes and (ii) provision establishing certain reserves and allowances being deductible in different periods for financial and tax reporting purposes.

The provision for income taxes pertaining to continuing operations consists of the following at July 31:

	<u>1984</u>	<u>1983</u>	<u>1982</u>
Federal:			
Deferred (benefit)	\$(552,000)	\$552,000	
Charge equivalent to the utilization of income tax loss carryforward			\$1,146,000
Total	<u>(552,000)</u>	<u>552,000</u>	<u>1,146,000</u>
State, principally current	<u>(5,000)</u>	<u>128,000</u>	<u>18,000</u>
Total	<u>\$(557,000)</u>	<u>\$680,000</u>	<u>\$1,164,000</u>

The benefit in fiscal 1984 relates to the reversal of net deferred tax credits established in fiscal 1983. No benefit has been recognized for the available net operating loss carryforwards in 1984 because realization of such benefits is not assured.

The extraordinary credits included in the accompanying Consolidated Statements of Operations for fiscal 1982 consist of the "charge equivalent" set forth above less the tax benefit relating to discontinued operations.

#### 10. SHAREHOLDERS' EQUITY (DEFICIENCY)

##### Option and Warrant Plans and Agreements

1982 Incentive Stock Option Plan - In December 1982, the shareholders approved the 1982 Incentive Stock Option and Appreciation Plan which provides for the granting to key employees and officers of incentive stock options to purchase up to 500,000 shares of the Company's common stock at prices not less than the fair market value of such shares on the date the option is granted. The plan also provides for the granting of Stock Appreciation Rights (SARs) in conjunction with the options. The SARs entitle the holder to receive payment, in exchange for the surrender in whole or in part of the related option, of an amount equal to the excess of the fair market value at the time of surrender over the aggregate option price of such shares. Such payment may be made in shares of common stock of the Company, in cash, or a combination thereof, as determined by the committee administering the plan.

1976 Incentive Stock Option Plan - No additional options or SARs may be granted under the Company's 1976 Incentive Stock Option Plan. Under this plan, the Company had granted options to officers and key employees at prices which were not less than 85 percent of the fair market value of such shares on the date of grant and are exercisable over a period determined by the Board of Directors at the time of grant.

The difference between the option price and the fair market value on the date of grant for all options issued under the 1976 Incentive Option Plan was considered compensation expense. The amount charged to expense in fiscal 1982 was \$24,000. All options granted subsequent to January 1, 1982 are at an option price equivalent to 100 percent of the fair market value of the Company's common stock at the date of grant and, therefore, no compensation has been recorded for such options.

Incentive Warrant Plan - The Company's Incentive Warrant Plan for Directors of the Company who were neither officers nor employees of the Company was terminated; however, there are currently warrants to purchase 15,500 shares of stock outstanding under the Plan. Warrants which had been granted under the Plan become exercisable over a period of ten years.

Other Warrants - In February 1983, the Company sold 800,000 warrants in connection with the issuance of the 13% Subordinated Notes (see Note 8). Each warrant entitles the holder to purchase one share of the Company's common stock at a price of \$11, subject to adjustment, until January 31, 1988. For accounting purposes these warrants were valued at \$1,328,000. As of July 31, 1984, none have been exercised.

Warrant Held by STC - The Company issued a warrant to STC in July 1983 as partial consideration for the acquisition of the COM 2 Product Line (see Note 4) to purchase 450,000 shares of the Company's common stock at \$12 per share, subject to adjustment, until July 1, 1988. For accounting purposes this warrant was valued at \$1,058,000. As of July 31, 1984, no portion of this warrant has been exercised.

