

COMTECH TELECOMMUNICATIONS CORP /DE/
Form 10-Q
March 08, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended January 31, 2007

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.

Yes 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

Accelerated filer

Non-accelerated filer

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of March 2, 2007, the number of outstanding shares of Common Stock, par value \$.10 per share, of the registrant was 23,152,760 shares.

COMTECH TELECOMMUNICATIONS CORP.
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PART I
FINANCIAL INFORMATION
COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

Item 1.	January 31, 2007	July 31, 2006
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 266,214,000	251,587,000
Restricted cash		1,003,000
Accounts receivable, net	68,700,000	70,047,000
Inventories, net	73,816,000	61,043,000
Prepaid expenses and other current assets	5,676,000	7,178,000
Deferred tax asset - current	8,205,000	7,591,000
	422,611,000	398,449,000
Total current assets		
Property, plant and equipment, net	26,060,000	24,732,000
Goodwill	24,387,000	22,244,000
Intangibles with finite lives, net	6,276,000	6,855,000
Deferred financing costs, net	2,176,000	2,449,000
Other assets, net	431,000	537,000
	481,941,000	455,266,000
Total assets		
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 19,553,000	28,337,000
Accrued expenses and other current liabilities	38,126,000	41,230,000
Customer advances and deposits	9,147,000	3,544,000
Deferred service revenue	4,906,000	9,896,000
Current installments of other obligations	129,000	154,000
Interest payable	1,050,000	1,050,000
Income taxes payable	5,585,000	5,252,000
	78,496,000	89,463,000
Total current liabilities		
Convertible senior notes	105,000,000	105,000,000
Other obligations, less current installments	177,000	243,000
Deferred tax liability - non-current	6,592,000	6,318,000
	190,265,000	201,024,000
Total liabilities		
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 23,348,622 shares and 23,052,593 shares at January 31, 2007 and July 31, 2006, respectively	2,335,000	2,305,000
Additional paid-in capital	147,893,000	139,487,000
Retained earnings	141,633,000	112,635,000

	<u>291,861,000</u>	<u>254,427,000</u>
Less:		
Treasury stock (210,937 shares)	(185,000)	(185,000)
	<u>291,676,000</u>	<u>254,242,000</u>
Total stockholders' equity	291,676,000	254,242,000
	<u>\$ 481,941,000</u>	<u>455,266,000</u>
Total liabilities and stockholders' equity	\$ 481,941,000	455,266,000

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended January 31,		Six months ended January 31,	
	2007	2006	2007	2006
Net sales	\$ 111,383,000	95,741,000	208,453,000	202,308,000
Cost of sales	61,533,000	54,650,000	119,228,000	121,013,000
Gross profit	49,850,000	41,091,000	89,225,000	81,295,000
Expenses:				
Selling, general and administrative	18,257,000	15,809,000	34,844,000	31,857,000
Research and development	7,616,000	6,007,000	14,773,000	12,756,000
Amortization of intangibles	679,000	603,000	1,328,000	1,199,000
	26,552,000	22,419,000	50,945,000	45,812,000
Operating income	23,298,000	18,672,000	38,280,000	35,483,000
Other expense (income):				
Interest expense	672,000	672,000	1,367,000	1,346,000
Interest income	(3,315,000)	(2,172,000)	(6,490,000)	(3,947,000)
Income before provision for income taxes	25,941,000	20,172,000	43,403,000	38,084,000
Provision for income taxes	7,770,000	6,868,000	14,405,000	13,316,000
Net income	\$ 18,171,000	13,304,000	28,998,000	24,768,000
Net income per share:				
Basic	\$ 0.79	0.59	1.26	1.09
Diluted	\$ 0.68	0.50	1.09	0.94
Weighted average number of common shares outstanding basic	23,095,000	22,741,000	23,022,000	22,694,000
Weighted average number of common and common equivalent shares outstanding assuming dilution diluted	27,491,000	27,354,000	27,440,000	27,367,000

See accompanying notes to condensed consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six months ended January 31,	
	2007	2006
	<hr/>	<hr/>
Cash flows from operating activities:		
Net income	\$ 28,998,000	24,768,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	3,558,000	2,875,000
Amortization of intangible assets with finite lives	1,328,000	1,199,000
Amortization of stock-based compensation	3,347,000	2,834,000
Amortization of deferred financing costs	273,000	273,000
(Gain) loss on disposal of property, plant and equipment	(2,000)	16,000
Provision for allowance for doubtful accounts	18,000	99,000
Provision for excess and obsolete inventory	1,549,000	987,000
Excess income tax benefit from stock option exercises	(1,855,000)	(1,154,000)
Deferred income tax (benefit) expense	(340,000)	650,000
Changes in assets and liabilities, net of effects of acquisition:		
Restricted cash securing letter of credit obligations	1,003,000	31,000
Accounts receivable	1,329,000	(20,036,000)
Inventories	(14,004,000)	(9,743,000)
Prepaid expenses and other current assets	1,502,000	(1,459,000)
Other assets	106,000	(38,000)
Accounts payable	(8,784,000)	(1,626,000)
Accrued expenses and other current liabilities	(3,717,000)	1,493,000
Customer advances and deposits	5,603,000	(189,000)
Deferred service revenue	(4,990,000)	2,035,000
Income taxes payable	2,292,000	3,310,000
	<hr/>	<hr/>
Net cash provided by operating activities	17,214,000	6,325,000
	<hr/>	<hr/>
Cash flows from investing activities:		
Purchases of property, plant and equipment	(4,870,000)	(4,643,000)
Purchases of other intangibles with finite lives		(197,000)
Payments for business acquisition	(2,614,000)	
	<hr/>	<hr/>
Net cash used in investing activities	(7,484,000)	(4,840,000)
	<hr/>	<hr/>
Cash flows from financing activities:		
Principal payments on other obligations	(91,000)	(115,000)
Excess income tax benefit from stock option exercises	1,855,000	1,154,000
Proceeds from exercises of stock options	2,770,000	1,425,000
Proceeds from issuance of employee stock purchase plan shares	363,000	315,000
	<hr/>	<hr/>
Net cash provided by financing activities	4,897,000	2,779,000
	<hr/>	<hr/>
Net increase in cash and cash equivalents	14,627,000	4,264,000
Cash and cash equivalents at beginning of period	251,587,000	214,413,000
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 266,214,000	218,677,000

Supplemental cash flow disclosures:

Cash paid during the period for:

Interest	\$ 1,073,000	1,073,000
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Income taxes	\$ 12,055,000	9,447,000
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Noncash investing activities:

Accrued business acquisition payments (See Note 5)	\$ 613,000	
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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 and six months ended January 31, 2007 and 2006 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 and six months ended January 31, 2007 and 2006, 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 January 31,		Six months ended January 31,	
	2007	2006	2007	2006
Cost of sales	\$ 122,000	105,000	262,000	181,000
Selling, general and administrative expenses	1,188,000	1,238,000	2,609,000	2,323,000
Research and development expenses	227,000	195,000	476,000	330,000
Stock-based compensation expense before income tax benefit	1,537,000	1,538,000	3,347,000	2,834,000
Income tax benefit	(579,000)	(351,000)	(1,074,000)	(625,000)
Net stock-based compensation expense	\$ 958,000	1,187,000	2,273,000	2,209,000

Of the total stock-based compensation expense before income tax benefit recognized in the three months ended January 31, 2007 and 2006, \$41,000 and \$99,000, respectively, related to awards issued pursuant to the ESPP. Of the total stock-based compensation expense before income tax benefit recognized in the six months ended January 31, 2007 and 2006, \$83,000 and \$138,000, respectively, related to awards issued pursuant to the ESPP. Stock-based compensation that was capitalized and included in ending inventory at January 31, 2007 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 and six months ended January 31, 2007 and 2006. 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 January 31, 2007 and 2006 was \$13.79 and \$15.79, respectively. The per share weighted average fair value of stock options granted during the six months ended January 31, 2007 and 2006 was \$10.68 and \$14.23, 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 January 31,		Six months ended January 31,	
	2007	2006	2007	2006
Expected dividend yield	0%	0%	0%	0%
Expected volatility	45.47%	50.90%	45.47%	51.76%
Risk-free interest rate	4.48%	4.43%	4.89%	4.12%
Expected term (years)	3.63	3.63	3.63	3.63

Options granted during the three and six months ended January 31, 2007 and 2006 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, a contractual term of ten years and generally a vesting period of five years.

