COMTECH TELECOMMUNICATIONS CORP /DE/
Form 10-Q/A
December 18, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A

Amendment No. 1

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended October 31, 2006

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-7928

(Exact name of registrant as specified in its charter)

Delaware	**11-2139466**
(State or other jurisdiction of incorporation /organization)	(I.R.S. Employer Identification Number)
68 South Service Road, Suite 230, Melville, NY	**11747**
(Address of principal executive offices)	(Zip Code)

(631) 962-7000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
o Yes x No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of November 30, 2006, the number of outstanding shares of Common Stock, par value $.10 per share, of the registrant was 23,081,936 shares.

COMTECH TELECOMMUNICATIONS CORP.
INDEX

		Page
PART I.	**FINANCIAL INFORMATION**	
Item 1.	Condensed Consolidated Financial Statements	
	Condensed Consolidated Balance Sheets - October 31, 2006 (Unaudited) and July 31, 2006	2
	Condensed Consolidated Statements of Operations - Three Months Ended October 31, 2006 and 2005 (Unaudited)	3
	Condensed Consolidated Statements of Cash Flows - Three Months Ended October 31, 2006 and 2005 (Unaudited)	4
	Notes to Condensed Consolidated Financial Statements	5
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	27
Item 4.	Controls and Procedures	27
PART II.	**OTHER INFORMATION**	
Item 1.	Legal Proceedings	27
Item 1A.	Risk Factors	27
Item 6.	Exhibits	28
Signature Page		29

EXPLANATORY NOTE

Comtech Telecommunications Corp. and Subsidiaries (the Company) is amending its Quarterly Report on Form 10-Q for the quarter ended October 31, 2006, as filed on December 4, 2006 (the Original Form 10-Q), to conform with Rule 10-01(d) of Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended. On December 16, 2006, KPMG LLP (KPMG), the Company s independent registered public accounting firm, completed its review of the Company s condensed consolidated financial statements for the quarter ended October 31, 2006.

The Original Form 10-Q included an explanatory paragraph in Part I, Item 1 and a risk factor in Part II, Item 1A, which indicated that on November 30, 2006, KPMG advised the Company that it believed that one of its staff accountants who worked on the engagement to audit the financial statements of the Company made an investment in the Company s common stock and that this matter raised a question as to whether KPMG s independence had been impaired.

On December 16, 2006, KPMG concluded that its independence has not been compromised, and the Audit Committee of the Board of Directors of the Company (the Audit Committee), based on the information provided by KPMG, also concluded that KPMG s independence has not been compromised. In making this determination, the Audit Committee considered, among other factors, that (i) the investment by the staff accountant was believed to be de minimis (approximately $5,000); (ii) the staff accountant had a low-level of responsibility as compared to other members of the audit engagement team; (iii) all original work performed by the staff accountant that required agreeing amounts to source documents, performing analytical reviews and performing other significant procedures was re-performed and evaluated by other KPMG partners, managers and staff not previously associated with the audit of the Company s financial statements; and (iv) as a result of this re-performance, KPMG is unaware of any material changes or errors in any of the Company s consolidated financial statements or any required changes to Management s Reports on Internal Control Over Financial Reporting. In addition, the Audit Committee considered that all other members of the audit engagement team were interviewed by KPMG regarding this matter and that these interviews revealed no additional independence matters.

Except for the removal of the explanatory paragraph in Part I, Item 1 and an update of the Risk Factors in Part II, Item 1A, there are no other changes to the Original Form 10-Q.

PART I

FINANCIAL INFORMATION

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

Item 1.	October 31, 2006	July 31, 2006
Assets	(Unaudited)	
Current assets:		
Cash and cash equivalents	$ 245,560,000	251,587,000
Restricted cash	1,003,000	1,003,000
Accounts receivable, net	69,300,000	70,047,000
Inventories, net	72,046,000	61,043,000
Prepaid expenses and other current assets	6,949,000	7,178,000
Deferred tax asset - current	7,211,000	7,591,000
Total current assets	402,069,000	398,449,000
Property, plant and equipment, net	25,755,000	24,732,000
Goodwill	24,387,000	22,244,000
Intangibles with finite lives, net	6,955,000	6,855,000
Deferred financing costs, net	2,312,000	2,449,000
Other assets, net	364,000	537,000
Total assets	$ 461,842,000	455,266,000
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 26,182,000	28,337,000
Accrued expenses and other current liabilities	31,468,000	41,230,000
Customer advances and deposits	6,393,000	3,544,000
Deferred service revenue	7,360,000	9,896,000
Current installments of other obligations	138,000	154,000
Interest payable	525,000	1,050,000
Income taxes payable	8,677,000	5,252,000
Total current liabilities	80,743,000	89,463,000
Convertible senior notes	105,000,000	105,000,000
Other obligations, less current installments	210,000	243,000
Deferred tax liability non-current	6,398,000	6,318,000
Total liabilities	192,351,000	201,024,000
Commitments and contingencies (See Note 14)		
Stockholders equity:		
Preferred stock, par value $.10 per share; shares authorized and unissued 2,000,000		
Common stock, par value $.10 per share; authorized 100,000,000 shares, issued 23,287,098 shares and 23,052,593 shares at October 31, 2006 and July 31, 2006, respectively	2,329,000	2,305,000
Additional paid-in capital	143,885,000	139,487,000
Retained earnings	123,462,000	112,635,000

Item 1.	October 31, 2006	July 31, 2006
	269,676,000	254,427,000
Less:		
Treasury stock (210,937 shares)	(185,000)	(185,000)
Total stockholders equity	269,491,000	254,242,000
Total liabilities and stockholders equity	$ 461,842,000	455,266,000

See accompanying notes to condensed consolidated financial statements.