The following table sets forth summarized information concerning the Company's stock options and warrants:

	1984		1983	
	<u>Number</u>	<u>Exercise Price Range</u>	<u>Number</u>	<u>Exercise Price Range</u>
Options/warrants outstanding at the beginning of the year	1,818,000	\$2.07-\$13.69	446,050	\$2.07-\$ 5.37
Granted	417,550	1.81- 10.63	270,000	4.56- 13.69
Warrants sold as part of public offering			800,000	11.00
Warrants issued to STC			450,000	12.00
Exercised	(11,030)	2.07- 4.56	(71,150)	2.07- 5.37
Expired/cancelled	<u>(326,920)</u>	2.07- 13.69	<u>(76,900)</u>	2.07- 4.63
Options/war-rants out-standing at the end of the year	<u>1,897,600</u>	1.81- 12.00	<u>1,818,000</u>	2.07- 13.69
Options/war-rants exer-cisable at the end of the year	<u>1,473,360</u>	2.07- 12.00	<u>1,424,780</u>	2.07- 12.00
Options/war-rants avail-able for grant at the end of the year	<u>181,700</u>		<u>107,600</u>	

#### Employee Stock Purchase Plan

In December 1981, the shareholders approved an Employee Stock Purchase Plan under which a maximum of 300,000 shares of the Company's authorized and unissued common stock were reserved for offering to employees, other than officers and directors, who have been employed for at least one year and met certain other minimum eligibility requirements. Under the terms of the plan, at the beginning of each six-month period, commencing with the first business day of January 1982, participants are granted the right to purchase up to 100 shares of the Company's common stock at a price equal to 85 percent of the fair market value of such stock at either the beginning or the end of the period, on whichever

date the price is lower. Employees electing to participate in the plan may purchase stock by executing a subscription agreement and authorizing payroll deductions. During the fiscal years ended July 31, 1984, 1983 and 1982, employees purchased 12,491, 16,083 and 9,566 shares, respectively. At July 31, 1984, 261,860 shares are reserved for possible future issuances under this plan.

#### Employment Agreements

Three employees of a subsidiary had contracts under which such employees could earn the right to purchase up to 200,000 shares of the Company's common stock at a price of \$.10 per share if the subsidiary achieved certain specified earnings milestones (166,000 of which had been earned and distributed as of July 31, 1984). The difference between the fair market value of the Company's common stock on the date each milestone (or portion thereof) was achieved and the purchase price was accounted for as compensation expense. Such compensation charged (credited) to operations amounted to \$(98,000) in 1984, \$297,000 in 1983 and \$420,000 in 1982. Subsequent to July 31, 1984, these three employees all left the employ of the Company.

In June and September 1982, the Company entered into agreements with two officers under which they received, or were entitled to receive, subject to certain restrictions, an aggregate of 175,000 shares of the Company's common stock at a price of \$.10 per share. The differences between the fair market value of the Company's common stock as of the date of the respective agreements and the purchase price are treated as compensation expense over the term of the respective officers' employment contracts. Compensation expense relating to agreements with officers and employees was \$262,000 in 1984 and \$137,000 in 1983.

During 1984, in connection with the resignation of one of the officers, the Company purchased 75,000 shares of treasury stock.

#### Public Offering

In August 1983, the Company made a public offering of 750,000 shares of its common stock, the net proceeds from which amounted to \$5,631,000.

### 11. COMMITMENTS AND CONTINGENCIES

#### Letters of Credit

In connection with the performance of work under certain contracts, the Company is required to establish letters of credit and/or performance guarantees. As of July 31, 1984, the Company is committed under an open letter of credit of \$1,500,000, which expired on September 15, 1984.

In previous years, the Company had entered into various contracts with a foreign government. Such contracts generally required the Company to provide letters of credit in favor of that government or a bank controlled by it. At July 31, 1980, as a result of a contractual dispute and the deterioration in the political relationship between the United States and the foreign government, the Company established a reserve of \$4,976,000 to fully provide for the outstanding letters of credit relating to the disputed contract. During subsequent fiscal years, the Company continued to seek a negotiated settlement and was successful to the extent that the letters of credit were substantially reduced. Consequently, during fiscal 1981 and 1983, the Company reversed \$2,551,000 and \$210,000, respectively, of the previously established reserve.

During fiscal 1983, the Company was required to provide cash collateral of \$2,431,000 to secure the remaining open letters of credit of \$2,307,000 pertaining to the contracts with the foreign government. Such letters of credit were drawn down in April 1984, at which time they were paid in full from the liquidation of the collateral and the related amount was charged to the allowance for estimated losses on contracts.