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 \$1,959,000 and \$1,154,000 for the six months ended January 31, 2007 and 2006, respectively. Of these amounts, \$1,855,000 and \$1,154,000, respectively, represents excess income tax benefits and has been classified as a financing cash inflow in the Company's Condensed Consolidated Statements of Cash Flows for the six months ended January 31, 2007 and 2006, respectively. The Company settles employee stock option exercises with new shares.

At January 31, 2007, total remaining unrecognized compensation cost related to unvested stock-based awards was \$14,895,000, net of estimated forfeitures of \$1,498,000. The net cost is expected to be recognized over a weighted average period of 2.2 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 697,000 and 702,000 shares for the three months ended January 31, 2007 and 2006, respectively, were not included in the EPS calculation because their effect would have been anti-dilutive. Stock options to purchase 1,035,000 and 663,000 shares for the six months ended January 31, 2007 and 2006, respectively, were not included in the 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 January 31,		Six months ended January 31,	
	2007	2006	2007	2006
Numerator:				
Net income for basic calculation	\$ 18,171,000	13,304,000	28,998,000	24,768,000
Effect of dilutive securities:				
Interest expense (net of tax) on convertible senior notes	417,000	408,000	833,000	831,000
Numerator for diluted calculation	\$ 18,588,000	13,712,000	29,831,000	25,599,000
Denominator:				
Denominator for basic calculation	23,095,000	22,741,000	23,022,000	22,694,000
Effect of dilutive securities:				
Stock options	1,063,000	1,280,000	1,085,000	1,340,000
Conversion of convertible senior notes	3,333,000	3,333,000	3,333,000	3,333,000
Denominator for diluted calculation	27,491,000	27,354,000	27,440,000	27,367,000

(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 \$2,614,000 and expects to make guaranteed payments of \$613,000 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 and six months ended January 31, 2006 and were not material for the three and six months ended January 31, 2007. 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:

		<u>Estimated Useful Lives</u>
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
	<u>2,892,000</u>	
Aggregate purchase price	<u>\$ 3,227,000</u>	

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:

	<u>January 31, 2007</u>	<u>July 31, 2006</u>
Accounts receivable from commercial customers	\$ 37,888,000	36,700,000
Unbilled receivables on contracts-in-progress	1,667,000	10,361,000
Amounts receivable from the U.S. government and its agencies	30,118,000	24,362,000
	<u>69,673,000</u>	<u>71,423,000</u>
Less allowance for doubtful accounts	973,000	1,376,000
Accounts receivable, net	<u>\$ 68,700,000</u>	<u>70,047,000</u>

There was no retainage included in unbilled receivables at January 31, 2007 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 January 31, 2007 and July 31, 2006, a prime contractor represented 7.2% and 16.6%, respectively, of accounts receivable, net.

(7) Inventories

Inventories consist of the following:

	<u>January 31, 2007</u>	<u>July 31, 2006</u>
Raw materials and components	\$ 42,582,000	35,835,000
Work-in-process and finished goods	37,837,000	31,331,000
	<u>80,419,000</u>	<u>67,166,000</u>
Less reserve for excess and obsolete inventories	6,603,000	6,123,000

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Inventories, net	\$	73,816,000	61,043,000
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Inventories directly related to long-term contracts were \$18,147,000 and \$8,349,000 at January 31, 2007 and July 31, 2006, respectively. At January 31, 2007 and July 31, 2006, \$4,124,000 and \$3,406,000, respectively, of the inventory balance above related to a contract from a third party commercial customer to outsource its manufacturing.

(8) Accrued Expenses

Accrued expenses and other current liabilities consist of the following:

	<u>January 31, 2007</u>	<u>July 31, 2006</u>
Accrued wages and benefits	\$ 12,824,000	17,361,000
Accrued commissions	4,897,000	5,745,000
Accrued warranty	10,564,000	10,468,000
Accrued hurricane related costs (See Note 14)	2,240,000	2,240,000
Accrued business acquisition payments (See Note 5)	613,000	
Other	6,988,000	5,416,000
	<u> </u>	<u> </u>
Accrued expenses and other current liabilities	\$ 38,126,000	41,230,000
	<u> </u>	<u> </u>

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 six months ended January 31, 2007, the Company recorded a reduction in its estimated reserve for warranty obligations of \$667,000 primarily 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 six months ended January 31, 2007 and 2006 were as follows:

	<u>Six months ended January 31,</u>	
	<u>2007</u>	<u>2006</u>
Balance at beginning of period	\$ 10,468,000	7,910,000
Provision for warranty obligations	3,549,000	4,735,000
Reversal of warranty liability	(667,000)	
Charges incurred	(2,786,000)	(1,828,000)
	<u> </u>	<u> </u>
Balance at end of period	\$ 10,564,000	10,817,000
	<u> </u>	<u> </u>

(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

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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). 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 January 31, 2007, 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 January 31, 2007. 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 non-qualified 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 January 31, 2007, the Company had granted stock options representing the right to purchase an aggregate of 4,818,760 shares (net of 540,540 canceled options) at prices ranging between \$3.13 - \$41.51, of which 2,960,645 are outstanding at January 31, 2007. As of January 31, 2007, 1,858,115 stock options have been exercised. All options granted through January 31, 2007 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 certain stock option activity during the three and six months ended January 31, 2007:

	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
Granted	21,500	35.67		
Expired/canceled	(52,925)	27.06		
Exercised	(55,050)	11.45		
Outstanding at January 31, 2007	3,112,607	\$ 19.05	5.2	\$ 52,834,000
Exercisable at January 31, 2007	1,002,232	\$ 13.40	5.7	\$ 22,664,000
Expected to vest at January 31, 2007	2,018,480	\$ 21.68	4.9	\$ 28,943,000

The total intrinsic value of stock options exercised during the three months ended January 31, 2007 and 2006 was \$1,454,000 and \$1,869,000, respectively. The total intrinsic value of stock options exercised during the six months ended January 31, 2007 and 2006 was \$6,677,000 and \$5,766,000, 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 the date of issuance through participation in the payroll-deduction based ESPP. Through the second quarter of fiscal 2007, the Company issued 248,595 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 January 31,		Six months ended January 31,	
	2007	2006	2007	2006
<u>United States</u>				
U.S. government	58.5%	47.5%	57.5%	47.4%
Commercial customers	12.9%	15.3%	13.5%	14.5%
Total United States	71.4%	62.8%	71.0%	61.9%

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<u>International</u>				
North African country	4.6%	10.8%	4.2%	13.2%
Other international customers	24.0%	26.4%	24.8%	24.9%
Total International	28.6%	37.2%	29.0%	38.1%

International sales include sales to U.S. domestic companies for inclusion in products that will be sold to international customers. For the three and six months ended January 31, 2007, except for sales to the U.S. government, no other customer represented more than 10% of consolidated net sales. For the three and six months ended January 31, 2006, one customer, a prime contractor, represented 12.0% and 12.1%, respectively, 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 and six months ended January 31, 2007, unallocated expenses include \$1,537,000 and \$3,347,000, respectively, of stock-based compensation expense and for the three and six months ended January 31, 2006, unallocated expenses include \$1,538,000 and \$2,834,000, 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 January 31, 2007

(in thousands)	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers	Unallocated	Total
Net sales	\$ 62,569	39,728	9,086		\$ 111,383
Operating income (expense)	19,439	8,200	817	(5,158)	23,298
Interest income	23	7		3,285	3,315
Interest expense	9	2		661	672
Depreciation and amortization	1,718	353	352	1,583	4,006
Expenditure for long-lived assets, including intangibles	1,344	569	173	11	2,097
Total assets at January 31, 2007	138,273	39,914	29,750	274,004	481,941

Three months ended January 31, 2006

(in thousands)	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers	Unallocated	Total
Net sales	\$ 49,029	36,209	10,503		\$ 95,741
Operating income (expense)	13,032	7,648	2,069	(4,077)	18,672
Interest income	(7)	4		2,175	2,172
Interest expense	9		2	661	672
Depreciation and amortization	1,498	262	320	1,565	3,645
Expenditure for long-lived assets, including intangibles	1,315	126	355	18	1,814
Total assets at January 31, 2006	124,386	39,504	22,095	231,334	417,319

Six months ended January 31, 2007

(in thousands)	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers	Unallocated	Total
Net sales	\$ 114,599	75,383	18,471		\$ 208,453
Operating income (expense)	32,339	14,309	1,666	(10,034)	38,280
Interest income	49	12		6,429	6,490
Interest expense	21	24		1,322	1,367
Depreciation and amortization	3,408	695	691	3,439	8,233
Expenditure for long-lived assets, including intangibles	3,389	3,855	489	43	7,776
Total assets at January 31, 2007	138,273	39,914	29,750	274,004	481,941

