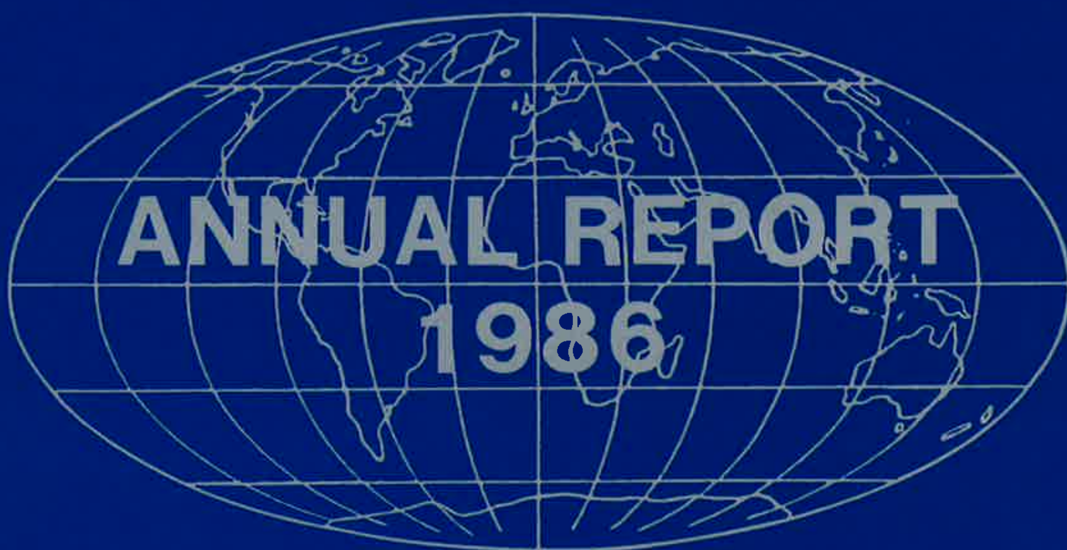
COMTECH INC.



ANNUAL REPORT
1986

ABOUT THE COMPANY

Comtech Inc. was incorporated in 1967 as Comtech Laboratories, Inc. The Company is 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 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. and Comtech Systems, Inc.

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

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

ANNUAL MEETING

Shareholders are cordially invited to attend and participate in the Annual Meeting of Shareholders scheduled for Thursday, January 15, 1987 at 10:00 a.m. at:

Hotel Royal Plaza
Walt Disney World Village
Lake Buena Vista, FL 32830-2203

Tel: (305) 828-2828

AVAILABILITY OF FORM 10-K

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

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.

TO OUR SHAREHOLDERS AND EMPLOYEES:

Comtech still has quite a way to go. However, I am pleased to report that during this last year we have made progress with respect to plans and programs to deal with our long-term debt and to improve our business operations.

. . . After extended negotiations, Comtech and Storage Technology Corporation finally completed the restructuring of the approximately $2.5 million debt owed to Storage Technology. Details of the revised arrangement are highlighted in the Notes to Consolidated Financial Statements.

. . . Pursuant to a plan for an initial public offering of securities of Premier Microwave Corporation, a wholly-owned subsidiary, Premier filed a registration statement covering units of Premier shares and warrants, proposed to be offered largely by Comtech. Work has also been ongoing with Drexel Burnham Lambert Incorporated in connection with a proposed exchange offer by Comtech to the holders of Comtech's 13% Subordinated Notes, which would include the right to acquire Premier shares. If during the current fiscal year, market conditions and other factors ultimately allow these transactions in one form or another to occur and be successfully completed, and there can be no assurance as to this, we will have put Comtech in a position to move forward aggressively with, among other things, a much sounder balance sheet.

. . . In each of the last three quarters of our fiscal year 1986, and for the year as a whole, Comtech reported income from continuing operations before interest and non-recurring items. We are particularly pleased with this accomplishment.

Looking at overall results for the year, Comtech had a net loss of $606,000 or $.13 per share as compared to net income of $6,675,000 or $1.39 per share for the year earlier period. The fiscal 1986 results include operating income of $416,000 before interest and non-recurring items as compared to an operating loss of $1,377,000 in 1985. The fiscal year 1985 results reflected a loss of $933,000 from continuing operations, a loss of $1,375,000 from discontinued operations, an after-tax gain of $6,583,000 from the sale of subsidiaries, and a $2,400,000 extraordinary credit from the utilization of tax loss carryforwards. The 1985 results also benefitted from a $2,544,000 gain on the sale of a Hauppauge, N.Y. manufacturing facility. Sales from continuing operations were $15,948,000 for fiscal 1986 as compared to $18,955,000 for fiscal 1985. Backlog at July 31, 1986 rose to $20,733,000 as compared to $13,156,000 a year before.

With that as background, I would like to report to you on Comtech's three principal businesses, as they have been developing since the restructuring and consolidation of our operations, which had been a principal focus of management during fiscal 1986.

Comtech Systems, Inc.

The business of CSI is the design, manufacture and installation of systems, antennas, and equipment for defense and commercial satellite and troposcatter communication applications. CSI was formed last year by combining the operations of Comtech Systems International, Inc. and Comtech Antenna Corporation.

During our last fiscal year, the transition from capability to reality got underway. Although our systems segment of CSI encountered order delays somewhat beyond expectations, in the last quarter things began to click.

In June 1986, CSI received a $1.5 million contract from General Electric Co. to provide two digital troposcatter links to interconnect the over-the-horizon radar control system for the U.S. Air Force. In August 1986, we announced the award to CSI of a $9 million contract from ITT/ FEC for synthesized troposcatter and microwave radio equipment. The shelterized Comtech-supplied systems to be provided under these awards utilize Comtech Systems, Inc. troposcatter and microwave radios and Comtech Microwave Corp. high power amplifiers.

The antenna segment of CSI has continued to expand its product lines and customer base, and this resulted in record sales and bookings over the past twelve months. We also incorporated a resin transfer molding technique into the antenna manufacturing process, thus providing the ability to manufacture very close-tolerance fiberglass antenna panels for high frequency operation of our product line.

We are particularly proud of CSI's accomplishments last year. These include: — installation of the first digital troposcatter system for the U.S. Air Force on U.S. soil utilizing a fade resistant modem technique; — development and sales of a new Ku-Band transportable 3.5-meter antenna product line for the audio, video and digital business satellite communications market; — development of a new 3-meter tactical troposcatter transportable antenna system and its successful testing by the U.S. Government for military qualification at the U.S. Army Test and Evaluation Command Aberdeen

Proving Ground; and — use of the company's 3.5- and 5-meter transportable satellite antenna systems for transmission of major U.S. Network coverage of the American/Russian Summit held in Reykjavik, Iceland.

Comtech Microwave Corp.

CMC is a supplier of a broad range of sophisticated receiving and transmitting equipment. Some of these include cryogenically cooled low noise parametric amplifiers, klystron high power amplifiers, low phase noise frequency agile up/down converters and mini-satellite terminals, which are used in the transmit/receive links of satellite communications earth stations for defense applications.