#### United States Government Contracts

Certain of the Company's contracts are subject to audit by the Defense Contract Audit Agency and/or the General Accounting Office. Until such audits are completed, the ultimate profit on these contracts cannot be determined; however, in the opinion of management, the final contract settlements will not have a material adverse effect on the Company's financial condition.

#### Litigation

The Company has been named as a defendant in various suits and claims. Management believes, based on discussions with counsel, that the ultimate liability to the Company in these matters, if any, would not have a material adverse impact on its financial condition.

#### Operating Leases

The Company has entered into operating lease agreements for equipment, manufacturing and office facilities for initial periods ranging from 3 to 10 years. The scheduled rentals under these agreements, exclusive of CDC's commitments (see Note 1), are as follows:

<u>Fiscal Year Ending July 31,</u>	<u>Amount</u>
1985	\$ 987,893
1986	953,051
1987	843,458
1988	742,876
1989	621,368
Thereafter	<u>2,769,342</u>
Total	<u>\$6,917,988</u>

Rent expense was \$1,345,000 in 1984, \$808,000 in 1983 and \$563,000 in 1982.

#### 12. DISCONTINUED OPERATION

During fiscal 1982, the Company discontinued its large antenna business following the completion of its obligations under contracts executed prior to its decision to discontinue the business. Accordingly, the accompanying consolidated financial statements reflect the large antenna business as a discontinued operation. Net sales of the discontinued operation were \$45,000 in 1983 and \$129,000 in 1982. During fiscal 1983, all of the assets of the large antenna business were either sold, scrapped or transferred for use by the Company's small antenna business (see Note 7).

#### 13. SEGMENT AND PRINCIPAL CUSTOMER INFORMATION

For the purposes of segment reporting, management considers the Company to operate primarily in one industry, the communications equipment industry.

During the fiscal years ended July 31, 1984, 1983 and 1982 approximately 35, 56 and 53 percent, respectively, of the Company's net sales resulted from contracts with United States Government agencies and prime contractors of such agencies. The only other customer which constituted more than 10 percent of the Company's consolidated net sales during any year in the period presented was the foreign government referred to in Note 11, sales to which comprised 11 percent of net sales in 1982.

Approximately 19, 15 and 19 percent of net sales in 1984, 1983 and 1982, respectively, resulted from export sales, including sales to the foreign government referred to above.



14. SUPPLEMENTARY INCOME STATEMENT INFORMATION

Certain supplementary income statement information is as follows:

	Fiscal Year	
	1984	1983
Maintenance and repairs	\$ 430,000	\$336,000
Amortization of intangibles and deferred expenses	553,000	572,000

The corresponding amounts in 1982 were not material.

15. VALUATION ALLOWANCES AND RESERVES

The following is a summary of the activity in the Company's valuation accounts:

	<u>Balance at Beginning of Year</u>	<u>Charged to Costs and Expenses</u>	<u>Charged to Other Accounts</u>	<u>Deductions</u>	<u>Balance at End of Year</u>
<u>Allowance for doubtful accounts</u>					
1984	\$ 308,000	\$ 49,000		\$ 235,000	\$ 122,000
1983	108,000	284,000	\$ 4,000	88,000	308,000
1982	1,031,000	136,000		1,059,000 (a)	108,000
<u>Allowance for estimated losses on contracts</u>					
1984	\$2,307,000	\$ 922,000	\$1,821,000	\$2,307,000 (b)	\$2,743,000
1983	2,517,000			210,000	2,307,000
1982	3,650,000		772,000	1,905,000	2,517,000
<u>Inventory reserves</u>					
1984	\$3,486,000	\$3,470,000		\$ 31,000	\$6,925,000
1983	1,240,000	180,000	\$2,338,000 (c)	272,000	3,486,000
1982	190,000	1,050,000			1,240,000
<u>Reserve for Loss on Sale of Assets</u>					
1984		\$4,700,000 (d)			\$4,700,000

- (a) At August 1, 1981, the balance in the allowance for doubtful accounts primarily was intended to cover the uncertainty of collection of a receivable of \$944,000 arising from a contract with a foreign customer. In fiscal 1982, the Company charged such receivable to the allowance.
- (b) See Note 11 for information concerning the drawdown of certain letters of credit which had been drawn in favor of a foreign government.
- (c) Represents the allowances for obsolescence and used product refurbishment ascribed to the COM 2 Product Line at the time of its acquisition (see Note 4).
- (d) Represents the estimated loss relating to the sale of assets and the close-down costs of certain operations.