2

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended October 31,	
	2006	2005
Net sales	$ 97,070,000	106,567,000
Cost of sales	57,695,000	66,363,000
Gross profit	39,375,000	40,204,000
Expenses:		
Selling, general and administrative	16,587,000	16,048,000
Research and development	7,157,000	6,749,000
Amortization of intangibles	649,000	596,000
	24,393,000	23,393,000
Operating income	14,982,000	16,811,000
Other expense (income):		
Interest expense	695,000	674,000
Interest income	(3,175,000)	(1,775,000)
Income before provision for income taxes	17,462,000	17,912,000
Provision for income taxes	6,635,000	6,448,000
Net income	$ 10,827,000	11,464,000
Net income per share:		
Basic	$ 0.47	0.51
Diluted	$ 0.41	0.43
Weighted average number of common shares outstanding basic	22,948,000	22,646,000
Weighted average number of common and common equivalent shares outstanding assuming dilution diluted	27,389,000	27,379,000

See accompanying notes to condensed consolidated financial statements.

3

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months ended October 31,	
	2006	**2005**
Cash flows from operating activities:		
Net income	$ 10,827,000	11,464,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization of property, plant and equipment	1,768,000	1,371,000
Amortization of intangible assets with finite lives	649,000	596,000
Amortization of stock-based compensation	1,810,000	1,296,000
Amortization of deferred financing costs	137,000	137,000
(Gain) loss on disposal of property, plant and equipment	(4,000)	5,000
Provision for allowance for doubtful accounts	27,000	44,000
Provision for excess and obsolete inventory	550,000	469,000
Excess income tax benefit from stock option exercises	(295,000)	(397,000)
Deferred income tax expense (benefit)	460,000	(334,000)
Changes in assets and liabilities, net of effects of acquisition:		
Restricted cash securing letter of credit obligations		31,000
Accounts receivable	720,000	(13,523,000)
Inventories	(11,235,000)	(4,648,000)
Prepaid expenses and other current assets	229,000	(645,000)
Other assets	173,000	(2,000)
Accounts payable	(2,155,000)	5,215,000
Accrued expenses and other current liabilities	(10,798,000)	(2,319,000)
Customer advances and deposits	2,849,000	808,000
Deferred service revenue	(2,536,000)	1,668,000
Interest payable	(525,000)	(525,000)
Income taxes payable	3,720,000	6,493,000
Net cash (used in) provided by operating activities	(3,629,000)	7,204,000
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2,773,000)	(2,913,000)
Purchases of other intangibles with finite lives		(113,000)
Payments for business acquisition	(2,191,000)	
Net cash used in investing activities	(4,964,000)	(3,026,000)
Cash flows from financing activities:		
Principal payments on other obligations	(49,000)	(57,000)
Excess income tax benefit from stock option exercises	295,000	397,000
Proceeds from exercises of stock options	2,140,000	958,000
Proceeds from issuance of employee stock purchase plan shares	180,000	154,000
Net cash provided by financing activities	2,566,000	1,452,000
Net (decrease) increase in cash and cash equivalents	(6,027,000)	5,630,000
Cash and cash equivalents at beginning of period	251,587,000	214,413,000

	Three months ended October 31,	
Cash and cash equivalents at end of period	$ 245,560,000	220,043,000
Supplemental cash flow disclosures:		
Cash paid during the period for:		
Interest	$ 1,083,000	1,062,000
Income taxes	$ 2,455,000	308,000
Noncash investing activities:		
Accrued business acquisition payments (See Note 5)	$ 1,036,000	

See accompanying notes to condensed consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) *General*

The accompanying condensed consolidated financial statements of Comtech Telecommunications Corp. and Subsidiaries (the Company) as of and for the three months ended October 31, 2006 and 2005 are unaudited. In the opinion of management, the information furnished reflects all material adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the unaudited interim periods. The results of operations for such periods are not necessarily indicative of the results of operations to be expected for the full fiscal year. For the three months ended October 31, 2006 and 2005, comprehensive income was equal to net income.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results may differ from those estimates.

These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the fiscal year ended July 31, 2006 and the notes thereto contained in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC), and all of the Company s other filings with the SEC.

(2) *Reclassifications*

Certain reclassifications have been made to previously reported financial statements to conform to the Company s current financial statement format.