Six months ended January 31, 2006

(in thousands)	Telecommunications Transmission	Mobile Data Communications	RF Microwave Amplifiers	Unallocated	Total
Net sales	\$ 99,913	75,643	26,752		\$ 202,308
Operating income (expense)	25,270	11,849	6,277	(7,913)	35,483
Interest income	(38)	(9)		3,994	3,947
Interest expense	20		3	1,323	1,346
Depreciation and amortization	2,928	504	590	2,886	6,908
Expenditure for long-lived assets, including intangibles	3,975	360	464	41	4,840
Total assets at January 31, 2006	124,386	39,504	22,095	231,334	417,319

Intersegment sales for the three months ended January 31, 2007 and 2006 by the telecommunications transmission segment to the RF microwave amplifiers segment were \$1,727,000 and \$2,462,000, respectively. Intersegment sales for the six months ended January 31, 2007 and 2006 by the telecommunications transmission segment to the RF microwave amplifiers segment were \$3,568,000 and \$3,307,000, respectively. For the three months ended January 31, 2007 and 2006, intersegment sales by the telecommunications transmission segment to the mobile data communications segment were \$16,331,000 and \$10,115,000, respectively. For the six months ended January 31, 2007 and 2006, intersegment sales by the telecommunications transmission segment to the mobile data communications segment were \$33,736,000 and \$28,401,000, respectively. Intersegment sales have been eliminated from the tables above.

(13) Intangible Assets

Intangible assets with finite lives as of January 31, 2007 and July 31, 2006 are as follows:

January 31, 2007				
	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Existing technology	7.22	\$ 12,903,000	10,396,000	\$ 2,507,000
Proprietary, core and licensed technology	8.57	5,145,000	1,910,000	3,235,000
Other	5.61	975,000	441,000	534,000
Total		\$ 19,023,000	12,747,000	\$ 6,276,000

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 January 31, 2007 and 2006 was \$679,000 and \$603,000, respectively. Amortization expense for the six months ended January 31, 2007 and 2006 was \$1,328,000 and \$1,199,000, respectively. The estimated amortization expense for the twelve months ending January 31, 2008, 2009, 2010, 2011 and 2012 is \$1,877,000, \$1,303,000, \$1,231,000, \$1,082,000 and \$623,000, respectively.

The changes in carrying amount of goodwill by segment for the six months ended January 31, 2007 are 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 January 31, 2007	\$ 8,817,000	7,148,000	8,422,000	\$ 24,387,000

(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 January 31, 2007, 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. The original trial date of February 13, 2007 has been postponed, and no new trial date has been scheduled. 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

On February 15, 2007, the FASB released SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159) to provide companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective as of the beginning of our fiscal 2009. Early adoption is permitted. The Company is not yet in a position to determine what, if any, effects SFAS No. 159 will have on its consolidated financial statements.

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.

(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. Comtech Tolt Technologies, Inc. (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 January 31, 2007:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 261,236,000	2,664,000	2,314,000		\$ 266,214,000
Accounts receivable, net		67,180,000	1,520,000		68,700,000
Inventories, net		73,816,000			73,816,000
Prepaid expenses and other current assets	1,407,000	3,963,000	306,000		5,676,000
Deferred tax asset - current	598,000	7,607,000			8,205,000
Total current assets	263,241,000	155,230,000	4,140,000		422,611,000
Property, plant and equipment, net	867,000	24,522,000	671,000		26,060,000
Investment in subsidiaries	216,826,000	5,452,000		(222,278,000)	
Goodwill		23,440,000	947,000		24,387,000
Intangibles with finite lives, net		5,442,000	834,000		6,276,000
Deferred tax asset - non-current			174,000	(174,000)	
Deferred financing costs, net	2,176,000				2,176,000
Other assets, net	56,000	354,000	21,000		431,000
Intercompany receivables		69,778,000		(69,778,000)	
Total assets	\$ 483,166,000	284,218,000	6,787,000	(292,230,000)	\$ 481,941,000
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable	\$ 692,000	18,609,000	252,000		\$ 19,553,000
Accrued expenses and other current liabilities	5,015,000	32,613,000	498,000		38,126,000
Customer advances and deposits		9,104,000	43,000		9,147,000
Deferred service revenue		4,906,000			4,906,000
Current installments of other obligations		129,000			129,000
Interest payable	1,050,000				1,050,000
Income taxes payable	5,560,000		25,000		5,585,000
Total current liabilities	12,317,000	65,361,000	818,000		78,496,000
Convertible senior notes	105,000,000				105,000,000
Other obligations, less current installments		177,000			177,000
Deferred tax liability - non-current	4,912,000	1,854,000		(174,000)	6,592,000
Intercompany payables	69,261,000		517,000	(69,778,000)	
Total liabilities	191,490,000	67,392,000	1,335,000	(69,952,000)	190,265,000
Commitments and contingencies					
Stockholders' equity:					
Preferred stock					
Common stock	2,335,000	4,000		(4,000)	2,335,000

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Additional paid-in capital	147,893,000	81,410,000	5,187,000	(86,597,000)	147,893,000
Retained earnings	141,633,000	135,412,000	265,000	(135,677,000)	141,633,000
	<u>291,861,000</u>	<u>216,826,000</u>	<u>5,452,000</u>	<u>(222,278,000)</u>	<u>291,861,000</u>
Less:					
Treasury stock	(185,000)				(185,000)
	<u>291,676,000</u>	<u>216,826,000</u>	<u>5,452,000</u>	<u>(222,278,000)</u>	<u>291,676,000</u>
Total stockholders' equity					
Total liabilities and stockholders' equity	\$ 483,166,000	284,218,000	6,787,000	(292,230,000)	\$ 481,941,000
	<u>\$ 483,166,000</u>	<u>284,218,000</u>	<u>6,787,000</u>	<u>(292,230,000)</u>	<u>\$ 481,941,000</u>

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

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
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
Total current assets	239,950,000	150,625,000	7,874,000		398,449,000
Property, plant and equipment, net	914,000	23,295,000	523,000		24,732,000
Investment in subsidiaries	191,046,000	5,496,000		(196,542,000)	
Goodwill		21,297,000	947,000		22,244,000
Intangibles with finite lives, net		5,933,000	922,000		6,855,000
Deferred tax asset - non-current			174,000	(174,000)	
Deferred financing costs, net	2,449,000				2,449,000
Other assets, net	56,000	459,000	22,000		537,000
Intercompany receivables		59,824,000		(59,824,000)	
Total assets	\$ 434,415,000	266,929,000	10,462,000	(256,540,000)	\$ 455,266,000
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable	\$ 390,000	27,497,000	450,000		\$ 28,337,000
Accrued expenses and other current liabilities	6,683,000	32,806,000	1,741,000		41,230,000
Customer advances and deposits		3,502,000	42,000		3,544,000
Deferred service revenue		9,896,000			9,896,000
Current installments of other obligations		154,000			154,000
Interest payable	1,050,000				1,050,000
Income taxes payable	4,428,000		824,000		5,252,000
Total current liabilities	12,551,000	73,855,000	3,057,000		89,463,000
Convertible senior notes	105,000,000				105,000,000
Other obligations, less current installments		243,000			243,000
Deferred tax liability - non-current	4,707,000	1,785,000		(174,000)	6,318,000
Intercompany payables	57,915,000		1,908,000	(59,823,000)	
Total liabilities	180,173,000	75,883,000	4,965,000	(59,997,000)	201,024,000
Commitments and contingencies					
Stockholders' equity:					
Preferred stock					
Common stock	2,305,000	4,000		(4,000)	2,305,000
Additional paid-in capital	139,487,000	81,410,000	5,187,000	(86,597,000)	139,487,000
Retained earnings	112,635,000	109,632,000	310,000	(109,942,000)	112,635,000
	254,427,000	191,046,000	5,497,000	(196,543,000)	254,427,000
Less:					
Treasury stock	(185,000)				(185,000)
Total stockholders' equity	254,242,000	191,046,000	5,497,000	(196,543,000)	254,242,000