Last year, this operation successfully discharged its assignment to complete the pending projects of the discontinued Government Systems Division. Additionally, CMC turned in a modest operating profit for the year and successfully completed development of new low noise phase lock oscillators for X-band satellite frequency converter applications and a retrofit program for replacement of TWT amplifiers with X-band solid state 10W GASFET amplifiers.

Although, here too, booking delays were encountered, CMC did obtain two major awards from the U.S. Army Communications Command: — in July 1986, a contract was received for approximately $850,000 for delivery of RF GASFET Intermediate Power Amplifiers which are for use with the new generation of X-band satellite terminals fielded by the U.S. Armed Forces worldwide; and — in October 1986, CMC was awarded a contract for $1.6 million for Analog Simple Data Interface (ASDI) which provides a passive interface for voice or data communications over switched analog telephone trunks.

Premier Microwave Corporation

Premier Microwave is engaged in the design and manufacture of microwave components. Its product line and on-going programs and accomplishments this year included: — fuze and waveguide "beam rider" antennas for over 3600 Sparrow missiles; — initial developmental order as a supplier of antennas for the AMRAAM (Advanced Medium Range Air-to-Air Missile) which is being tested and is under consideration as a missile to augment and eventually replace the Sparrow as the primary long-range, air-to-air superiority missile; — microwave front ends and voltage controlled oscillators for use in the APN-59 Navigation Radar, of which over 2000 have already been deployed on large transport tankers and B-52 aircraft; — horn and spiral antennas for the Type 14 and 18 Periscopes; — phase and frequency matched multichannel bandpass filters for the LAMPS (Light Aircraft Multipurpose System) helicopter systems; — harmonic filters and arc sensors for use in the ASR-9 Weather Radar, soon to be deployed by the FAA; and — various microwave components for the BPS-12, 13, 14 and 15 series of Submarine Navigation Radars, MK-86 and MK-92 Gunfire Control Systems, as well as the SPG-53 and SPG-55 Fire Control Systems used on destroyers, fighter aircraft and guidance missile cruisers.

In May 1986, Michael Taber moved into the position of President and Chief Executive Officer of Premier from his financial role at the parent company. Leonard Kardon continues to serve Premier as Vice Chairman and an advisor. At the same time, Arthur Alex became Vice President-Operations and Dr. Ernest Wantuch Vice President-Engineering.

The "Supercomp" Division of Premier, formed in May 1985 to design, develop and manufacture active miniature microwave integrated assemblies and supercomponents, booked over $500,000 of new orders during fiscal 1986. Among these orders were initial developmental PIN-diode switches for the North Warning System expected to reach production deployment during the latter part of 1987 and digital attenuators for the ALQ-119 Electronic Countermeasure System. This pod-mounted jamming system is used on the F-111, A-10 and F-16 aircraft.

Our Thanks

My observation last year has current vitality - the time required to put Comtech solidly on the road to recovery and move it into a positive cash flow position, and the degree of success we will achieve, largely depends on effectively addressing our long-term debt structure and increasing sales. That remains the challenge -- and the challenge remains the opportunity.

We have been going forward with dedication, with energy and with frustration as we attempt to deal with these and other important matters. We have been relying heavily on the loyal and highly-motivated efforts of our employees, and we thank them. We recognize as well the support of our shareholders, customers and suppliers.

Fred Kornberg

November 18, 1986

Fred Kornberg
Chairman of the
Board and President

FINANCIAL SECTION TABLE OF CONTENTS

Comtech Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

JULY 31, 1986 AND 1985 (NOTE 1)

ASSETS	1986	1985
CURRENT ASSETS:		
Cash	$ 2,026,000	$ 4,838,000
Accounts receivable - net (Notes 3, and 9)	3,758,000	3,962,000
Inventories - net (Notes 2, 4 and 9)	2,188,000	2,507,000
Prepaid expenses and other	726,000	554,000
Total current assets	8,698,000	11,861,000
PROPERTY, PLANT AND EQUIPMENT - net (Notes 2, 5 and 9)	3,546,000	3,483,000
OTHER ASSETS (including cash deposit of $1,145,000 in 1986) (Notes 1, 2 and 14)	2,141,000	1,070,000
TOTAL	$14,385,000	$16,414,000

See Notes to Consolidated Financial Statements.

LIABILITIES AND SHAREHOLDERS' DEFICIENCY	1986	1985
CURRENT LIABILITIES:		
Accounts payable	$ 1,115,000	$ 1,531,000
Accrued expenses	3,171,000	3,996,000
Allowance for estimated losses on contracts (Notes 2, 9 and 15)	2,931,000	3,220,000
Current maturities of long-term debt (Note 6)	1,140,000	2,696,000
Total current liabilities	8,357,000	11,443,000
LONG-TERM DEBT (Note 6)	11,582,000	10,240,000
OTHER LIABILITIES	119,000	30,000
COMMITMENTS AND CONTINGENCIES (Notes 10 and 15)		
SHAREHOLDERS' DEFICIENCY (Note 8):		
Preferred stock, $.10 par value Shares authorized: 2,000,000 Shares issued: none		
Common stock, $.10 par value Shares authorized: 20,000,000 Shares issued: 1986, 4,790,137 and 1985, 4,730,890	479,000	473,000
Additional paid-in capital	12,917,000	12,691,000
Deficit	(18,889,000)	(18,283,000)
	(5,493,000)	(5,119,000)
Treasury stock - 75,000 shares - at cost	(180,000)	(180,000)
Shareholders' deficiency	(5,673,000)	(5,299,000)
TOTAL	$14,385,000	$16,414,000

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE FISCAL YEARS ENDED JULY 31, 1986, 1985 AND 1984 (NOTE 1)

	1986	1985	1984
CONTINUING OPERATIONS:			
Net sales (Notes 2, and 11)	$15,948,000	$18,955,000	$18,227,000
Operating costs and expenses: (Note 12)			
Cost of sales (Notes 2 and 15)	11,119,000	15,383,000	25,607,000
Selling, general and administrative	3,653,000	4,714,000	8,564,000
Research and product development (Note 2)	760,000	235,000	862,000
Total operating costs and expenses	15,532,000	20,332,000	35,033,000
Operating income (loss) from continuing operations	416,000	(1,377,000)	(16,806,000)
Other - net (Note 13)	(1,022,000)	444,000	(3,332,000)
Loss from continuing operations before income taxes	(606,000)	(933,000)	(20,138,000)
Income taxes (benefit) (Notes 2 and 7)			(557,000)
LOSS FROM CONTINUING OPERATIONS	(606,000)	(933,000)	(19,581,000)
DISCONTINUED OPERATIONS - net (Note 14)		5,208,000	(8,305,000)
INCOME (LOSS) BEFORE EXTRAORDINARY CREDIT	(606,000)	4,275,000	(27,886,000)
EXTRAORDINARY CREDIT (Note 14)		2,400,000	
NET INCOME (LOSS)	$ (606,000)	$ 6,675,000	$(27,886,000)
EARNINGS (LOSS) PER SHARE (Note 2):			
Continuing operations	$ (.13)	$ (.19)	$(4.14)
Discontinued operations - net		1.08	(1.75)
Extraordinary credit		.50	
Earnings (loss) per share	$ (.13)	$ 1.39	$(5.89)
Weighted average number of common and common equivalent shares outstanding	4,758,066	4,815,799	4,730,528

See Notes to Consolidated Financial Statements.