(3) *Stock-Based Compensation*

The Company applies the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, which establishes the accounting for employee stock-based awards. Under the provisions of SFAS No. 123(R), stock-based compensation is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period of the grant). The Company used the modified prospective method upon adopting SFAS No. 123(R).

The Company recognized stock-based compensation for awards issued under the Company s Stock Option Plans and the Company s 2001 Employee Stock Purchase Plan (the ESPP) in the following line items in the Condensed Consolidated Statements of Operations:

	Three months ended October 31,	
	2006	**2005**
Cost of sales	$ 140,000	76,000
Selling, general and administrative expenses	1,421,000	1,085,000
Research and development expenses	249,000	135,000
Stock-based compensation expense before income tax benefit	1,810,000	1,296,000
Income tax benefit	(495,000)	(274,000)
Net stock-based compensation expense	$ 1,315,000	1,022,000

5

Of the total stock-based compensation expense before income tax benefit recognized in the three months ended October 31, 2006 and 2005, $42,000 and $39,000, respectively, related to awards issued pursuant to the ESPP. Stock-based compensation that was capitalized and included in ending inventory at October 31, 2006 and July 31, 2006 was $58,000 and $61,000, respectively.

The Company estimates the fair value of stock options using the Black-Scholes option pricing model. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company s stock options granted during the three months ended October 31, 2006 and 2005. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the employees who receive equity awards.

The per share weighted average fair value of stock options granted during the three months ended October 31, 2006 and 2005 was $10.58 and $14.18, respectively. In addition to the exercise and grant date prices of the awards, certain weighted average assumptions that were used to estimate the fair value of stock option grants in the respective periods are listed in the table below:

	Three months ended October 31,	
	2006	**2005**
Expected dividend yield	0%	0%
Expected volatility	45.47%	51.79%
Risk-free interest rate	4.91%	4.11%
Expected term (years)	3.63	3.63

Options granted during the three months ended October 31, 2006 and 2005 had exercise prices equal to the fair market value of the stock on the date of grant, a contractual term of five years and a vesting period of three years. All options granted through July 31, 2005 had exercise prices equal to the fair market value of the stock on the date of grant and a contractual term of ten years and generally a vesting period of five years. As of October 31, 2006, the weighted average estimated forfeiture rate was 8.4%.

The Company estimates expected volatility by considering the historical volatility of the Company s stock, the implied volatility of publicly traded stock options in the Company s stock and the Company s expectations of volatility for the expected term of stock-based compensation awards. The risk-free interest rate is based on the United States (U.S.) treasury yield curve in effect at the time of grant. The expected option term is the number of years that the Company estimates that options will be outstanding prior to exercise. The expected term of the awards issued after July 31, 2005 was determined using the simplified method prescribed in SEC Staff Accounting Bulletin (SAB) No. 107.

The actual income tax benefit recorded relating to the exercise of stock option awards was $295,000 and $397,000 for the three months ended October 31, 2006 and 2005, respectively, and is classified as a financing cash inflow in the Company s Condensed Consolidated Statements of Cash Flows. The Company settles employee stock option exercises with new shares.

At October 31, 2006, total remaining unrecognized compensation cost related to unvested stock-based awards was $16,909,000, net of estimated forfeitures. That cost is expected to be recognized over a weighted average period of 2.4 years.

(4) *Earnings Per Share*

The Company calculates earnings per share (EPS) in accordance with SFAS No. 128, Earnings per Share. Basic EPS is computed based on the weighted average number of shares outstanding. Diluted EPS reflects the dilution from potential common stock issuable pursuant to the exercise of stock options and the conversion of convertible senior notes, if dilutive, outstanding during each period. Stock options to purchase 1,373,000 and 623,000 shares for the three months ended October 31, 2006 and 2005, respectively, were not included in the diluted EPS calculation because their effect would have been anti-dilutive.

In accordance with Emerging Issues Task Force (EITF) Issue No. 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share, the Company includes the impact of the assumed conversion of its 2.0% convertible senior notes in calculating diluted EPS.

The following table reconciles the numerators and denominators used in the basic and diluted EPS calculations:

	Three months ended October 31,	
	2006	2005
Numerator:		
Net income for basic calculation	$ 10,827,000	11,464,000
Effect of dilutive securities:		
Interest expense (net of tax) on convertible senior notes	416,000	423,000
Numerator for diluted calculation	$ 11,243,000	11,887,000
Denominator:		
Denominator for basic calculation	22,948,000	22,646,000
Effect of dilutive securities:		
Stock options	1,108,000	1,400,000
Conversion of convertible senior notes	3,333,000	3,333,000
Denominator for diluted calculation	27,389,000	27,379,000

(5) *Acquisition*

In August 2006, the Company acquired certain assets and assumed certain liabilities of Insite Consulting, Inc. (Insite), a logistics application software company, for $3,227,000, including transaction costs of $256,000. To date, the Company has paid $2,191,000 and expects to make guaranteed payments of $1,036,000 through the first quarter of fiscal 2008. In addition to the guaranteed purchase price, the Company might be required to make certain earn-out payments based on the achievement of future sales targets. The first part of the earn-out cannot exceed $1,350,000 and is limited to a five-year period. The second part of the earn-out, which is for a ten-year period, is unlimited and based on a per unit future sales target primarily relating to new commercial satellite-based mobile data communication markets. Insite has developed the geoOps Enterprise Location Monitoring System, a software-based solution that allows customers to integrate legacy data systems with near-real time logistics and operational data systems. Sales and income relating to the Insite assets acquired would not have been material to the Company s results of operations for the three months ended October 31, 2005 and were not material for the three months ended October 31, 2006. This operation was combined with the Company s existing business and is part of the mobile data communications segment.