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Total liabilities and stockholders' equity	\$ 434,415,000	266,929,000	10,462,000	(256,540,000)	\$ 455,266,000
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The following reflects the condensed consolidating statement of operations for the three months ended January 31, 2007:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Net sales	\$	109,833,000	1,630,000	(80,000)	\$ 111,383,000
Cost of sales		60,659,000	954,000	(80,000)	61,533,000
Gross profit		49,174,000	676,000		49,850,000
Expenses:					
Selling, general and administrative		17,506,000	751,000		18,257,000
Research and development		7,147,000	469,000		7,616,000
Amortization of intangibles		635,000	44,000		679,000
		25,288,000	1,264,000		26,552,000
Operating income (loss)		23,886,000	(588,000)		23,298,000
Other expense (income):					
Interest expense	662,000	10,000			672,000
Interest income and other	(3,284,000)	(19,000)	(12,000)		(3,315,000)
Income (loss) before income taxes and equity in undistributed earnings (loss) of subsidiaries	2,622,000	23,895,000	(576,000)		25,941,000
Provision for (benefit from) income taxes	970,000	6,974,000	(174,000)		7,770,000
Net earnings (loss) before equity in undistributed earnings (loss) of subsidiaries	1,652,000	16,921,000	(402,000)		18,171,000
Equity in undistributed earnings (loss) of subsidiaries	16,519,000	(402,000)		(16,117,000)	
Net income (loss)	\$ 18,171,000	16,519,000	(402,000)	(16,117,000)	\$ 18,171,000

The following reflects the condensed consolidating statement of operations for the three months ended January 31, 2006:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Net sales	\$	94,086,000	1,722,000	(67,000)	\$ 95,741,000
Cost of sales		53,884,000	833,000	(67,000)	54,650,000
Gross profit		40,202,000	889,000		41,091,000
Expenses:					
Selling, general and administrative		15,027,000	782,000		15,809,000
Research and development		5,630,000	377,000		6,007,000
Amortization of intangibles		559,000	44,000		603,000

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		21,216,000	1,203,000		22,419,000
		<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating income (loss)		18,986,000	(314,000)		18,672,000
Other expense (income):					
Interest expense	661,000	11,000			672,000
Interest income and other	(2,175,000)	3,000			(2,172,000)
		<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income (loss) before income taxes and equity in undistributed earnings (loss) of subsidiaries	1,514,000	18,972,000	(314,000)		20,172,000
Provision for (benefit from) income taxes	563,000	6,403,000	(98,000)		6,868,000
		<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net earnings (loss) before equity in undistributed earnings (loss) of subsidiaries	951,000	12,569,000	(216,000)		13,304,000
Equity in undistributed earnings (loss) of subsidiaries	12,353,000	(216,000)		(12,137,000)	
		<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income (loss)	\$ 13,304,000	12,353,000	(216,000)	(12,137,000)	\$ 13,304,000
		<u> </u>	<u> </u>	<u> </u>	<u> </u>

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The following reflects the condensed consolidating statement of operations for the six months ended January 31, 2007:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Net sales	\$	203,133,000	5,555,000	(235,000)	\$ 208,453,000
Cost of sales		116,575,000	2,888,000	(235,000)	119,228,000
Gross profit		86,558,000	2,667,000		89,225,000
Expenses:					
Selling, general and administrative		33,054,000	1,790,000		34,844,000
Research and development		13,889,000	884,000		14,773,000
Amortization of intangibles		1,240,000	88,000		1,328,000
		48,183,000	2,762,000		50,945,000
Operating income (loss)		38,375,000	(95,000)		38,280,000
Other expense (income):					
Interest expense	1,323,000	44,000			1,367,000
Interest income and other	(6,429,000)	(37,000)	(24,000)		(6,490,000)
Income (loss) before income taxes and equity in undistributed earnings (loss) of subsidiaries	5,106,000	38,368,000	(71,000)		43,403,000
Provision for (benefit from) income taxes	1,889,000	12,543,000	(27,000)		14,405,000
Net earnings (loss) before equity in undistributed earnings (loss) of subsidiaries	3,217,000	25,825,000	(44,000)		28,998,000
Equity in undistributed earnings (loss) of subsidiaries	25,781,000	(44,000)		(25,737,000)	
Net income (loss)	\$ 28,998,000	25,781,000	(44,000)	(25,737,000)	\$ 28,998,000

The following reflects the condensed consolidating statement of operations for the six months ended January 31, 2006:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Net sales	\$	199,145,000	3,273,000	(110,000)	\$ 202,308,000
Cost of sales		119,686,000	1,437,000	(110,000)	121,013,000
Gross profit		79,459,000	1,836,000		81,295,000
Expenses:					
Selling, general and administrative		30,364,000	1,493,000		31,857,000
Research and development		12,090,000	666,000		12,756,000
Amortization of intangibles		1,111,000	88,000		1,199,000

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		43,565,000	2,247,000		45,812,000
		<u> </u>	<u> </u>		<u> </u>
Operating income (loss)		35,894,000	(411,000)		35,483,000
Other expense (income):					
Interest expense	1,323,000	23,000			1,346,000
Interest income and other	(3,995,000)	31,000	17,000		(3,947,000)
		<u> </u>	<u> </u>		<u> </u>
Income (loss) before income taxes and equity in undistributed earnings (loss) of subsidiaries	2,672,000	35,840,000	(428,000)		38,084,000
Provision for (benefit from) income taxes	994,000	12,457,000	(135,000)		13,316,000
		<u> </u>	<u> </u>		<u> </u>
Net earnings (loss) before equity in undistributed earnings (loss) of subsidiaries	1,678,000	23,383,000	(293,000)		24,768,000
Equity in undistributed earnings (loss) of subsidiaries	23,090,000	(293,000)		(22,797,000)	
		<u> </u>	<u> </u>		<u> </u>
Net income (loss)	\$ 24,768,000	23,090,000	(293,000)	(22,797,000)	\$ 24,768,000
		<u> </u>	<u> </u>		<u> </u>

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The following reflects the condensed consolidating statement of cash flows for the six months ended January 31, 2007:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Cash flows from operating activities:					
Net income (loss)	\$ 28,998,000	25,781,000	(44,000)	(25,737,000)	\$ 28,998,000
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization of property, plant and equipment	92,000	3,362,000	104,000		3,558,000
Amortization of intangible assets with finite lives		1,240,000	88,000		1,328,000
Amortization of stock-based compensation	1,328,000	2,017,000	2,000		3,347,000
Amortization of deferred financing costs	273,000				273,000
Gain on disposal of property, plant and equipment		(3,000)	1,000		(2,000)
Provision for allowance for doubtful accounts		144,000	(126,000)		18,000
Provision for excess and obsolete inventory		1,570,000	(21,000)		1,549,000
Excess income tax benefit from stock option exercises	(1,855,000)				(1,855,000)
Deferred income tax expense (benefit)	158,000	(498,000)			(340,000)
Equity in undistributed (earnings) loss of subsidiaries	(25,781,000)	44,000		25,737,000	
Intercompany accounts	13,362,000	(11,969,000)	(1,393,000)		
Changes in assets and liabilities, net of effects of acquisition:					
Restricted cash securing letter of credit obligations		1,003,000			1,003,000
Accounts receivable		(1,299,000)	2,628,000		1,329,000
Inventories		(14,025,000)	21,000		(14,004,000)
Prepaid expenses and other current assets	(306,000)	1,602,000	206,000		1,502,000
Other assets		105,000	1,000		106,000
Accounts payable	302,000	(8,888,000)	(198,000)		(8,784,000)
Accrued expenses and other current liabilities	(1,668,000)	(806,000)	(1,243,000)		(3,717,000)
Customer advances and deposits		5,602,000	1,000		5,603,000
Deferred service revenue		(4,990,000)			(4,990,000)
Income taxes payable	3,092,000		(800,000)		2,292,000
Net cash provided by (used in) operating activities	17,995,000	(8,000)	(773,000)		17,214,000
Cash flows from investing activities:					
Purchases of property, plant and equipment	(45,000)	(4,572,000)	(253,000)		(4,870,000)
Payments for business acquisition		(2,614,000)			(2,614,000)
Net cash used in investing activities	(45,000)	(7,186,000)	(253,000)		(7,484,000)
Cash flows from financing activities:					
Principal payments on other obligations		(91,000)			(91,000)
Excess income tax benefit from stock option exercises	1,855,000				1,855,000
Proceeds from exercises of stock options	2,770,000				2,770,000
Proceeds from issuance of employee stock purchase plan shares	363,000				363,000
Net cash provided by (used in) financing activities	4,988,000	(91,000)			4,897,000

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Net increase (decrease) in cash and cash equivalents	22,938,000	(7,285,000)	(1,026,000)	14,627,000
Cash and cash equivalents at beginning of period	238,298,000	9,949,000	3,340,000	251,587,000
Cash and cash equivalents at end of period	\$ 261,236,000	2,664,000	2,314,000	\$ 266,214,000