STATEMENTS OF CHANGES IN CONSOLIDATED FINANCIAL POSITION

FOR THE FISCAL YEARS ENDED JULY 31, 1986, 1985 AND 1984 (NOTE 16)

	1986	1985	1984
FINANCIAL RESOURCES WERE PROVIDED FROM (USED BY):			
Continuing operations:			
Loss from continuing operations	$ (606,000)	$ (933,000)	$(19,581,000)
Items not affecting working capital:			
Depreciation and amortization of property, plant and equipment	879,000	850,000	1,027,000
Deferred Federal income taxes			(557,000)
Other - net	362,000	280,000	(100,000)
Funds provided from (used by) continuing operations	635,000	197,000	(19,211,000)
Funds provided from (used by) discontinued operations		7,608,000	(7,312,000)
Total from operations*	635,000	7,805,000	(26,523,000)
Increase in long-term debt	1,638,000	125,000	3,354,000
Issuance of common shares	232,000	63,000	5,987,000
Increase (decrease) in other liabilities - net		(135,000)	71,000
Disposal and reclassification of property, plant and equipment - net	(127,000)	148,000	3,611,000
Decrease in net noncurrent assets of discontinued operations		3,238,000	
Total	2,378,000	11,244,000	(13,500,000)
FINANCIAL RESOURCES WERE USED FOR:			
Purchase of property, plant and equipment	815,000	496,000	1,460,000
Reduction in long-term debt	462,000	1,706,000	11,386,000
Increase (decrease) in other assets - net	1,178,000		(668,000)
Purchase of treasury stock			180,000
Increase in net noncurrent assets of discontinued operations			925,000
Total	2,455,000	2,202,000	13,283,000
INCREASE (DECREASE) IN WORKING CAPITAL	$ (77,000)	$ 9,042,000	$(26,783,000)

*The extraordinary credit had no impact on working capital in fiscal 1985.

See Notes to Consolidated Financial Statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)

FOR THE FISCAL YEARS ENDED JULY 31, 1986, 1985 AND 1984

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	TREASURY STOCK	SHAREHOLDERS' EQUITY (DEFICIENCY)
	SHARES ISSUED	AMOUNT				
BALANCE, AUGUST 1, 1983	3,844,465	$385,000	$ 6,729,000	$ 2,928,000		$ 10,042,000
Shares issued in public offering of common stock	750,000	75,000	5,556,000			5,631,000
Shares issued in connection with stock option, warrant, purchase and employment agreements	87,181	9,000	347,000			356,000
Shares purchased from former officer					$(180,000)	(180,000)
Net loss				(27,886,000)		(27,886,000)
BALANCE, JULY 31, 1984	4,681,646	469,000	12,632,000	(24,958,000)	(180,000)	(12,037,000)
Shares issued in connection with stock option, warrant, purchase and employment agreements	49,244	4,000	59,000			63,000
Net income				6,675,000		6,675,000
BALANCE, JULY 31, 1985	4,730,890	473,000	12,691,000	(18,283,000)	(180,000)	(5,299,000)
Shares issued in connection with stock purchase and employment agreements	59,247	6,000	226,000			232,000
Net loss				(606,000)		(606,000)
BALANCE, JULY 31, 1986	4,790,137	$479,000	$12,917,000	$(18,889,000)	$(180,000)	$ (5,673,000)

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: RECENT DEVELOPMENTS

As reflected in the consolidated financial statements, Comtech Inc. 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 15 and the operating losses of a subsidiary, Comtech Communications Corp. (CCC). The net loss resulted in the Company experiencing liquidity problems and having a net shareholders' deficiency. As a result of these and other matters, management assessed the Company's operations and future and implemented plans to sell certain assets and businesses and use the proceeds therefrom to reduce debt and replenish working capital.

As part of the Company's plans, it sold, during fiscal 1985, the business of two subsidiaries, Comtech Data Corporation and CCC (see Note 14), as well as a factory facility formerly used by the Company's Government Systems Division (see Note 13). In September 1986, the Company modified and extended its obligation due to Storage Technology Corporation to reduce immediate cash flow requirements (see Note 6). The Company is actively exploring other means of restructuring and reducing debt and expanding its product lines and business.

The Company, in July 1986, was awarded a $9,000,000 contract for the delivery of synthesized troposcatter and microwave radio equipment. The terms of the contract award provide for the Company to receive 100 percent progress billings (the proceeds from which are restricted for use on this contract) and require the Company to deposit $1,390,000 (of which $1,145,000 is included in the balance sheet caption "Other assets" at July 31, 1986) with the customer to serve as a performance bond. The customer will return the deposit to the Company on a pro rata basis as equipment is shipped. Shipping is scheduled to start in May 1987 and be completed in April 1988.

On July 28, 1986, the Company's wholly-owned subsidiary, Premier Microwave Corporation (Premier), filed a registration statement under the Securities Act of 1933 for an initial public offering of 500,000 units, each unit consisting of four shares of Premier's common stock and a common stock purchase warrant. Of the 2,000,000 shares of common stock offered as part of the units, 1,350,000 (representing approximately 33 percent of the common shares outstanding) will be sold by the Company and 650,000 will be newly-issued shares sold by Premier. No assurance can be given that such public offering will be successful. However, if it is fully subscribed, such offering will result in the Company owning 57 percent of Premier and recording a significant gain on the sale of a portion of its investment in Premier. The accompanying consolidated financial statements for fiscal 1986 includes net sales of $7,290,000 and total assets of $4,264,000 pertaining to Premier.

Despite the foregoing accomplishments and other cost containment programs introduced by management, the Company's continuing operations incurred a loss in fiscal 1986, and the Company continues to have a net shareholders' deficiency. 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 and ultimately to attain profitable operations.

NOTE 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 balances and transactions have been eliminated.

Sales Recognition

Sales from continuing operations made under long-term contracts are generally recognized under the unit-of-delivery method of accounting, except for large multi-year programs involving significant start-up time and costs, which are accounted for under the percentage-of-completion method of accounting. Retainages and estimated earnings in excess of amounts billed on such multi-year programs are reflected as unbilled receivables.

Other sales are recognized upon the sooner of shipment or title transfer.