The Insite purchase price was allocated as follows:

		Estimated Useful Lives
Fair value of net tangible assets acquired	$ 335,000	
Adjustments to record intangible assets at fair value:		
Existing technology	447,000	7 years
Other intangibles	302,000	1 to 10 years
Goodwill	2,143,000	Indefinite
	2,892,000	

Aggregate purchase price	$	3,227,000

The valuation of existing technology was based primarily on the discounted capitalization of royalty expense saved because the Company now owns the asset. The valuation of other intangibles was primarily based on the value of the discounted cash flows that the related assets could be expected to generate in the future.

(6) *Accounts Receivable*

Accounts receivable consist of the following:

		October 31, 2006	July 31, 2006
Accounts receivable from commercial customers	$	36,228,000	36,700,000
Unbilled receivables on contracts-in-progress		2,154,000	10,361,000
Amounts receivable from the U.S. government and its agencies		32,310,000	24,362,000
		70,692,000	71,423,000
Less allowance for doubtful accounts		1,392,000	1,376,000
Accounts receivable, net	$	69,300,000	70,047,000

There was no retainage included in unbilled receivables at October 31, 2006 or July 31, 2006. In the opinion of management, substantially all of the unbilled balances will be billed and collected within one year. As of October 31, 2006 and July 31, 2006, a prime contractor represented 8.7% and 16.6%, respectively, of accounts receivable, net.

(7) *Inventories*

Inventories consist of the following:

		October 31, 2006	July 31, 2006
Raw materials and components	$	43,703,000	35,835,000
Work-in-process and finished goods		34,071,000	31,331,000
		77,774,000	67,166,000
Less reserve for excess and obsolete inventories		5,728,000	6,123,000
Inventories, net	$	72,046,000	61,043,000

Inventories directly related to long-term contracts were $17,636,000 and $8,349,000 at October 31, 2006 and July 31, 2006, respectively. At October 31, 2006 and July 31, 2006, $3,146,000 and $3,406,000, respectively, of the inventory balance above related to a contract from a third party commercial customer to outsource its manufacturing. The decrease in the reserve relates primarily to the write-off of previously reserved for inventory, offset by a provision for excess and obsolete inventory.

(8) *Accrued Expenses*

Accrued expenses and other current liabilities consist of the following:

		October 31, 2006	July 31, 2006
Accrued wages and benefits	$	9,030,000	17,361,000
Accrued commissions		4,910,000	5,745,000
Accrued warranty		9,479,000	10,468,000
Accrued hurricane related costs (See Note 14)		2,240,000	2,240,000
Accrued business acquisition payments (See Note 5)		1,036,000	

Other		4,773,000	5,416,000
Accrued expenses and other current liabilities	$	31,468,000	41,230,000

The Company provides warranty coverage for most of its products for a period of at least one year from the date of shipment. The Company records a liability for estimated warranty expense based on historical claims, product failure rates and other factors. In the three months ended October 31, 2006, the Company recorded a reduction in its estimated reserve for warranty obligations of $517,000 due to lower than anticipated claims received to date on a large over-the-horizon microwave system contract whose warranty period is nearing expiration. Changes in the Company s product warranty liability during the three months ended October 31, 2006 and 2005 were as follows:

		Three months ended October 31,	
		2006	**2005**
Balance at beginning of period	$	10,468,000	7,910,000
Provision for warranty obligations		1,282,000	1,939,000
Reversal of warranty liability		(517,000)	
Charges incurred		(1,754,000)	(872,000)
Balance at end of period	$	9,479,000	8,977,000

(9) *2.0% Convertible Senior Notes*

On January 27, 2004, the Company issued $105,000,000 of its 2.0% convertible senior notes in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from this transaction were $101,179,000 after deducting the initial purchaser s discount and other transaction costs of $3,821,000.