16. SUBSEQUENT EVENTS AND UNAUDITED PRO FORMA DATA

The caption "Assets subsequently sold - net" consists of the following at July 31, 1984:

Net carrying value of the Company's Hauppauge, New York manufacturing facility	\$ 2,837,000
First mortgage thereon (see Note 8)	<u>(1,802,000)</u>
Net	<u>\$ 1,035,000</u>

In October 1984, the Company sold the facility for \$6,200,000 in cash, resulting in a net gain, after expenses, of approximately \$2,544,000. The net proceeds of the sale were used to repay the first mortgage and the remainder was used to prepay a significant portion of the Army loan (see Note 8).

The "Pro Forma" column on the accompanying consolidated balance sheets has been prepared assuming that (i) the sales of CDC's net assets (see Note 1) and the Hauppauge facility had taken place on July 31, 1984 and (ii) the proceeds from such sale were used to repay the mortgage on the Hauppauge facility, the outstanding bank debt, the past due portion of the principal and interest due to STC and prepay a significant portion of the Army Loan (see Note 8). The remainder of the proceeds were assumed to be held as cash.

AUDITORS' OPINION

To The Board of Directors  
and Shareholders of Comtech Inc.:

We have examined the consolidated balance sheets of Comtech Inc. (formerly Comtech Telecommunications Corp.) and subsidiaries as of July 31, 1984 and 1983 and the related consolidated statements of operations, changes in shareholders' equity (deficiency) and changes in financial position for each of the three fiscal years in the period ended July 31, 1984. 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 discussed in Note 1, there are conditions which may indicate that the Company will be unable to continue as a going-concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going-concern.

As discussed in Note 3, on August 13, 1984, the United States Army terminated one of the Company's major contracts for default and, among other things, demanded repayment of approximately \$1,821,000 of unliquidated progress payments. The Army also has asserted the right to assess the Company for reprocurement costs, if any. In addition, the Company has cancelled purchase orders and agreements relating to this contract which were previously placed with vendors. The Company has filed an appeal with the Armed Services Board of Contract Appeals and is presently negotiating settlements with vendors. The ultimate loss on this contract cannot be fully determined until the appeal process and vendor negotiations are completed or otherwise resolved.

In our opinion, subject to the effects on the fiscal 1984 consolidated financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the preceding two paragraphs been known, such consolidated financial statements present fairly the financial position of Comtech Inc. and subsidiaries at July 31, 1984 and 1983 and the results of their operations and the changes in their financial position for each of the three fiscal years in the period ended July 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

*Deloitte Haskins & Sells*

November 5, 1984  
(Except for Notes 1 and 8, for which  
the date is November 27, 1984.)

**MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS**

Liquidity and Capital Resources

During the 1984 fiscal year, the Company experienced severe liquidity difficulties largely caused by ongoing operating losses, principally incurred by its Government Systems Division and its Comtech Communications Corp. subsidiary.

In August, 1984, the U.S. Army terminated for default, assertedly as a result of delay by the Company, its contract with the Company for the production of 221 transportable microwave radios and, among other things, demanded repayment of approximately \$1,821,000 of unliquidated progress payments. The Army also asserted the right to assess the Company for reprocurement costs, if any. In addition, the Company has cancelled purchase orders and agreements relating to this contract which were previously placed with vendors. The Company, which contends the Army caused or contributed to delays in performance, has filed an appeal with the Armed Services Board of Contract Appeals as to the nature of the termination and is presently negotiating settlements with vendors. The ultimate loss on this contract cannot be fully determined until the appeal process and vendor negotiations are completed or otherwise resolved.