Costs and Expenses

Cost of sales is based on actual manufacturing costs incurred and, in the case of partial shipments on long-term contracts, 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 contract performance 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 that the charge for the estimated loss 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 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 the net assets acquired, which amounted to $528,000 and $543,000 at July 31, 1986 and 1985, respectively, is included in the balance sheet caption "Other assets" and is being amortized on the straight-line basis over 40 years.

NOTE 2: CONTINUED

Research and Product Development Costs

The Company charges research and product development costs to operations as incurred, except in those cases in which such costs are reimbursable under customer-funded contracts. Research and product development costs in fiscal 1986 include $418,000 relating to nonrecurring start-up costs of a new product line being developed by a subsidiary.

Income Taxes

Where appropriate, the Company provides deferred income taxes for transactions which are reported in different periods for financial reporting purposes than for income tax purposes (see Note 7). At July 31, 1986, no deferred taxes are recorded because of the existence of net operating loss carryforwards. No benefit has been recorded for these carryforwards because future utilization thereof is not assured.

If applicable, investment tax credits are accounted for as reductions of income taxes in the year in which the related assets are placed in service.

Earnings (Loss) Per Share

Earnings (loss) per share were calculated based on the weighted average number of common shares outstanding. The assumed exercise of all options and warrants was antidilutive in each of the three fiscal years in the period ended July 31, 1986.

Reclassifications

Certain amounts relating to fiscal 1985 and 1984 have been reclassified to conform with the fiscal 1986 presentation.

NOTE 3: ACCOUNTS RECEIVABLE

Accounts receivable consist of the following at July 31, 1986 and 1985:

	1986	1985
Amount receivable from the United States Government and its agencies	$1,133,000	$1,223,000
Unbilled receivables (including retainages) on contracts in progress	636,000	1,345,000
Accounts receivable from other customers	2,016,000	1,435,000
Total	3,785,000	4,003,000
Less - Allowance for doubtful accounts (Note 9)	(27,000)	(41,000)
Accounts receivable - net	$3,758,000	$3,962,000

NOTE 4: INVENTORIES

Inventories consist of the following at July 31, 1986 and 1985:

	1986	1985
Raw materials and components	$2,344,000	$2,285,000
Work-in-process	2,985,000	3,427,000
Finished goods	170,000	219,000
Gross inventories	5,499,000	5,931,000
Less:		
Progress payments	(169,000)	(294,000)
Inventory reserves (Note 9)	(3,142,000)	(3,130,000)
Inventories - net	$2,188,000	$2,507,000

Title to work-in-process is vested in the customer for those contracts which provide for progress, partial or advance payments to the extent of such payments received. Inventory reserves include reserves for obsolescence and for work-in-process associated with terminated contracts.

NOTE 5: PROPERTY, PLANT AND EQUIPMENT

Changes in property, plant and equipment used by continuing operations were as follows:

Year Ended	Balance at Beginning of Year	Additions at Cost	Transfers, Retirements or Sales	Balance at End of Year
July 31, 1986				
Land	$ 58,000			$ 58,000
Buildings and improvements	885,000	$ 7,000		892,000
Equipment	7,476,000	609,000	$ 215,000[a] (96,000)	8,204,000
Leasehold improvements	539,000	199,000	(35,000)	703,000
Total	$ 8,958,000	$ 815,000	$ 84,000	$ 9,857,000
July 31, 1985				
Land	$ 58,000			$ 58,000
Buildings and improvements	899,000		$ (14,000)	885,000
Equipment	7,679,000	$ 413,000	(616,000)	7,476,000
Leasehold improvements	443,000	83,000	13,000	539,000
Total	$ 9,079,000	$ 496,000	$ (617,000)	$ 8,958,000
July 31, 1984				
Land	$ 708,000		$ (650,000)[a]	$ 58,000
Buildings and improvements	3,442,000	$ 47,000	(2,590,000)[a]	899,000
Equipment	7,120,000	1,386,000	(827,000)	7,679,000
Leasehold improvements	501,000	27,000	(85,000)	443,000
Total	$11,771,000	$1,460,000	$(4,152,000)	$ 9,079,000

(a) Transferred to or from other accounts.

NOTE 5: CONTINUED

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

Year Ended	Balance at Beginning of Year	Charged to Profit and Loss	Transfers, Retirements, Renewals or Replacements	Balance at End of Year
July 31, 1986				
Buildings and improvements	$ 186,000	$ 36,000		$ 222,000
Equipment	5,145,000	756,000	$ (58,000) 15,000[a]	5,858,000
Leasehold improvements	144,000	87,000		231,000
Total	$ 5,475,000	$ 879,000	$ (43,000)	$6,311,000
July 31, 1985				
Building and improvements	$ 164,000	$ 35,000	$ (13,000)	$ 186,000
Equipment	4,853,000	764,000	(472,000)	5,145,000
Leasehold improvements	77,000	51,000	16,000	144,000
Total	$ 5,094,000	$ 850,000	$(469,000)	$5,475,000
July 31, 1984				
Buildings and improvements	$ 415,000	$ 119,000	$(370,000)[a]	$ 164,000
Equipment	4,153,000	843,000	(143,000)	4,853,000
Leasehold improvements	40,000	65,000	(28,000)	77,000
Total	$ 4,608,000	$1,027,000	$(541,000)	$5,094,000

(a) Transferred to or from other accounts.

NOTE 6: LONG TERM DEBT

Long-term debt consists of the following at July 31, 1986 and 1985:

	1986	1985
13% Subordinated Notes due 1991 (net of an unamortized discount of $747,000 and $913,000)	$ 9,253,000	$ 9,087,000
Promissory note payable to Storage Technology Corporation (STC)	2,209,000	2,209,000
Loan payable to the United States Army (including accrued interest of $421,000 and $616,000)	538,000	787,000
Obligations under capital leases	722,000	853,000
Total long-term debt	12,722,000	12,936,000
Less - Current maturities	(1,140,000)	(2,696,000)
Long-term portion	$11,582,000	$10,240,000

13% Subordinated Notes

In February 1983, the Company completed a public offering in which it sold $10,000,000 principal amount of 13% Subordinated Notes due February 1, 1991 and 800,000 warrants (see Note 8). 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.

Promissory Note Payable to STC

The promissory note payable to STC was renegotiated in September 1986 to be payable as follows: $500,000 upon signing the agreement, four quarterly payments of $175,000 commencing three months from the date of signing and quarterly payments of $125,000 thereafter. Interest, at the prime rate, is included in the quarterly payments. The Company has pledged the common stock and assets of its wholly-owned subsidiary, Comtech Microwave Corp., to secure this loan.

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, the proceeds from which were used 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 13), was repayable in sixty equal monthly installments 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 8.5 percent for the period July 1 to December 31, 1986. Interest accrued, on an uncompounded basis, through June 1, 1984 was scheduled to be paid, without further interest, in equal monthly installments during such sixty-month period.

NOTE 6: CONTINUED

In November 1984, the Company prepaid $3,539,000 of this loan from the proceeds of the sale of the Hauppauge facility (see Note 13) and reached an agreement to repay the remaining balance outstanding over a period of four years from that date.