The notes bear interest at an annual rate of 2.0% and, during certain periods, the notes are convertible into shares of the Company s common stock at an initial conversion price of $31.50 per share (a conversion rate of 31.7460 shares per $1,000 original principal amount of notes), subject to adjustment in certain circumstances. The notes may be converted if, during a conversion period on each of at least 20 trading days, the closing sale price of the Company s common stock exceeds 120% of the conversion price in effect. Upon conversion of the notes, in lieu of delivering common stock, the Company may, in its discretion, deliver cash or a combination of cash and common stock. The Company may, at its option, redeem some or all of the notes on or after February 4, 2009. Holders of the notes will have the right to require the Company to repurchase some or all of the outstanding notes on February 1, 2011, February 1, 2014 and February 1, 2019 and upon certain events, including a change in control. If not redeemed by the Company or repaid pursuant to the holders right to require repurchase, the notes mature on February 1, 2024. The notes have substantive conversion features as defined by EITF No. 05-1, Accounting for the Conversion of an Instrument that Becomes Convertible Upon the Issuer s Exercise of a Call Option. Accordingly, the Company will not recognize a gain or loss if it issues common stock upon the conversion and settlement of these notes.

The 2.0% interest is payable in cash, semi-annually, through February 1, 2011. After such date, the 2.0% interest will be accreted into the principal amount of the notes. Also, commencing with the six-month period beginning February 1, 2009, if the average note price for the applicable trading period equals 120% or more of the accreted principal amount of such notes, the Company will pay contingent interest at an annual rate of 0.25%.

The notes are general unsecured obligations of the Company, ranking equally in right of payment with all of its other existing and future unsecured senior indebtedness and senior in right of payment to any of its future subordinated indebtedness. All of Comtech Telecommunications Corp. s (the Parent) wholly-owned subsidiaries have issued full and unconditional guarantees in favor of the holders of the Company s 2.0% convertible senior notes (the Guarantor Subsidiaries), except for the subsidiary that purchased Memotec, Inc. in fiscal 2004 (the Non-Guarantor Subsidiary). Comtech Tolt Technologies, Inc. (Tolt), which was purchased in February 2005, became a guarantor in July 2005. These full and unconditional guarantees are joint and several. Other than supporting the operations of its subsidiaries, the Parent has no independent assets or operations and there are currently no significant restrictions on its ability, or the ability of the guarantors, to obtain funds from each other by dividend or loan. Consolidating financial information regarding the Parent, the Guarantor Subsidiaries and the Non-Guarantor Subsidiary can be found in Note 16 to the condensed consolidated financial statements.

The net proceeds of the offering are being used for working capital and general corporate purposes and potentially may be used for future acquisitions of businesses or technologies or repurchases of the Company s common stock. The Company filed a registration statement with the SEC, which has become effective, for the resale of the notes and the shares of common stock issuable upon conversion of the notes.

(10) *Stock Option Plans and Employee Stock Purchase Plan*

The Company has stock option and employee stock purchase plans as follows:

1993 Incentive Stock Option Plan The 1993 Incentive Stock Option Plan, as amended, provided for the granting to key employees and officers of incentive and non-qualified stock options to purchase up to 2,345,625 shares of the Company s common stock at prices generally not less than the fair market value at the date of grant with the exception of anyone who, prior to the grant, owns more than 10% of the voting power, in which case the exercise price cannot be less than 110% of the fair market value. In addition, it provided formula grants to non-employee members of the Company s Board of Directors. The term of the options could be no more than ten years. However, for incentive stock options granted to any employee who, prior to the granting of the option, owns stock representing more than 10% of the voting power, the option term could be no more than five years. As of October 31, 2006, the Company had granted stock options representing the right to purchase an aggregate of 2,016,218 shares (net of 428,441 canceled options) at prices ranging between $0.67 - $5.31 per share, of which 151,962 are outstanding at October 31, 2006. To date, 1,864,256 shares have been exercised. Outstanding awards have been transferred to the 2000 Stock Incentive Plan. The terms applicable to these awards prior to the transfer continue to apply. The plan was terminated by the Company s Board of Directors in December 1999 due to the approval by the shareholders of the 2000 Stock Incentive

Plan.

2000 Stock Incentive Plan The 2000 Stock Incentive Plan, as amended, provides for the granting to all employees and consultants of the Company (including prospective employees and consultants) non-qualified stock options, stock appreciation rights, restricted stock, performance shares, performance units and other stock-based awards. In addition, employees of the Company are eligible to be granted incentive stock options. Non-employee directors of the Company are eligible to receive non-discretionary grants of nonqualified stock options subject to certain limitations. The aggregate number of shares of common stock which may be issued may not exceed 5,737,500 plus the shares that were transferred to the Plan relating to outstanding awards that were previously granted, or available for grant, under the 1982 Incentive Stock Option Plan and the 1993 Incentive Stock Option Plan. The Stock Option Committee of the Company s Board of Directors, consistent with the terms of the Plan, will determine the types of awards to be granted, the terms and conditions of each award and the number of shares of common stock to be covered by each award. Grants of incentive and non-qualified stock options may not have a term exceeding ten years or no more than five years in the case of an incentive stock option granted to a stockholder who owns stock representing more than 10% of the voting power. As of October 31, 2006, the Company had granted stock options representing the right to purchase an aggregate of 4,850,185 shares (net of 487,615 canceled options) at prices ranging between $3.13 - $41.51, of which 3,047,120 are outstanding at October 31, 2006. As of October 31, 2006, 1,803,065 stock options have been exercised. All options granted through October 31, 2006 had exercise prices equal to the fair market value of the common stock on the date of grant. All options granted through July 31, 2005 have a term of ten years. All options granted since August 1, 2005 have a term of five years.