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The following reflects the condensed consolidating statement of cash flows for the six months ended January 31, 2006:

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiary</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
Cash flows from operating activities:					
Net income (loss)	\$ 24,768,000	23,090,000	(293,000)	(22,797,000)	\$ 24,768,000
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization of property, plant and equipment					
	52,000	2,771,000	52,000		2,875,000
Amortization of intangible assets with finite lives					
		1,111,000	88,000		1,199,000
Amortization of stock-based compensation					
	1,054,000	1,780,000			2,834,000
Amortization of deferred financing costs					
	273,000				273,000
Loss on disposal of property, plant and equipment					
		16,000			16,000
Provision for allowance for doubtful accounts					
		99,000			99,000
Provision for excess and obsolete inventory					
		958,000	29,000		987,000
Excess income tax benefit from stock option exercises					
	(1,154,000)				(1,154,000)
Deferred income tax expense					
	640,000	10,000			650,000
Equity in undistributed (earnings) loss of subsidiaries					
	(23,090,000)	293,000		22,797,000	
Intercompany accounts					
	(1,189,000)	340,000	849,000		
Changes in assets and liabilities:					
Restricted cash securing letter of credit obligations					
	31,000				31,000
Accounts receivable					
		(19,450,000)	(586,000)		(20,036,000)
Inventories					
		(9,714,000)	(29,000)		(9,743,000)
Prepaid expenses and other current assets					
	157,000	(1,390,000)	(226,000)		(1,459,000)
Other assets					
		(36,000)	(2,000)		(38,000)
Accounts payable					
	(75,000)	(1,521,000)	(30,000)		(1,626,000)
Accrued expenses and other current liabilities					
	(899,000)	2,474,000	(82,000)		1,493,000
Customer advances and deposits					
		(335,000)	146,000		(189,000)
Deferred service revenue					
		2,035,000			2,035,000
Income taxes payable					
	3,310,000				3,310,000
Net cash provided by (used in) operating activities					
	<u>3,878,000</u>	<u>2,531,000</u>	<u>(84,000)</u>		<u>6,325,000</u>
Cash flows from investing activities:					
Purchases of property, plant and equipment					
	(42,000)	(4,569,000)	(32,000)		(4,643,000)
Purchase of other intangibles with finite lives					
		(197,000)			(197,000)
Net cash used in investing activities					
	<u>(42,000)</u>	<u>(4,766,000)</u>	<u>(32,000)</u>		<u>(4,840,000)</u>
Cash flows from financing activities:					
Principal payments on other obligations					
		(115,000)			(115,000)
Excess income tax benefit from stock option exercises					
	1,154,000				1,154,000
Proceeds from exercises of stock options					
	1,425,000				1,425,000
Proceeds from issuance of employee stock purchase plan shares					
	315,000				315,000
Net cash provided by (used in) financing activities					
	<u>2,894,000</u>	<u>(115,000)</u>			<u>2,779,000</u>
	<u>6,730,000</u>	<u>(2,350,000)</u>	<u>(116,000)</u>		<u>4,264,000</u>

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Net increase (decrease) in cash and cash equivalents				
Cash and cash equivalents at beginning of period	212,579,000	1,111,000	723,000	214,413,000
Cash and cash equivalents at end of period	\$ 219,309,000	(1,239,000)	607,000	\$ 218,677,000

ITEM 2.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain information in this Quarterly Report on Form 10-Q contains forward-looking statements, including but not limited to, information relating to our future performance and financial condition, our plans and objectives and our assumptions regarding such future performance, financial condition, plans and objectives that involve certain significant known and unknown risks and uncertainties and other factors not under our control which may cause actual results, future performance and financial condition, and achievement of our plans and objectives to be materially different from the results, performance or other expectations implied by these forward-looking statements. These factors include the timing of receipt of, and our performance on, new orders that can cause significant fluctuations in net sales and operating results, the timing and funding of government contracts, adjustments to gross profits on long-term contracts, risks associated with international sales, rapid technological change, evolving industry standards, frequent new product announcements and enhancements, changing customer demands, changes in prevailing economic and political conditions, and other factors described herein and in our other filings with the Securities and Exchange Commission (SEC).

OVERVIEW

We design, develop, produce and market innovative products, systems and services for advanced communications solutions. We believe many of our solutions play a vital role in providing or enhancing communication capabilities when terrestrial communications infrastructure is unavailable or ineffective.

We conduct our business through three complementary segments: telecommunications transmission, mobile data communications and RF microwave amplifiers. We sell our products to a diverse customer base in the global commercial and government communications markets. We believe we are a leader in the market segments that we serve.

Our telecommunications transmission segment, which is currently our largest business segment, provides sophisticated equipment and systems that are used to enhance satellite transmission efficiency and that enable wireless communications in environments where terrestrial communications are unavailable, inefficient or too expensive. Our mobile data communications segment provides customers with an integrated solution including mobile satellite transceivers and satellite network support to enable global satellite-based communications when mobile, real-time, secure transmission is required for applications including logistics, support and battlefield command and control applications. Our RF microwave amplifiers segment designs, manufactures and markets solid-state, high-power, broadband RF microwave amplifier products.

A substantial portion of our sales may be derived from a limited number of relatively large customer contracts, the timing of revenues from which cannot be predicted. Quarterly and period-to-period sales and operating results may be significantly affected by one or more of such contracts. In addition, our gross profit is affected by a variety of factors, including the mix of products, systems and services sold, production efficiencies, estimates of warranty expense, price competition and general economic conditions. Our gross profit may also be affected by the impact of any cumulative adjustments to contracts that are accounted for under the percentage-of-completion method. Accordingly, we can experience significant fluctuations in sales and operating results from quarter-to-quarter and period-to-period comparisons may not be indicative of future performance.

Revenue from the sale of our products is generally recognized when the earnings process is complete, upon shipment or customer acceptance. Revenue from contracts relating to the design, development or manufacturing of complex electronic equipment to a buyer's specification or to provide services relating to the performance of such contracts is recognized using the percentage-of-completion method. Revenue from contracts that contain multiple elements that are not accounted for under the percentage-of-completion method are accounted for in accordance with Emerging Issues Task Force (EITF) Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. Revenue from these contracts is allocated to each respective element based on each element's relative fair value and is recognized when the respective revenue recognition criteria for each element are met.

Our contract with the United States (U.S.) Army for the Movement Tracking System (MTS) is for an eight-year period ending in July 2007 with a warranty period that we anticipate will continue through our fiscal 2011. Revenue recognition is based on the percentage-of-completion method. The gross margin is based on the estimated sales and expenses (including warranty costs) for the entire eight-year contract. The amount of revenue recognized has been limited to the amount of funded orders received from the U.S. Army. We recognize service time revenue based on a network availability method which recognizes prepaid service time on a straight-line basis from the date of shipment through the end of the contract term in July 2007.

In August 2006, we acquired certain assets and assumed certain liabilities of Insite Consulting, Inc. (Insite), a logistics application software company, for \$3.2 million, including transaction costs of \$0.3 million, plus certain earn-out payments based on the achievement of future sales targets. The first part of the earn-out cannot exceed \$1.4 million 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 our results of operations for the three and six months ended January 31, 2006 and were not material for the three and six months ended January 31, 2007. This operation was combined with our existing business and is part of the mobile data communications segment.

CRITICAL ACCOUNTING POLICIES

We consider certain accounting policies to be critical due to the estimation process involved in each.

Revenue Recognition on Long-Term Contracts. Revenues and related costs from long-term contracts relating to the design, development or manufacturing of complex electronic equipment to a buyer's specification or to provide services relating to the performance of such contracts are recognized using the percentage-of-completion method. Revenue is recognized based on the relationship of total costs incurred to total projected costs, or, alternatively, based on output measures, such as units delivered. Profits expected to be realized on such contracts are based on total estimated sales for the contract compared to total estimated costs, including warranty costs, at completion of the contract. These estimates are reviewed and revised periodically throughout the lives of the contracts, and adjustments to profits resulting from such revisions are made cumulative to the date of the change. Estimated losses on long-term contracts are recorded in the period in which the losses become evident.