Capital Leases

The obligations under capital leases relate to certain equipment leased by the Company having net carrying values (pertaining to continuing operations) of $677,000 and $824,000 at July 31, 1986 and 1985.

Debt Maturities

Long-term debt is scheduled to mature as follows:

Fiscal Year Ending July 31,	Amount
1987	$ 1,140,000
1988	982,000
1989	3,071,000
1990	2,976,000
1991	4,553,000
Total	$12,722,000

NOTE 7: INCOME TAXES

Available Carryforwards

For financial reporting purposes, the Company has available net operating tax loss carryforwards of approximately $19,000,000 at July 31, 1986. It expects that its Federal income tax return for the fiscal year ended July 31, 1986 will include net operating loss carryforwards of approximately $13,300,000, expiring principally in the period 1997 to 2001. The difference between these two carryforward amounts is principally a result of (i) 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 and (ii) certain reserves and provisions established for financial reporting purposes which are not currently deductible for income tax purposes. Its Federal income tax return is also expected to have investment, foreign and research and development tax credit carryforwards of approximately $185,000 and a capital loss carryforward of approximately $1,500,000.

Components of Provision for Income Taxes

The income tax benefit pertaining to continuing operations for the fiscal year ended July 31, 1984 consisted principally of the reversal of previously recorded net deferred tax credits.

NOTE 8: SHAREHOLDERS' EQUITY (DEFICIENCY)

Option and Warrant Plans and Agreements

The Company has several option and warrant plans and agreements.

1982 Incentive Stock Option Plan - The 1982 Incentive Stock Option and Appreciation Plan 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 Stock Option Plan was considered compensation expense. All options granted under this plan subsequent to January 1, 1982 were 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, warrants to purchase 19,500 shares of stock remain 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 6). 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, 1986, none have been exercised.

Warrant Held by STC - STC holds a warrant to purchase 450,000 shares of the Company's common stock which expires on July 1, 1988. As part of the agreement with STC described in Note 6, the exercise price of the warrant has been reduced from $12 to $2 per share, subject to adjustment, as defined in the agreement.

For financial reporting purposes, this warrant was valued at $1,058,000 at the time of issuance. As of July 31, 1986 no portion of this warrant had been exercised.

NOTE 8: CONTINUED

Option and Warrant Activity

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

	1986		1985	
	Number	Exercise Price Range	Number	Exercise Price Range
Options/warrants outstanding at the beginning of the fiscal year	1,608,600	$1.125-$12.00	1,897,600	$1.81-$12.00
Granted	72,666	1.19 - 1.50	199,300	1.125- 1.59
Expired/cancelled	(41,000)	1.59 - 4.69	(488,300)	1.125-11.375
Options/warrants outstanding at the end of the fiscal year	1,640,266	1.125-11.00	1,608,600	1.125-12.00
Options/warrants exercisable at the end of the fiscal year	1,506,786	1.125-11.00	1,403,340	1.94- 12.00
Options/warrants available for grant at the end of the fiscal year	374,600		364,000	

NOTE 8: CONTINUED

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan under which 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 meet certain other minimum eligibility requirements. Under the terms of the plan, at the beginning of each six-month period, 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, 1986, 1985 and 1984, employees purchased 9,247, 27,244 and 12,491 shares, respectively. At July 31, 1986, 225,369 shares are reserved for possible future issuances under this plan.

Other Agreements

Three employees of a former subsidiary had contracts under which such employees purchased 200,000 shares of the Company's common stock at a price of $.10 per share based on the achievement of certain specified earnings milestones. 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 $27,000 in 1985 and $(98,000) in 1984 and is included in the caption "Discontinued operations - net" in the accompanying Consolidated Statements of Operations.

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 $89,000 each in 1986 and 1985 and $262,000 in 1984. At July 31, 1986, 50,000 shares remain issuable under these agreements.

During fiscal 1984, the Company purchased 75,000 shares of treasury stock from one of these officers upon his resignation. A portion of the proceeds was used by the officer to repay a $125,000 loan due to the Company.

NOTE 9: VALUATION ALLOWANCES AND RESERVES

The following summarizes the activity in the Company's valuation allowances and reserves:

	Balance at Beginning of Year	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Year
Allowance for doubtful accounts					
1986	$ 41,000	$ 2,000		$ 16,000	$ 27,000
1985	16,000	25,000			41,000
1984	51,000			35,000	16,000
Inventory reserves					
1986	$3,130,000	$ 12,000			$3,142,000
1985	2,987,000	86,000	$ 147,000	$ 90,000	3,130,000
1984	1,131,000	1,887,000		31,000	2,987,000
Reserve for Loss on Sale of Assets					
1986	$ 700,000		$ 110,000	$ 74,000	$ 736,000
1985	700,000				700,000
1984		$ 700,000			700,000
Allowance for estimated losses on contracts					
1986	$3,220,000	$ 297,000		$ 586,000[a]	$2,931,000
1985	2,742,000	424,000	$ 250,000	196,000	3,220,000
1984	2,307,000	921,000	1,821,000	2,307,000	2,742,000

[a] Includes $426,000 which was reversed as no longer considered necessary by management.

NOTE 10: COMMITMENTS AND CONTINGENCIES

United States Government Contracts

Certain of the Company's contracts are subject to audit by the applicable governmental agencies. 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. (See Note 15 for information concerning a terminated contract.)

Litigation

The Company is 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 the Company's financial condition.

Operating Leases

The Company has entered into operating lease agreements for equipment, manufacturing and office facilities for initial periods ranging from three to ten years.

The minimum scheduled rentals under these agreements are as follows:

Fiscal Year Ending July 31,	Amount
1987	$ 319,000
1988	321,000
1989	268,000
1990	273,000
1991	265,000
Thereafter	258,000
Total	$1,704,000

Rent expense charged to continuing operations was $444,000 in 1986, $554,000 in 1985 and $716,000 in 1984.

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, 1986, the Company is committed under open letters of credit of $421,000, which are secured by certificates of deposit.

NOTE 11: SEGMENT AND PRINCIPAL CUSTOMER INFORMATION

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

During the fiscal years ended July 31, 1986, 1985 and 1984 approximately 75, 78 and 77 percent, respectively, of the Company's net sales from continuing operations resulted from contracts with United States Government agencies and prime contractors of such agencies.

Export sales were not significant in any fiscal year presented.

NOTE 12: SUPPLEMENTARY INCOME STATEMENT INFORMATION

Certain supplementary income statement information relating to continuing operations is as follows for the fiscal years ended July 31, 1986, 1985 and 1984:

	1986	1985	1984
Maintenance and repairs	$292,000	$396,000	$201,000
Amortization of intangibles and deferred expenses	362,000	362,000	538,000

Advertising costs amounted to $173,000 in fiscal 1986 and were not material during the fiscal years ended July 31, 1985 and 1984. Royalties and taxes other than income and payroll were not significant during any fiscal year presented.