The following table summarizes stock option activity during the three months ended October 31, 2006:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at July 31, 2006	2,919,242	$ 15.99	5.9	$ 34,373,000
Granted	645,100	27.00		
Expired/canceled	(138,025)	9.91		
Exercised	(227,235)	9.42		
Outstanding at October 31, 2006	3,199,082	$ 18.94	5.5	$ 53,671,000
Exercisable at October 31, 2006	1,035,282	$ 13.25	5.9	$ 23,223,000
Expected to vest at October 31, 2006	2,091,159	$ 21.67	5.2	$ 29,407,000

The total intrinsic value of stock options exercised during the three months ended October 31, 2006 and 2005 was $5,223,000 and $3,897,000, respectively.

2001 Employee Stock Purchase Plan The ESPP was approved by the shareholders on December 12, 2000 and 675,000 shares of the Company s common stock were reserved for issuance. The ESPP is intended to provide eligible employees of the Company the opportunity to acquire common stock in the Company at 85% of fair market value at date of issuance through participation in the payroll-deduction based ESPP. Through the first quarter of fiscal 2007, the Company issued 242,121 shares of its common stock to participating employees in connection with the ESPP.

(11) *Customer and Geographic Information*

Sales by geography and customer type, as a percentage of consolidated net sales, are as follows:

	Three months ended October 31,	
	2006	**2005**
United States		
U.S. government	56.3%	47.4%
Commercial customers	14.3%	13.7%
Total United States	70.6%	61.1%
International		
North African country	3.7%	15.3%
Other international customers	25.7%	23.6%
Total International	29.4%	38.9%

International sales include sales to U.S. domestic companies for inclusion in products that will be sold to international customers. For the three months ended October 31, 2006, except for sales to the U.S. government, no other customer represented more than 10% of consolidated net sales. For the three months ended October 31, 2005, one customer, a prime contractor, represented 12.5% of consolidated net sales.

(12) *Segment Information*

Reportable operating segments are determined based on the Company s management approach. The management approach, as defined by SFAS No. 131, is based on the way that the chief operating decision-maker organizes the segments within an enterprise for making decisions about resources to be allocated and assessing their performance. While the Company s results of operations are primarily reviewed on a consolidated basis, the chief operating decision-maker also manages the enterprise in three operating segments: (i) telecommunications transmission, (ii) mobile data communications and (iii) RF microwave amplifiers. Telecommunications transmission products include satellite earth station products (such as analog and digital modems, frequency converters, power amplifiers, and voice gateways) and over-the-horizon microwave communications products and systems. Mobile data communications products include satellite-based mobile location, tracking and messaging hardware and related services. RF microwave amplifier products include solid-state, high-power, broadband amplifier products that use the microwave and radio frequency spectrums.

Unallocated expenses result from such corporate expenses as legal, accounting and executive compensation. In addition, for the three months ended October 31, 2006 and 2005, unallocated expenses include $1,810,000 and $1,296,000, respectively, of stock-based compensation expense. Interest expense (which includes amortization of deferred financing costs) associated with the Company s 2.0% convertible senior notes is not allocated to the operating segments. Depreciation and amortization includes amortization of stock-based compensation. Unallocated assets consist principally of cash, deferred financing costs and deferred tax assets. Substantially all of the Company s long-lived assets are located in the U.S.

Corporate management defines and reviews segment profitability based on the same allocation methodology as presented in the segment data tables below.

	Three months ended October 31, 2006	
(in thousands)	**Unallocated**	**Total**

	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers		
Net sales	$ 52,030	35,655	9,385		$ 97,070
Operating income (expense)	12,900	6,109	849	(4,876)	14,982
Interest income	26	5		3,144	3,175
Interest expense	12	22		661	695
Depreciation and amortization	1,690	342	339	1,856	4,227
Expenditure for long-lived assets, including intangibles	2,045	3,286	316	32	5,679
Total assets at October 31, 2006	141,832	39,934	26,711	253,365	461,842

	Three months ended October 31, 2005				
(in thousands)	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers	Unallocated	Total
Net sales	$ 50,884	39,434	16,249		$ 106,567
Operating income (expense)	12,238	4,201	4,208	(3,836)	16,811
Interest income	(31)	(13)		1,819	1,775
Interest expense	11		1	662	674
Depreciation and amortization	1,430	242	270	1,321	3,263
Expenditure for long-lived assets, including intangibles	2,660	234	109	23	3,026
Total assets at October 31, 2005	115,348	38,978	22,096	230,863	407,285

Intersegment sales for the three months ended October 31, 2006 and 2005 by the telecommunications transmission segment to the RF microwave amplifiers segment were $1,841,000 and $845,000, respectively. For the three months ended October 31, 2006 and 2005, intersegment sales by the telecommunications transmission segment to the mobile data communications segment were $17,405,000 and $18,286,000, respectively. Intersegment sales have been eliminated from the tables above.