Some of our largest contracts, including our MTS contract with the U.S. Army, are accounted for using the percentage-of-completion method. We have been engaged in the production and delivery of goods and services on a continual basis under contractual arrangements for many years. Historically, we have demonstrated an ability to accurately estimate revenues and expenses relating to our long-term contracts. However, there exist inherent risks and uncertainties in estimating revenues, expenses and progress toward completion, particularly on larger or longer-term contracts. If we do not accurately estimate the total sales, related costs and progress towards completion on such contracts, the estimated gross margins may be significantly impacted or losses may need to be recognized in future periods. Any such resulting changes in margins or contract losses could be material to our results of operations and financial position.

In addition, most government contracts have termination for convenience clauses that provide the customer with the right to terminate the contract at any time. Such terminations could impact the assumptions regarding total contract revenues and expenses utilized in recognizing profit under the percentage-of-completion method of accounting. Changes to these assumptions could materially impact our results of operations and financial position. Historically, we have not experienced material terminations of our long-term contracts.

We also address customer acceptance provisions in assessing our ability to perform our contractual obligations under long-term contracts. Our inability to perform on our long-term contracts could materially impact our results of operations and financial position. Historically, we have been able to perform on our long-term contracts.

Accounting for Stock-Based Compensation. As discussed further in Notes to Condensed Consolidated Financial Statements Note (3) *Stock-Based Compensation*, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R) on August 1, 2005 using the modified prospective method.

We have used and expect to continue to use the Black-Scholes option pricing model to compute the estimated fair value of stock-based awards. The Black-Scholes option pricing model includes assumptions regarding dividend yields, expected volatility, expected option term and risk-free interest rates. The assumptions used in computing the fair value of stock-based awards reflect our best estimates, but involve uncertainties relating to market and other conditions, many of which are outside of our control. We estimate expected volatility by considering the historical volatility of our stock, the implied volatility of publicly traded stock options in our stock and our expectations of volatility for the expected term of stock-based compensation awards. As a result, if other assumptions or estimates had been used for options granted to date, the stock-based compensation expense that was recorded for the three and six months ended January 31, 2007 and 2006 could have been materially different. Furthermore, if different assumptions are used in future periods, stock-based compensation expense could be materially impacted in the future.

Impairment of Goodwill and Other Intangible Assets. As of January 31, 2007, our goodwill and other intangible assets, aggregated \$30.7 million. In assessing the recoverability of goodwill and other intangibles, we must make various assumptions regarding estimated future cash flows and other factors in determining the fair values of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets in future periods. Any such resulting impairment charges could be material to our results of operations.

Provision for Warranty Obligations. We provide warranty coverage for most of our products, including products under long-term contracts. We record a liability for estimated warranty expense based on historical claims, product failure rates and other factors. There exist inherent risks and uncertainties in estimating warranty expenses, particularly on larger or longer-term contracts. Accordingly, if we do not accurately estimate our warranty costs, any changes to our original estimates could be material to our results of operations and financial position.

Accounting for Income Taxes. Our deferred tax assets and liabilities are determined based on temporary differences between financial reporting and tax bases of assets and liabilities, applying enacted tax rates expected to be in effect for the year in which the differences are expected to reverse. The provision for income taxes is based on domestic and international statutory income tax rates in the tax jurisdictions where we operate, permanent differences between financial reporting and tax reporting and available credits and incentives. Significant judgment is required in determining income tax provisions and tax positions. We may be challenged upon review by the applicable taxing authority and positions taken by us may not be sustained. We provide tax reserves for tax exposures relating to periods subject to audit. The development of reserves for these exposures requires consideration of timing and judgments about tax issues and potential outcomes, and is a subjective critical estimate. In certain circumstances, the ultimate outcome of exposures and risks involves significant uncertainties. If actual outcomes differ materially from these estimates, they could have a material impact on our results of operations and our financial position.

Provisions for Excess and Obsolete Inventory. We record a provision for excess and obsolete inventory based on historical and future usage trends. Several factors may influence the sale and use of our inventories, including decisions to exit a product line, technological change and new product development. These factors could result in a change in the amount of excess and obsolete inventory on hand. Additionally, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In the future, if we determine that our inventory was overvalued, we would be required to recognize such costs in our financial statements at the time of such determination. Any such charges could be material to our results of operations and financial position.

Allowance for Doubtful Accounts. We perform credit evaluations of our customers and adjust credit limits based upon customer payment history and current creditworthiness, as determined by our review of our customers' current credit information. Generally, we will require cash in advance or payment secured by irrevocable letters of credit before an order is accepted from an international customer that we do not do business with regularly. In addition, we seek to obtain insurance for certain international customers. We monitor collections and payments from our customers and maintain an allowance for doubtful accounts based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the allowances established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and the financial health of specific customers. Changes to the estimated allowance for doubtful accounts could be material to our results of operations and financial position.

COMPARISON OF THE RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JANUARY 31, 2007 AND JANUARY 31, 2006

Net Sales. Consolidated net sales were \$111.4 million and \$95.7 million for the three months ended January 31, 2007 and 2006, respectively, representing an increase of \$15.7 million, or 16.4%. The increase in net sales reflects growth in the telecommunications transmission and mobile data communications segments, partially offset by lower sales, as anticipated, in the RF microwave amplifiers segment.

Net sales in our telecommunications transmission segment were \$62.6 million and \$49.0 million for the three months ended January 31, 2007 and 2006, respectively, an increase of \$13.6 million, or 27.8%. Sales in this segment reflect increased sales of our over-the-horizon microwave systems and continued strong demand for our satellite earth station products. Sales of our over-the-horizon microwave systems were higher due to deliveries of our new 16 Mbps troposcatter modem upgrade kits for use on the U.S. Department of Defense's (DoD) AN/TRC-170 digital troposcatter terminals, which were partially offset, as previously anticipated, by lower sales, both direct and indirect, of our over-the-horizon microwave systems to a North African country. We believe our North African country end-customer is between major phases of a large program. Net sales during the three months ended January 31, 2007 were positively impacted by \$1.2 million relating to a gross profit adjustment on a large over-the-horizon microwave system contract, discussed below. Sales in the over-the-horizon microwave systems product line can fluctuate dramatically from period to period based on the receipt of large contracts and our performance thereon. Our telecommunications transmission segment represented 56.2% and 51.2% of consolidated net sales for three months ended January 31, 2007 and 2006, respectively.

Net sales in our mobile data communications segment were \$39.7 million and \$36.2 million for the three months ended January 31, 2007 and 2006, respectively, an increase of \$3.5 million, or 9.7%. The increase in net sales was due to an increase in deliveries to the U.S. Army and Army National Guard for ongoing support of MTS program activities and higher sales of battlefield command and control applications to the U.S. military. This increase was partially offset by a decline in sales of \$4.6 million related to the impact of our decision, made in fiscal 2006, to significantly de-emphasize stand-alone sales of low margin turnkey employee mobility solutions. Net sales during the three months ended January 31, 2007 and 2006 were positively impacted by \$3.8 million and \$6.7 million, respectively, relating to the MTS gross profit adjustments discussed below. There continues to be uncertainty as to the ultimate amount and timing of additional U.S. Army and Army National Guard orders that we receive, and as such, quarterly sales and profitability can continue to fluctuate dramatically. The MTS contract is not subject to automatic renewal or extension upon its scheduled expiration in July 2007 and we are not privy to the procurement strategy of the U.S. Army. Although subject to change, based on public information available, the President's preliminary proposed DoD budget for the government's fiscal year beginning October 1, 2007 has \$143.1 million of funding available for the MTS program (comprised of \$73.2 million from the base budget and \$69.9 million from the Global War on Terrorism budget). If the MTS contract, which expires in July 2007, is not renewed, extended or if we fail to succeed in a recompetitiveness process, it would have a material adverse impact on our business and results of operations. In addition, we are aware that the government has experienced delays in the receipt of certain components that are provided to us for incorporation into our satellite transceivers. If we do not receive these government furnished components in a timely manner, we could experience delays in fulfilling funded and anticipated orders from our customers. Our mobile data communications segment represented 35.6% and 37.8% of consolidated net sales for the three months ended January 31, 2007 and 2006, respectively.

Net sales in our RF microwave amplifiers segment were \$9.1 million for the three months ended January 31, 2007, compared to \$10.5 million for the three months ended January 31, 2006, a decrease of \$1.4 million, or 13.3%. The decrease in net sales was due to lower sales, as anticipated, of our amplifiers that are incorporated into improvised explosive device jamming systems. Our RF microwave amplifiers segment represented 8.2% and 11.0% of consolidated net sales for the three months ended January 31, 2007 and 2006, respectively.