NOTE 13: OTHER - NET

Other - net consists of the following for the three fiscal years ended July 31, 1986, 1985 and 1984:

	1986	1985	1984
		Income (Expense)	
Interest - net	$(1,491,000)	$(2,100,000)	$(2,632,000)
Gain (loss) on sale or write-down of assets		2,544,000	(700,000)
Tax refund, gain on transfer of contracts to other companies, etc.	451,000		
Other - net	18,000		
Total	$(1,022,000)	$ 444,000	$(3,332,000)

The $2,544,000 gain on sale of assets in fiscal 1985 related to the net proceeds of $5,500,000 in cash received from the sale of the Company's former factory facility in Hauppauge, New York. The proceeds of the sale were used to repay an outstanding first mortgage and to prepay a substantial portion of a loan due to the Army (see Note 6).

NOTE 14: DISCONTINUED OPERATIONS

During fiscal 1985, the Company sold the net assets of its wholly-owned subsidiary, Comtech Data Corporation, for an aggregate cash consideration of $12,200,000 and its wholly-owned subsidiary, CCC (see Note 1), for an aggregate consideration of $4,000,000 (comprised of $3,500,000 in cash and a $500,000 interest-bearing promissory note due in April 1987). These transactions resulted in gains, before income taxes, of $8,983,000, including the reversal of a $4,000,000 reserve recorded at July 31, 1984. The proceeds from these sales were used to reduce long-term debt and replenish working capital.

The net operating results of discontinued operations are included in the caption "Discontinued operations - net" in the accompanying Consolidated Statements of Operations and consist of:

	1985	1984
OPERATIONS:		
Net sales	$6,106,000	$22,167,000
Costs and expenses:		
Cost of sales	4,679,000	18,971,000
Selling, general and administrative	2,205,000	6,145,000
Research and development	624,000	1,365,000
Interest - net	(27,000)	(9,000)
Provision for write-down of assets		4,000,000
Total	7,481,000	30,472,000
Operating loss	(1,375,000)	(8,305,000)
GAIN ON SALE OF BUSINESS - net of applicable income taxes of $2,400,000 in 1985	6,583,000	
DISCONTINUED OPERATIONS - net	$5,208,000	$(8,305,000)

The extraordinary credit included in the accompanying Consolidated Statements of Operations for fiscal 1985 represents the benefit realized from the utilization of Federal income tax loss carryforwards in connection with the taxes associated with the gain on disposal of discontinued operations.

NOTE 15: TERMINATION OF 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. 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 (GFE) and repayment of unliquidated progress payments amounting to $1,821,000, together with interest thereon commencing with the date of termination. It also asserted its right to assess the Company for reprocurement costs. During fiscal 1986, the Company was advised that the Army does not intend to reprocure the equipment covered by the terminated contract. As of July 31, 1986 the Company had returned all GFE and completed settlements with substantially all vendors affected by the contract termination.

In November 1984, the Company, which contends that 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 amount in the balance sheet caption "Allowance for estimated losses on contracts" principally relates to this contract at July 31, 1986 and 1985 and includes accruals for all unliquidated progress payments, accrued interest and open vendor claims. In the event that the Company's appeal is successful or, if it negotiates a more favorable settlement with the Army, the difference between the amount accrued and the ultimate settlement will be reversed and included in income in the year in which the settlement occurs.

During the fiscal year ended July 31, 1984, the Company recognized losses of $6,542,000 (included in the caption "Cost of sales" in the accompanying Consolidated Statements of Operations) on this contract, including the estimated costs associated with termination.

NOTE 16: CHANGES IN COMPONENTS OF WORKING CAPITAL

Changes in working capital by component for each of the three fiscal years in the period ended July 31, 1986 were:

	1986	1985	1984
Increase (decrease) in current assets:			
Cash	$(2,812,000)	$ 4,475,000	$ (2,368,000)
Accounts receivable - net	(204,000)	(1,700,000)	(2,641,000)
Inventories - net	(319,000)	87,000	(2,015,000)
Prepaid expenses and other	172,000	339,000	(535,000)
Assets subsequently sold - net	—	(1,035,000)	1,035,000
Net current assets of discontinued operations	—	(4,870,000)	(6,078,000)
Total	(3,163,000)	(2,704,000)	(12,602,000)
(Increase) decrease in current liabilities:			
Accounts payable	416,000	1,628,000	(1,078,000)
Accrued expenses	825,000	53,000	(714,000)
Allowance for estimated losses on contracts	289,000	(478,000)	(435,000)
Current maturities of long-term debt	1,556,000	10,543,000	(11,954,000)
Total	3,086,000	11,746,000	(14,181,000)
INCREASE (DECREASE) IN WORKING CAPITAL	$ (77,000)	$ 9,042,000	$(26,783,000)

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AUDITORS' OPINION

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

We have examined the consolidated balance sheets of Comtech Inc. and subsidiaries (the Company) as of July 31, 1986 and 1985 and the related consolidated statements of operations, changes in consolidated financial position and shareholders' equity (deficiency) for each of the three fiscal years in the period ended July 31, 1986. 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.

In our report dated October 17, 1985, our opinion on the 1985 and 1984 consolidated financial statements was also qualified as being subject to the effects of such adjustments, if any, as might have been required had the outcome of certain uncertainties involving the termination of a significant contract been known. As discussed in Note 15, during fiscal 1986, the Company (i) was advised that the U.S. Army does not intend to reprocure the equipment covered by the terminated contract and (ii) settled substantially all claims with vendors affected by the contract termination. Accordingly, our present opinion on the 1985 and 1984 consolidated financial statements, as expressed herein, is different from that expressed in our previous report as it relates to this matter.

In our opinion, subject to the effects on the consolidated financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the second preceding paragraph been known, such consolidated financial statements present fairly the financial position of Comtech Inc. and subsidiaries at July 31, 1986 and 1985 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, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells

DELOITTE HASKINS & SELLS
October 13, 1986

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

Beginning in the fiscal year ended July 31, 1984, the Company experienced severe liquidity difficulties largely caused by operating losses during that year, principally incurred by its former Government Systems Division and Comtech Communications Corp. subsidiary. The Company had a net loss for the 1984 fiscal year of $27,886,000, attributable in large part to the termination of its U. S. Army Radio Contract, certain asset write-offs and inventory reserves, as well as continuing operating losses of Comtech Communications Corp. Operating losses continued during the first half of fiscal 1985, but in the second half of such year the Company's liquidity improved, principally as a result of the receipt of proceeds from the sale of certain of the Company's subsidiaries. However, while the Company's liquidity difficulties continued during fiscal 1986, its operating income before interest and non-recurring items was $416,000 for the year.