The Company has undertaken a number of significant actions to curtail its operating losses, reduce its indebtedness, and meet its liquidity requirements. It has discontinued certain of the business activities previously engaged in by its Government Systems Division and reassigned to its other operating entities the bulk of its remaining activities thereby, among other things, eliminating significant facility and other overhead and personnel costs not required for the ongoing activities. In connection with Comtech Communications Corp., budgets have been modified to bring estimated expenses more closely in line with currently anticipated revenue levels.

In early October 1984, the Company sold its Hauppauge, Long Island building, which had housed the Government Systems Division, applying the net proceeds of approximately \$5,500,000 to reduce indebtedness, including the first mortgage and a major portion of the Company's loan from the Department of the Army, which had been secured by a second mortgage.

As of November 1, 1984, the unpaid principal balance of the Army loan was \$256,000. Such amount is repayable monthly in equal installments over four years commencing November 1, 1984, together with interest at a rate set, effective prospectively every six months, by the Secretary of the Treasury pursuant to the Contracts Dispute Act of 1978, which rate is 14.375% for the period through December 31, 1984. The unpaid balance of interest accrued through June 1, 1984, in the approximate amount of \$778,000, is payable without interest in equal monthly installments during the four-year period.

On November 7, 1984, the assets of the Company's Comtech Data Corporation subsidiary were sold to Fairchild Data Corporation, a subsidiary of Fairchild Industries, Inc., for an anticipated aggregate purchase price of approximately \$12,000,000. Of the initial \$9,000,000 received at the closing, approximately \$8,100,000 was used to repay the Company's entire outstanding secured bank debt, including accrued interest. An additional \$2,400,000 was received on November 26, 1984, of which approximately \$1,300,000 was used to repay indebtedness. The balance of the sales proceeds are to be received in March 1985. Approximately \$2,500,000 of the net proceeds are to be used to replenish working capital.

The Company is continuing to assess its operations and is actively engaged in discussions concerning the sale of certain other assets.

The Company having paid its entire outstanding bank debt, does not currently have a bank credit facility. Any new letters of credit will be issued on a secured basis subject to the prior bank approval. At July 31, 1984, the Company had outstanding a \$1,500,000 letter of credit which expired on September 15, 1984.

The principal balance of \$2,210,000 of the Company's purchase note issued to Storage Technology Corporation is payable in two equal annual installments on July 1, 1985 and 1986. Interest is payable on a quarterly basis at the prime lending rate. In addition, on February 1 and August 1, 1985 interest payments of \$650,000 each on the Company's 13% Subordinated Notes will be due.

Cash and short-term investments at July 31, 1984 were \$320,000 (which had increased to approximately \$2,400,000 at November 12, 1984) as compared to \$2,780,000 at July 31, 1983. In April 1984, certificates of deposit in the aggregate amount of approximately \$2,300,000, previously pledged as collateral, were used to satisfy obligations under letters of credit relating to a contract with an agency of a foreign country.

The Company's continuation as a going-concern is dependent upon, among other things, its ability to generate sufficient cash flow to meet its obligations on a timely basis, to maintain acceptable relationships with vendors to enable the Company to complete satisfactorily its contractual obligations, to comply with the terms and covenants of its financing agreements, to obtain additional financing or other sources of funds as may be required and ultimately to attain profitable operations.

## Results of Operations

### Fiscal Year 1984 Compared To Fiscal Year 1983:

For the fiscal year 1984, the Company had a net loss of \$27,886,000 on sales of \$40,394,000. This compares with net income of \$1,409,000 on sales of \$36,589,000 for the prior year.

The sales increase of \$3,805,000 or 10%, over the prior year reflects in part the contributions of Comtech Communications Corp., Premier Microwave Corporation, and Comtech Data Corporation. The results of Premier Microwave were included in the six months ended July 31, 1983 and the year ended July 31, 1984. The results of Comtech Communications were included for the current year and in July of the prior year. Sales increased despite reversals of estimated revenues recognized by the Government Systems Division, as discussed below, as well as a decline in sales of this Division.