International sales (which include sales to U.S. companies for inclusion in products which are sold to international customers) represented 28.6% and 37.2% of consolidated net sales for the three months ended January 31, 2007 and 2006, respectively. Domestic commercial sales represented 12.9% and 15.3% of consolidated net sales for the three months ended January 31, 2007 and 2006, respectively. Sales to the U.S. government (including sales to prime contractors to the U.S. government) represented 58.5% and 47.5% of consolidated net sales for the three months ended January 31, 2007 and 2006, respectively.

During the three months ended January 31, 2007 and 2006, one customer, a prime contractor, represented 7.7% and 12.0% of consolidated net sales. Direct and indirect sales to a North African country (including certain sales to the prime contractor mentioned above) during the three months ended January 31, 2007 and 2006 represented 4.6% and 10.8% of consolidated net sales, respectively.

Gross Profit. Gross profit was \$49.9 million and \$41.1 million for the three months ended January 31, 2007 and 2006, respectively, representing an increase of \$8.8 million, or 21.4%. The increase in gross profit was primarily attributable to the increase in net sales discussed above, as well as an increase in the gross profit percentage to 44.8% for the three months ended January 31, 2007 from 42.9% for the three months ended January 31, 2006. As discussed below, we recorded favorable cumulative adjustments to certain long-term contracts, partially offset by a firmware-related warranty provision in both periods.

Excluding the impact of adjustments to both net sales and gross profit, as discussed below, our gross profit as a percentage of net sales for the three months ended January 31, 2007 and 2006 would have been 42.7% and 39.9%, respectively. The increase in the gross profit percentage was primarily due to (i) a higher proportion of our consolidated net sales occurring in our telecommunications transmission segment, which typically realizes higher margins than our other two segments; (ii) increased operating efficiencies in our mobile data communications segment, including the benefit of our decision to significantly de-emphasize stand-alone sales of low margin turnkey employee mobility solutions to further focus our efforts on selling commercial satellite-based mobile data applications; and (iii) the reduction in our estimated reserve for warranty obligations by \$0.2 million due to lower than anticipated claims received to date on a large over-the-horizon microwave system contract whose warranty period is nearing expiration.

During the three months ended January 31, 2007 and 2006, we recorded favorable cumulative gross profit adjustments of \$4.9 million (of which \$3.8 million related to the mobile data communications segment and \$1.1 million related to the telecommunications transmission segment) and \$7.3 million (of which \$6.5 million related to the mobile data communications segment and \$0.8 million related to the RF microwave amplifiers segment), respectively, relating to our ongoing review of total estimated contract revenues and costs, and the related gross margin at completion, on long-term contracts. The adjustments in both periods were partially offset by a firmware-related warranty provision discussed below.

In our mobile data communications segment, during the three months ended January 31, 2007 and 2006, we increased the estimated gross profit at completion on the MTS contract, which resulted in a cumulative increase to the gross profit recognized in prior periods of \$3.8 million and \$6.5 million, respectively. These adjustments were the result of increased funding from the U.S. Army and Army National Guard, as well as improved operating efficiencies. We continue to rollout our next generation satellite transceiver, known as the MT 2012, and enhance our network and related software to provide increased speed and performance. We are working closely with our customers and currently expect to continue these initiatives. Unrelated to the next generation MTS technology upgrade, we continue to upgrade certain of our firmware that needs to be modified. Included in cost of sales for the three months ended January 31, 2007 and 2006 is a warranty provision related to modifying units previously shipped to non-MTS customers of \$0.4 million and \$1.7 million, respectively. An additional \$0.1 million and \$0.8 million was included in the MTS contract's estimated costs at completion relating to the same firmware modification for the three months ended January 31, 2007 and 2006, respectively. The ultimate amount of warranty expense relating to this firmware upgrade could differ from our current estimate and we may incur additional unanticipated costs or delays. As discussed in our *Critical Accounting Policies* *Provision for Warranty Obligations*, we periodically review and update our estimate of future warranty expense.

During the three months ended January 31, 2007, we increased the estimated gross profit at completion on a large over-the-horizon microwave system contract. This adjustment resulted in a \$1.1 million cumulative increase to gross profit recognized on this contract in prior periods. During the three months ended January 31, 2006, we increased the estimated gross profit at completion on a military contract in our RF microwave amplifiers segment as it was substantially completed. This adjustment resulted in a \$0.8 million cumulative increase to the gross profit recognized on the contract in prior periods.

Included in cost of sales for the three months ended January 31, 2007 and 2006 are provisions for excess and obsolete inventory of \$1.0 million and \$0.5 million, respectively. As discussed in our *Critical Accounting Policies* *Provisions for Excess and Obsolete Inventory*, we regularly review our inventory and record a provision for excess and obsolete inventory based on historical and projected usage assumptions.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$18.3 million and \$15.8 million for the three months ended January 31, 2007 and 2006, respectively, representing an increase of \$2.5 million, or 15.8%. The increase in expenses was primarily attributable to increased expenses (including higher payroll-related expenses) associated with the overall increase in net sales activity across our businesses. This increase was offset, in part, by lower expenses in our mobile data communications segment as we continue to de-emphasize stand-alone sales of low margin turnkey employee mobility solutions. The increase in payroll-related expenses is due, in part, to the increased headcount associated with the actual year-to-date and anticipated increase in sales for fiscal 2007 compared to fiscal 2006.

Amortization of stock-based compensation expense recorded as selling, general and administrative expenses for both the three months ended January 31, 2007 and 2006 was \$1.2 million. Amortization of stock-based compensation expense recorded as selling, general and administrative expenses for the three months ended January 31, 2007 was favorably impacted by a \$0.3 million reduction associated with an increase in the estimated forfeiture rate of stock-based awards. As a percentage of consolidated net sales, selling, general and administrative expenses were 16.4% and 16.5% for the three months ended January 31, 2007 and 2006, respectively.

Research and Development Expenses. Research and development expenses were \$7.6 million and \$6.0 million for the three months ended January 31, 2007 and 2006, respectively. Approximately \$5.1 million and \$4.5 million of such amounts, respectively, related to our telecommunications transmission segment, with the remaining expenses primarily related to our mobile data communications segment and, to a lesser extent, our RF microwave amplifiers segment.

As an investment for the future, we are continually enhancing our existing products and developing new products and technologies. Whenever possible, we seek customer funding for research and development to adapt our products to specialized customer requirements. During the three months ended January 31, 2007 and 2006, customers reimbursed us \$1.4 million and \$0.6 million, respectively, which is not reflected in the reported research and development expenses, but is included in consolidated net sales with the related costs included in cost of sales.

Amortization of stock-based compensation expense recorded as research and development expenses for both the three months ended January 31, 2007 and 2006 was \$0.2 million. Amortization of stock-based compensation expense recorded as research and development expenses for the three months ended January 31, 2007 was favorably impacted by a \$0.1 million reduction associated with an increase in the estimated forfeiture rate of stock-based awards. As a percentage of consolidated net sales, research and development expenses were 6.8% and 6.3% for the three months ended January 31, 2007 and 2006, respectively.

Amortization of Intangibles. Amortization of intangibles for the three months ended January 31, 2007 and 2006 was \$0.7 million and \$0.6 million, respectively. The amortization primarily relates to intangibles with finite lives that we acquired in connection with various acquisitions (including our acquisition of Insite).

Operating Income. Operating income for the three months ended January 31, 2007 and 2006 was \$23.3 million and \$18.7 million, respectively. The \$4.6 million, or 24.6% increase, was primarily the result of higher sales and gross profit, partially offset by increased operating expenses (including research and development), as discussed above.

Operating income in our telecommunications transmission segment increased to \$19.4 million for the three months ended January 31, 2007 from \$13.0 million for the three months ended January 31, 2006 as a result of increased net sales and gross profit, partially offset by higher operating expenses. As discussed above under *Gross Profit*, included in operating income in the three months ended January 31, 2007 is a cumulative adjustment related to a large over-the-horizon microwave systems contract which favorably impacted operating income by \$0.9 million.

Our mobile data communications segment generated operating income of \$8.2 million for the three months ended January 31, 2007 compared to \$7.6 million for the three months ended January 31, 2006. The increase in operating income was due to operating efficiencies achieved, including the benefit of lower selling, general and administrative expenses as we continue to de-emphasize stand-alone sales of low margin turnkey employee mobility solutions. As discussed above under *Gross Profit*, included in operating income in the three months ended January 31, 2007 and 2006, are the positive impacts from the cumulative adjustments, net of the respective firmware-related warranty provisions, of \$2.9 million and \$4.1 million, respectively.