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. 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 (GFE) and repayment of unliquidated progress payments amounting to $1,821,000, together with interest thereon commencing with the date of termination. It also asserted its right to assess the Company for reprocurement costs. During fiscal 1986, the Company was advised that the Army does not intend to reprocure the equipment covered by the terminated contract. As of July 31, 1986, the Company had returned all GFE and completed settlements with substantially all vendors affected by the contract termination. In November 1984, the Company, which contends that 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 amount in the balance sheet caption "Allowance for estimated losses on contracts" principally relates to this contract at July 31, 1986 and 1985 and includes accruals for all unliquidated progress payments, accrued interest and open vendor claims. In the event that the Company's appeal is successful or if it negotiates a more favorable settlement with the Army, the difference between the amount accrued and the ultimate settlement will be reversed and included in income in the year in which the settlement occurs. If there should be a decision adverse to the Company, while the Company believes that it could negotiate a repayment schedule with the U.S. Army, there is no assurance that it can do so or, if it cannot, that it will be able to repay the U.S. Army.

The Company has undertaken a number of significant actions to eliminate its operating losses, reduce its indebtedness and meet its liquidity requirements.

It has, over the past two years, 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. As a result of these measures and the sales of the operating units referred to below, the number of the Company's employees decreased from 604 at July 31, 1984 to 176 at July 31, 1986.

In early October 1984, the Company sold its Hauppauge, Long Island manufacturing facility, which had housed the Government Systems Division, applying the net proceeds of approximately $5,500,000 to reduce indebtedness, including the first mortgage of $1,876,000 and a major portion ($3,539,000) of the Company's loan from the Department of the Army, which had been secured by a second mortgage on the facility.

As of July 31, 1986, the unpaid principal balance of the Army Loan was $117,000. This principal balance is repayable monthly in equal installments ending on October 1, 1988, together with interest at an effective rate set prospectively every six months by the Secretary of the Treasury pursuant to the Contract Disputes Act of 1978. The rate for the period from July 1 through December 31, 1986 is 8.5%. The unpaid balance of interest accrued through June 1984 on the Army loan ($421,000 as of July 31, 1986) is payable without interest in equal monthly installments ending October 1, 1988. The current aggregate monthly payment by Comtech is approximately $22,000.

In November 1984, the net assets of the Company's wholly-owned Comtech Data Corporation subsidiary were sold for an aggregate purchase price of approximately $12,200,000, of which $9,400,000 was used to repay indebtedness, including the Company's entire outstanding secured bank debt, and the balance was used to replenish working capital.

In January 1985, the Company sold a wholly-owned subsidiary, Comtech Communications Corp., for an aggregate consideration of $4,000,000, consisting of $3,500,000 in cash and a $500,000 interest-bearing promissory note. The remaining principal balance of $300,000 is payable on April 30, 1987 and bears interest at 10.5% per annum, payable monthly. The net proceeds of the sale were used for working capital. This subsidiary, a start-up operation, was involved in the manufacture and sale of voice compression and voice concentration products and had incurred substantial losses in fiscal 1984 and 1985.

In September 1986, the Company entered into a new agreement with Storage Technology Corporation for the restructuring of the approximately $2,200,000 principal balance of Comtech's promissory note to StorageTek made in connection with the Company's acquisition of certain assets from StorageTek, plus accrued interest (approximately $269,000 at July 31, 1986). The agreement provides, among other things, for an initial payment of $500,000 and an extension of the payment period by means of a new note payable in quarterly installments through July 1, 1991. The Company's obligations are to be secured by a security interest in the assets of its Comtech Microwave Corp. subsidiary and the outstanding stock of such subsidiary. STC may, under certain circumstances, require the Company to grant certain additional security or make certain additional repayments on its obligations. The agreement also provides for an extension of the exercise period and the reduction to $2.00 of the exercise price of the warrant for 450,000 Comtech shares held by StorageTek.

The Company, having paid its entire outstanding bank debt, does not currently have a bank credit facility. At July 31, 1986, secured letters of credit were outstanding in the amount of approximately $421,000. Any new letters of credit will be issued on a secured basis subject to prior bank approval. Cash and short-term investments at July 31, 1986 were $2,026,000 compared to $4,838,000 at July 31, 1985. The principal reason for the decrease in the cash balance is the deposit with ITT/Federal Electric Corporation of which $1,145,000 is included in the caption "Other Assets" and has been excluded from the cash balances at July 31, 1986. The customer will return the deposit to the Company on a pro rata basis as the equipment is shipped. Shipping is scheduled to start in May 1987 and be completed in April 1988.

On August 1, 1986, the Company paid $650,000 of interest on its 13% Subordinated Notes due February 1, 1991. Interest payments are due each August 1 and February 1 until maturity.

On July 28, 1986 Premier Microwave Corporation, the Company's wholly-owned subsidiary, filed a registration statement on Form S-1 under the Securities Act of 1933, for an initial public offering of 500,000 units, each unit consisting of four shares of Premier's Common Stock and a Common Stock Purchase Warrant. Of the

2,000,000 shares of Common Stock offered as part of the Units, 1,350,000 are being sold by Comtech Inc. and 650,000 are being sold by Premier. If the Premier offering is consummated, the Company would benefit from the net proceeds it would receive from the public offering, but would suffer the loss of Premier's cash flow.

The Company's continuation as a going concern is dependent, among other things, upon its ability to generate sufficient cash flow from operations to meet its obligations and to sustain profitable operations.

Results of Operations

Fiscal Year 1986 Compared to Fiscal Year 1985

For the year ended July 31, 1986, the Company had a net loss of $606,000 as compared to net income of $6,675,000 for the prior year. The 1986 net loss included a $351,000 tax refund and a gain of $100,000 from novation of a contract. Operating income for fiscal year 1986 was $416,000 as compared to an operating loss of $1,377,000 in fiscal year 1985. The 1985 results included a loss of $933,000 from continuing operations (including a gain of $2,544,000 from the sale of one of its Hauppauge, Long Island manufacturing facilities) and a loss of $1,375,000 from discontinued operations. The financial results for the year ended July 31, 1985 were also significantly impacted by the gain, net of taxes, on the sale of two of the Company's subsidiaries, Comtech Data Corporation and Comtech Communications Corp., of approximately $6,583,000. The utilization of Federal net operating loss carryforwards contributed $2,400,000 of extraordinary credit to the results for 1985.

Sales decreased $3,007,000, or 16%, from 1985. This decrease, which reflected the completion in 1985 of certain contracts of the former Government Systems Division, was partially offset by increased revenues at Premier Microwave Corporation.

Cost of sales decreased $4,264,000, or 28%, from 1985, principally as the result of reduced sales volume and operating efficiencies implemented since 1985. During 1986, the Company incurred approximately $300,000 of additional costs to complete certain contracts of the former Government Systems Division.

Selling, general and administrative costs decreased $1,061,000, or 23%, resulting principally from staff reductions, the consolidation of Long Island operations, and other operating efficiency measures implemented during fiscal 1985 and 1986.

Research and development expenses increased $525,000, or 223%, principally because of the development costs at Premier's "Supercomp" Division as well as increased expenditures at Comtech Microwave Corp.