The revenue reversals of the Government Systems Division relate primarily to a contract with the U.S. Army - the AN/GSC-39 Satellite MT Contract. A reduction of \$3,633,000 on the MT Contract revenues recognized to April 30, 1984 resulted from a revised estimate of the total gross profit ultimately to be realized from completion of the contract. The gross profit percentage was reduced approximately 4.3% in recognition of costs incurred due to management and production difficulties encountered by this Division during fiscal 1984.

In August 1984 the Army terminated the AN/GRC-144 Radio Contract. As a result, the Company reversed all revenues recognized on this contract in fiscal 1984. In fiscal 1983, revenues recognized on this contract were \$2,090,000.

Cost of sales for the year increased \$20,362,000 or 83%, over the prior year. A major portion of this increase related to Comtech Communications which was included for the full year; inventory reserves taken by this subsidiary comprised \$2,200,000 of this increase. Other significant factors contributing to the increase in cost of sales were costs incurred on the U.S. Army Radio Contract, including estimated costs associated with its termination, and costs related to the operations of Premier, which were included for the full year, and of Comtech Data, which had increased sales.

Selling, general and administrative costs increased \$7,584,000 of which 58% was attributable to Comtech Communications and Premier and 22% was attributable to increased costs and reserves required for expenses of the Government Systems Division.

The financial results for fiscal 1984 also were adversely impacted by a reserve taken for loss on the sale of assets of \$4,700,000, which represents the estimated loss relating to the sale of certain assets and the close-down costs of certain operations of the Company.

Interest expense increased as a result of higher debt levels principally relating to the \$10 million of subordinated notes issued in February 1983, borrowings under the Company's credit lines and notes issued to Storage Technology Corporation.

Fiscal Year 1983 Compared to Fiscal 1982:

For the fiscal year 1983, sales increased to \$36,589,000 from \$33,487,000 in the prior year. The increase in the 1983 period results principally from the inclusion of the sales of Premier and Comtech Communications from the dates of their respective acquisitions (see Note 4 to the Consolidated Financial Statements). For fiscal year 1983, income from continuing operations before income taxes was \$2,046,000 as compared to \$2,663,000 the prior year (which included \$248,000 relating to gain on sale of assets).

The net earnings of \$1,409,000 in fiscal year 1983 included a \$43,000 gain (net of taxes) on discontinued operations while the prior year net earnings of \$2,380,000 reflected, among other things, a loss on discontinued operations (net of taxes) of \$143,000. The net earnings of the prior year also reflect an extraordinary credit of \$1,024,000 representing a reduction of income taxes resulting from the utilization of net operating loss carryforwards.

Net interest expense in 1983 declined as a result of lower debt levels and rates of interest as well as increased amounts of interest income. This was offset by increased selling, general and administrative expenses. This increase was attributable to increased sales volume, expenses associated with the termination of a former term loan and normal general and administrative expenses of Premier and Comtech Communications.

Research and development expense in the 1983 period increased as the resources needed for this purpose became more readily available.



SUMMARY OF SELECTED FINANCIAL DATA

(000's Omitted Except For Per Share Amounts)

COMTECH INC.

Year Ended July 31,	1984	1983	1982	1981	1980
Net sales	\$ <u>40,394</u>	\$ <u>36,589</u>	\$ <u>33,487</u>	\$ <u>31,669</u>	\$ <u>25,221</u>
Income (loss) from continuing operations	\$ <u>(28,443)</u>	\$ <u>1,366</u>	\$ <u>1,499</u>	\$ <u>1,188</u>	\$ <u>(9,883)</u>
Net income (loss)	\$ <u>(27,886)</u>	\$ <u>1,409</u>	\$ <u>2,380</u>	\$ <u>1,194</u>	\$ <u>(10,670)</u>
Earnings (loss) per share:					
Income (loss) from continuing operations	\$ <u>(5.89)</u>	\$ <u>.35</u>	\$ <u>.40</u>	\$ <u>.32</u>	\$ <u>(2.83)</u>
Net earnings (loss)	\$ <u>(5.89)</u>	\$ <u>.36</u>	\$ <u>.64</u>	\$ <u>.33</u>	\$ <u>(3.06)</u>
Total assets	\$ <u>31,851</u>	\$ <u>42,163</u>	\$ <u>19,679</u>	\$ <u>24,843</u>	\$ <u>27,075</u>
Long-term debt, including current maturities	\$ <u>24,174</u>	\$ <u>20,972</u>	\$ <u>6,323</u>	\$ <u>12,176</u>	\$ <u>13,134</u>
Shareholders' equity (deficiency)	\$ <u>(12,037)</u>	\$ <u>10,042</u>	\$ <u>5,625</u>	\$ <u>2,854</u>	\$ <u>1,241</u>