(13) *Intangible Assets*

Intangible assets with finite lives as of October 31, 2006 and July 31, 2006 are as follows:

	October 31, 2006			
	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Existing technology	7.22	$ 12,903,000	9,943,000	$ 2,960,000
Proprietary, core and licensed technology	8.57	5,145,000	1,723,000	3,422,000
Other	5.32	1,136,000	563,000	573,000
Total		$ 19,184,000	12,229,000	$ 6,955,000

	July 31, 2006			
	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Existing technology	7.23	$ 12,456,000	9,494,000	$ 2,962,000
Proprietary, core and licensed technology	8.57	5,145,000	1,554,000	3,591,000
Other	5.23	834,000	532,000	302,000
Total		$ 18,435,000	11,580,000	$ 6,855,000

Amortization expense for the three months ended October 31, 2006 and 2005 was $649,000 and $596,000, respectively. The estimated amortization expense for the twelve months ending October 31, 2007, 2008, 2009, 2010 and 2011 is $2,230,000, $1,304,000, $1,254,000, $1,121,000 and $843,000, respectively.

The changes in carrying amount of goodwill by segment for the three months ended October 31, 2006 is as follows:

	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers	Total
Balance at July 31, 2006	$ 8,817,000	5,005,000	8,422,000	$ 22,244,000
Acquisition of Insite (See Note 5)		2,143,000		2,143,000
Balance at October 31, 2006	$ 8,817,000	7,148,000	8,422,000	$ 24,387,000

12

(14) *Legal Proceedings*

The Company is subject to certain legal actions, which arise in the normal course of business. Although the ultimate outcome of litigation is difficult to accurately predict, the Company believes that the outcome of these actions will not have a material effect on its consolidated financial position or results of operations.

During fiscal 2005, two of the Company s leased facilities located in Florida experienced hurricane damage to both leasehold improvements and personal property. As of October 31, 2006, the Company has completed all restoration efforts relating to the hurricane damage and has recorded an $816,000 insurance recovery receivable and accrued a total of $2,240,000 for hurricane related costs. Despite a written agreement with the general contractor that the Company believes limits its liability for the cost of the repairs to the amount of insurance proceeds ultimately received from its insurance company, a dispute has arisen with the general contractor and a certain subcontractor over the subcontractor s demand for payment directly from the Company (by virtue of a purported assignment of rights and other grounds) in an amount exceeding the insurance proceeds by $816,000, plus late charges, interest, fees, costs and certain treble damages. As a result of this dispute, the Company deposited $1,422,000, representing the balance of the insurance proceeds it has received, in its attorneys trust account and filed a complaint for declaratory judgment in the 9th Judicial Circuit Court for Orange County, Florida. The general contractor and the subcontractor have filed separate and independent actions against the Company and its insurance company, all of which have now been consolidated under the Company s original action. The Company has also filed a cross-claim against its insurance company. Discovery cutoff was December 1, 2006 and trial has been scheduled for February 13, 2007; however, it is likely that this date will change. The Company does not expect that the outcome of this matter will have a material effect on its consolidated financial position.

(15) *Recent Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157) to clarify the definition of fair value, establish a framework for measuring fair value and expand the disclosures on fair value measurements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). SFAS No. 157 will be effective for the Company s first quarter of fiscal 2009. The Company is currently evaluating the impact SFAS No. 157 will have on its consolidated financial statements.

In September 2006, the SEC issued SAB No. 108 (SAB No. 108) which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB No. 108 must be applied prior to the end of the Company s fiscal year ending July 31, 2007. The Company has commenced the process of evaluating the potential effects of SAB No. 108 on its consolidated financial statements and is not yet in a position to determine what, if any, effect SAB No. 108 will have on its consolidated financial statements.

In July 2006, the FASB released FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting and reporting for uncertainties in income tax law and prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. FIN 48 prescribes a two-step evaluation process for tax positions. The first step is recognition based on a determination of whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step is to measure a tax position that meets the more-likely-than-not threshold. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. FIN 48 is effective beginning in the Company s first quarter of fiscal 2008. The cumulative effects, if any, of applying FIN 48 will be recorded as an adjustment to retained earnings as of the beginning of the period of adoption. The Company has commenced the process of evaluating the potential effects of FIN 48 on its consolidated financial statements and is not yet in a position to determine what, if any, effect FIN 48 will have on its consolidated financial statements.