Interest expense decreased $609,000, or 29%, principally as a result of the repayment of all outstanding bank debt during the second quarter of fiscal 1985.

Fiscal Year 1985 Compared to Fiscal Year 1984

For the year ended July 31, 1985, the Company had a net income of $6,675,000 as compared to a net loss of $27,886,000 for the prior year.

Sales for fiscal 1985 from continuing operations were $18,955,000 as compared to $18,227,000 for fiscal 1984.

Included in fiscal 1985 net income was a loss from continuing operations of $933,000 (including a gain of $2,544,000 from the sale of one of its Hauppauge, Long Island manufacturing facilities) as compared to the loss of $19,581,000 for the year ended July 31, 1984. The financial results for the year ended July 31, 1985 were also significantly impacted by the gain, net of taxes, on the sale of two of the Company's subsidiaries, Comtech Data Corporation and Comtech Communications Corp., of approximately $6,583,000. The utilization of Federal net operating loss carryforwards contributed $2,400,000 of extraordinary credit to the results for 1985.

Results for the year ended July 31, 1984 reflected, among other things, reversals of estimated revenues of $6,693,000 previously recognized by the former Government Systems Division, principally in connection with the Army Radio Contract and the Army MT Contract, resulting from changes in estimates of the ultimate gross profits to be realized on these contracts. The Army Radio Contract was terminated in August 1984 and the final system shipment under the Army MT Contract was made in August 1985.

Cost of sales of continuing operations for the year ended July 31, 1985 decreased $10,224,000, or 40%, compared with 1984. The year ended July 31, 1984 included, among other things, provisions aggregating approximately $5,272,000 for obsolete and surplus inventory, anticipated losses on certain contracts and certain relocation expenses primarily attributable to the operations of the Company's former Government Systems Division and Comtech Microwave Corp. subsidiary.

Selling, general and administrative costs of continuing operations decreased $3,850,000, or 45%, principally because the year ended July 31, 1984 included provisions of $1,647,000 to establish reserves for future expenses related to the Army MT Contract and Army Radio Contract, while the Company established significantly fewer provisions in fiscal 1985 while instituting personnel and other cost reductions.

Research and development expenses of continuing operations decreased $627,000, or 73%, due to lower budgets established for fiscal 1985 as part of the Company's cost containment programs.

Interest expense decreased $532,000, principally as a result of the repayment of all outstanding bank debt during the second quarter of fiscal 1985.

SUMMARY OF SELECTED FINANCIAL DATA

(Dollars in thousands, except for per share amounts)

	Year Ended July 31				
	1986(2)	1985(2)	1984(2)	1983(2)	1982
Selected Income Data:					
Net sales from continuing operations(1)	$15,948	$18,955	$ 18,227	$25,509	$24,805
Operating income (loss) from continuing operations	$ 416	$(1,377)	$(16,806)	$ 1,356	$ 2,599
Pretax income (loss) from continuing operations(1)	$ (606)	$ (933)	$(20,138)	$ 214	$ 1,287
Income (loss) from continuing operations(1)	$ (606)	$ (933)	$(19,581)	$ 120	$ 724
Net income (loss)	$ (606)	$ 6,675	$(27,886)	$ 1,409	$ 2,380
Earnings (loss) per share:					
Income (loss) from continuing operations(1)	$ (.13)	$ (.19)	$ (4.14)	$ .03	$ .33
Net income (loss)	$ (.13)	$ 1.39	$ (5.89)	$ .36	$ .64
Selected Balance Sheet Data:					
Working capital (deficit)	$ 341	$ 418	$ (8,624)	$18,159	$ 5,620
Total assets	$14,385	$16,414	$ 22,972	$39,852	$19,011
Long-term debt, excluding current maturities	$11,582	$10,240	$ 11,655	$19,687	$ 5,967
Shareholders' equity (deficiency)(3)	$(5,673)	$(5,299)	$(12,037)	$10,042	$ 5,625

(1) Amounts have been restated to reflect Comtech Data Corporation and Comtech Communications Corp. as discontinued operations.

(2) Includes Premier Microwave Corporation in continuing operations from January 28, 1983 (date of acquisition).

(3) No cash dividends have been declared on Comtech's Common Stock during any period presented.

PRICE RANGE OF COMMON STOCK AND WARRANTS

The Company's Common Stock and Warrants are traded in the over-the-counter market. Until September 3, 1985, they were quoted on NASDAQ, at which date they were deleted from listing for failure to meet NASDAQ's capital and surplus requirement. Under the rules of the National Association of Securities Dealers, a company is required to have a minimum capital and surplus of $375,000 in order to remain eligible for quotation on NASDAQ.

The following table sets forth the range of high and low closing bids of the Common Stock and Warrants as reported on NASDAQ for the periods indicated, except for the period after September 3, 1985, which reflects interdealer prices. The prices shown are representative quotations and do not include retail markups, markdowns or commissions and do not necessarily reflect actual transactions.

	Common Stock		Warrants	
	High Bid	Low Bid	High Bid	Low Bid
Fiscal Year ended 7-31-85				
First Quarter	$2	$ 7/8	$3/8	$1/8
Second Quarter	2-7/8	7/8	1/2	1/8
Third Quarter	3-1/16	1-7/8	1/2	1/4
Fourth Quarter	2-5/16	1-3/8	1/4	1/8
Fiscal Year ended 7-31-86				
First Quarter	1-1/2	1/2	1/8	1/8
Second Quarter	7/8	3/8	1/8	1/8
Third Quarter	1-3/8	5/8	1/8	1/8
Fourth Quarter	1-1/2	3/4	1/8	1/8
Fiscal Year ended 7-31-87				
First Quarter	$ 7/8	$ 5/8	$1/8	$1/8

No dividends were declared during any of the periods indicated. The payments of dividends (other than dividends payable in shares of stock) is restricted by the Indenture dated as of February 1, 1983 between the Company and J. Henry Schroder Bank & Trust Company, as Trustee, under which the Company's 13% Subordinated Notes due February 1, 1991 were issued. In addition, currently the Company is prohibited from paying dividends under the New York Business Corporation Law which provides that dividends may be declared and paid out of surplus only.

BOARD OF DIRECTORS

Fred Kornberg(1)
Chairman

Benjamin Adler(1)(3)
Business and Engineering
Consultant

George Bugliarello(2)(3)
President,
Polytechnic Institute of
New York

Joe E. Davis(2)
Private Investor

Richard L. Goldberg(1)
Partner, Botein Hays
& Sklar

Sol S. Weiner(2)(3)
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

John Bang
Corporate Controller, Secretary
and Treasurer

LEGAL COUNSEL

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

INDEPENDENT PUBLIC ACCOUNTANTS

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

REGISTRAR & TRANSFER AGENT

American Stock Transfer Company
99 Wall Street
New York, NY 10005

STOCK TRADED - OTC

Symbol - CMTL

COMTECH INC.

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