There have been no cash dividends declared on the Company's Stock. This Selected Financial Data should be read in conjunction with Item 7- Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8- Notes to Consolidated Financial Statements. See Note 1 to Consolidated Financial Statements for certain information with respect to the financial condition and results of operations of Comtech Data Corporation, the assets of which were sold on November 7, 1984.

QUARTERLY STOCK AND WARRANT PRICES AND DIVIDEND DATA 1983-1984

	(1)		Common Stock	
	Warrants		High	Low
	High	Low	Bid	Bid
Fiscal Year ended				
July 31, 1983:				
First Quarter	-	-	5 1/4	3 3/8
Second Quarter	-	-	8 1/4	5 1/8
Third Quarter	3 5/8	3 1/4	9 1/4	7 1/2
Fourth Quarter	6 3/8	3 1/4	14	8 1/8
Fiscal Year ended				
July 31, 1984:				
First Quarter	4 1/8	2 5/8	10 1/2	6 3/8
Second Quarter	2 3/4	1 7/8	7	5 1/8
Third Quarter	2	5/8	5 1/4	2 5/8
Fourth Quarter	5/8	3/8	2 3/4	1 1/2
Fiscal Year ending:				
July 31, 1985				
First Quarter	3/8	1/8	1 7/8	5/8

No dividends were declared during the Company's 1983 and 1984 fiscal years.

(1) Trading commenced March 22, 1983.

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The common stock and warrants of Comtech Inc. are 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. On August 9, 1983, the Company's stock was entered into the NASDAQ National Market System. Accordingly, the Company's stock is now subject to Last Sale Reporting, wherein the prices quoted will be reflective of actual closing prices on the applicable dates to be reported.

## **Board of Directors**

Fred Kornberg<sup>(1)</sup>  
Chairman

Benjamin Adler<sup>(3)</sup>  
Business and Engineering  
Consultant

George Bugliarello<sup>(3)</sup>  
President,  
Polytechnic Institute of  
New York

Joe E. Davis<sup>(2)</sup>  
Private Investor

Richard L. Goldberg<sup>(1)</sup>  
Partner, Botein Hays  
& Sklar

Jacob M. Schein<sup>(1)(2)</sup>  
Chairman and Chief  
Executive Officer,  
Henry Schein, Inc.

Sol S. Weiner<sup>(2)(3)</sup>  
Managing Director,  
Stenhouse, Weiner,  
Sherman, Ltd.,  
Management Consultants

(1) Executive Committee

(2) Audit Committee

(3) Compensation Committee

## **Officers**

Fred Kornberg  
Chief Executive  
Officer and President

William R. McEwen, Jr.  
Vice President and  
President of Comtech  
Communications Corp.

Joseph P. Sherer  
Vice President, General  
Counsel and Secretary

Michael H. Taber  
Corporate Controller and  
Treasurer

## **Legal Counsel**

Botein Hays & Sklar  
200 Park Avenue  
New York, NY 10166

## **Bank**

National Westminster  
Bank USA  
20 S. Oyster Bay Road  
Syosset, NY 11791

## **Independent Public Accountants**

Deloitte Haskins & Sells  
100 Crossways Park West  
Woodbury, NY 11797

## **Registrar & Transfer Agent**

American Transfer Company  
44 Beaver Street  
New York, NY 10004

**Stock Traded - OTC**

**NASDAQ Symbol - CMTL**

**COMTECH INC.**