In June 2006, the EITF reached a consensus on EITF No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (EITF No. 06-3). EITF No. 06-3 provides that taxes imposed by a governmental authority on a revenue producing transaction between a seller and a customer should be shown in the income statement on either a gross or a net basis, based on the entity s accounting policy, which should be disclosed pursuant to Accounting Principles Board (APB) Opinion No. 22, Disclosure of Accounting Policies. The Company early adopted EITF No. 06-3 in the first quarter of fiscal 2007. The Company will continue to present taxes within the scope of EITF No. 06-3 on a net basis. As such, the adoption of EITF No. 06-3 did not have any effect on the Company s consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154), which changes the requirements for the accounting and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principles, as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement to include the cumulative effect of changes in accounting principle in the income statement and instead requires that changes in accounting principle be retroactively applied. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. A correction of an error continues to be reported by restating prior period financial statements. The Company adopted SFAS No. 154 in the Company s first quarter of fiscal 2007, and its adoption did not have any effect on the Company s consolidated financial statements.

(16) *Condensed Consolidating Financial Information*

The consolidating financial information presented below reflects information regarding the Parent, the Guarantor Subsidiaries and the Non-Guarantor Subsidiary of the Company s 2.0% convertible senior notes. Tolt is included in the guarantor column for all periods presented and, in August 2006, its operations were combined with Comtech Mobile Datacom Corporation. In November 2006, Comtech Vipersat, Inc. was merged into Comtech EF Data Corp. The Parent s expenses associated with supporting the operations of its subsidiaries are allocated to the respective Guarantor Subsidiaries and the Non-Guarantor Subsidiary. The consolidating financial information presented herein is not utilized by the chief operating decision-maker in making operating decisions and assessing performance.

The following reflects the condensed consolidating balance sheet as of October 31, 2006:

	Parent	**Guarantor Subsidiaries**	**Non-Guarantor Subsidiary**	**Consolidating Entries**	**Consolidated Total**
Assets					
Current assets:					
Cash and cash equivalents	$ 241,358,000	1,306,000	2,896,000		$ 245,560,000
Restricted cash		1,003,000			1,003,000
Accounts receivable, net		66,156,000	3,144,000		69,300,000
Inventories, net		72,029,000	17,000		72,046,000
Prepaid expenses and other current assets	1,469,000	4,805,000	675,000		6,949,000
Deferred tax asset current	510,000	6,701,000			7,211,000
Total current assets	243,337,000	152,000,000	6,732,000		402,069,000
Property, plant and equipment, net	902,000	24,143,000	710,000		25,755,000
Investment in subsidiaries	200,307,000	5,854,000		(206,161,000)	
Goodwill		23,440,000	947,000		24,387,000
Intangibles with finite lives, net		6,077,000	878,000		6,955,000
Deferred tax asset non-current			174,000	(174,000)	
Deferred financing costs, net	2,312,000				2,312,000
Other assets, net	56,000	287,000	21,000		364,000
Intercompany receivables		56,489,000		(56,489,000)	
Total assets	$ 446,914,000	268,290,000	9,462,000	(262,824,000)	$ 461,842,000
Liabilities and Stockholders Equity					
Current liabilities:					
Accounts payable	$ 348,000	24,602,000	1,232,000		$ 26,182,000
Accrued expenses and other current liabilities	3,184,000	27,567,000	717,000		31,468,000
Customer advances and deposits		6,286,000	107,000		6,393,000
Deferred service revenue		7,360,000			7,360,000
Current installments of other obligations		138,000			138,000
Interest payable	525,000				525,000
Income taxes payable	7,598,000		1,079,000		8,677,000
Total current liabilities	11,655,000	65,953,000	3,135,000		80,743,000
Convertible senior notes	105,000,000				105,000,000
Other obligations, less current installments		210,000			210,000
Deferred tax liability non-current	4,752,000	1,820,000		(174,000)	6,398,000
Intercompany payables	56,016,000		473,000	(56,489,000)	
Total liabilities	177,423,000	67,983,000	3,608,000	(56,663,000)	192,351,000
Commitments and contingencies					
Stockholders equity:					
Preferred stock					
Common stock	2,329,000	4,000		(4,000)	2,329,000
Additional paid-in capital	143,885,000	81,410,000	5,187,000	(86,597,000)	143,885,000

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiary	Consolidating Entries	Consolidated Total
Retained earnings	123,462,000	118,893,000	667,000	(119,560,000)	123,462,000
	269,676,000	200,307,000	5,854,000	(206,161,000)	269,676,000
Less:					
Treasury stock	(185,000)				(185,000)
Total stockholders equity	269,491,000	200,307,000	5,854,000	(206,161,000)	269,491,000
Total liabilities and stockholders equity	$ 446,914,000	268,290,000	9,462,000	(262,824,000)	$ 461,842,000

(16) *Condensed Consolidating Financial Information (continued)*

The following reflects the condensed consolidating balance sheet as of July 31, 2006:

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiary	Consolidating Entries	Consolidated Total
Assets					
Current assets:					
Cash and cash equivalents	$ 238,298,000	9,949,000	3,340,000		$ 251,587,000
Restricted cash		1,003,000			1,003,000
Accounts receivable, net		66,025,000	4,022,000		70,047,000
Inventories, net		61,043,000			61,043,000
Prepaid expenses and other current assets	1,101,000	5,565,000	512,000		7,178,000
Deferred tax asset current	551,000	7,040,000			7,591,000