Operating income in our RF microwave amplifier segment decreased to \$0.8 million for the three months ended January 31, 2007 from \$2.1 million for the three months ended January 31, 2006, due primarily to lower net sales during the three months ended January 31, 2007. As discussed above under *Gross Profit*, included in the three months ended January 31, 2006 is a cumulative adjustment relating to certain contracts which favorably impacted operating income by \$0.7 million.

Unallocated operating expenses increased to \$5.2 million for the three months ended January 31, 2007 from \$4.1 million for the three months ended January 31, 2006 due primarily to higher payroll-related expenses. Amortization of stock-based compensation expense for both the three months ended January 31, 2007 and 2006 was \$1.5 million. Stock-based compensation expense for the three months ended January 31, 2007 was favorably impacted by a \$0.4 million reduction associated with an increase in the estimated forfeiture rate of stock-based awards.

Interest Expense. Interest expense was \$0.7 million for both the three months ended January 31, 2007 and 2006. Interest expense primarily represents interest associated with our 2.0% convertible senior notes issued in January 2004.

Interest Income. Interest income for the three months ended January 31, 2007 was \$3.3 million, as compared to \$2.2 million for three months ended January 31, 2006. The \$1.1 million increase was due primarily to an increase in interest rates and additional investable cash since January 31, 2006.

Provision for Income Taxes. The provision for income taxes was \$7.8 million and \$6.9 million for the three months ended January 31, 2007 and 2006, respectively. Our effective tax rate was 30.0% and 34.0% for the three months ended January 31, 2007 and 2006, respectively.

The decrease in the effective tax rate was primarily attributable to (i) the retroactive extension, in December 2006, of the Federal research and experimentation credit from December 31, 2005 until December 31, 2007; (ii) the approval by our stockholders of an amendment to the 2000 Stock Incentive Plan (the Plan) which will permit us to claim tax deductions for cash awards anticipated to be paid under the Plan without limitation under §162(m) of the Internal Revenue Code; and (iii) a tax benefit of \$0.2 million relating to disqualifying dispositions of incentive stock options. Included in the tax provision for the three months ended January 31, 2007 is a \$0.6 million tax benefit related to the retroactive application of the Federal research and experimentation credit to fiscal 2006. Our tax rate for the three months ended January 31, 2006 was favorably impacted by the recording of a net benefit of \$0.6 million relating to the favorable settlement of a state tax matter. Excluding the tax benefit relating to fiscal 2006, we now estimate our effective tax rate for fiscal 2007 will approximate 35.0%.

In fiscal 2006, we were informed by the Internal Revenue Service that our Federal income tax return for the fiscal year ended July 31, 2004 was selected for audit. The audit is ongoing and additional income tax returns for other fiscal years may be examined. If the outcome of the audit differs materially from our original income tax provisions, it could have a material adverse impact on our results of operations and financial position.

COMPARISON OF THE RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JANUARY 31, 2007 AND JANUARY 31, 2006

Net Sales. Consolidated net sales were \$208.5 million and \$202.3 million for the six months ended January 31, 2007 and 2006, respectively, representing an increase of \$6.2 million, or 3.1%. The increase in net sales reflects growth in the telecommunications transmission segment, partially offset by lower sales in the mobile data communications and RF microwave amplifiers segments.

Net sales in our telecommunications transmission segment were \$114.6 million and \$99.9 million for the six months ended January 31, 2007 and 2006, respectively, an increase of \$14.7 million, or 14.7%. Sales in this segment reflect continued strong demand for our satellite earth station products, as well as sales related to deliveries of our new 16 Mbps troposcatter modem upgrade kits for use on the U.S. DoD's AN/TRC-170 digital troposcatter terminals. As previously anticipated, sales of our over-the-horizon microwave systems to a North African country, both direct and indirect, were lower during the six months ended January 31, 2007 as we believe the end-customer is between major phases of a large program. Net sales during the six months ended January 31, 2007 were positively impacted by \$1.2 million relating to a gross profit adjustment on a large over-the-horizon microwave systems contract, discussed below. Sales in the over-the-horizon microwave systems product line can fluctuate dramatically from period to period based on the receipt of large contracts and our performance thereon. Our telecommunications transmission segment represented 54.9% and 49.4% of consolidated net sales for six months ended January 31, 2007 and 2006, respectively.

Net sales in our mobile data communications segment were \$75.4 million and \$75.6 million for the six months ended January 31, 2007 and 2006, respectively, a decrease of \$0.2 million, or 0.3%. The decrease in net sales was due to a decline of \$10.3 million of sales related to the impact of our decision, made in fiscal 2006, to significantly de-emphasize stand-alone sales of low margin turnkey employee mobility solutions. This decrease was significantly offset by an increase in deliveries to the U.S. Army and Army National Guard for ongoing support of MTS program activities and higher sales of battlefield command and control applications to the U.S. military. Net sales during the six months ended January 31, 2007 and 2006 were positively impacted by \$1.1 million and \$5.6 million, respectively, relating to the MTS gross profit adjustments discussed below. There continues to be uncertainty as to the ultimate amount and timing of additional U.S. Army and Army National Guard orders that we receive, and as such, quarterly sales and profitability can continue to fluctuate dramatically. The MTS contract is not subject to automatic renewal or extension upon its scheduled expiration in July 2007 and we are not privy to the procurement strategy of the U.S. Army. Although subject to change, based on public information available, the President's preliminary proposed DoD budget for the government's fiscal year beginning October 1, 2007 has \$143.1 million of funding available for the MTS program (comprised of \$73.2 million from the base budget and \$69.9 million from the Global War on Terrorism budget). If the MTS contract, which expires in July 2007, is not renewed, extended or if we fail to succeed in a re-compete process, it would have a material adverse impact on our business and results of operations. In addition, we are aware that the government has experienced delays in the receipt of certain components that are provided to us for incorporation into our satellite transceivers. If we do not receive these government furnished components in a timely manner, we could experience delays in fulfilling funded and anticipated orders from our customers. Our mobile data communications segment represented 36.2% and 37.4% of consolidated net sales for the six months ended January 31, 2007 and 2006, respectively.

Net sales in our RF microwave amplifiers segment were \$18.5 million for the six months ended January 31, 2007, compared to \$26.8 million for the six months ended January 31, 2006, a decrease of \$8.3 million, or 31.0%. The decrease in net sales was due to lower sales, as anticipated, of our amplifiers that are incorporated into improvised explosive device jamming systems. Our RF microwave amplifiers segment represented 8.9% and 13.2% of consolidated net sales for the six months ended January 31, 2007 and 2006, respectively.

International sales (which include sales to U.S. companies for inclusion in products which are sold to international customers) represented 29.0% and 38.1% of consolidated net sales for the six months ended January 31, 2007 and 2006, respectively. Domestic commercial sales represented 13.5% and 14.5% of consolidated net sales for the six months ended January 31, 2007 and 2006, respectively. Sales to the U.S. government (including sales to prime contractors to the U.S. government) represented 57.5% and 47.4% of consolidated net sales for the six months ended January 31, 2007 and 2006, respectively.

During the six months ended January 31, 2007 and 2006, one customer, a prime contractor, represented 7.1% and 12.1% of consolidated net sales. Direct and indirect sales to a North African country (including certain sales to the prime contractor mentioned above) during the six months ended January 31, 2007 and 2006 represented 4.2% and 13.2% of consolidated net sales, respectively.

Gross Profit. Gross profit was \$89.2 million and \$81.3 million for the six months ended January 31, 2007 and 2006, respectively, representing an increase of \$7.9 million, or 9.7%. The increase in gross profit was primarily attributable to the increase in net sales discussed above, as well as an increase in the gross profit percentage to 42.8% for the six months ended January 31, 2007 from 40.2% for the six months ended January 31, 2006. As discussed below, we recorded favorable cumulative adjustments to certain long-term contracts, partially offset by a firmware-related warranty provision in both periods.

Excluding the impact of adjustments to both net sales and gross profit, as discussed below, our gross profit as a percentage of net sales for the six months ended January 31, 2007 and 2006 would have been 41.2% and 39.1%, respectively. The increase in the gross profit percentage was primarily due to (i) a higher proportion of our consolidated net sales occurring in our telecommunications transmission segment, which typically realizes higher margins than our other two segments; (ii) increased operating efficiencies in our mobile data communications segment, including the benefit of our decision to significantly de-emphasize stand-alone sales of low margin turnkey employee mobility solutions to further focus our efforts on selling commercial satellite-based mobile data applications; and (iii) the reduction in our estimated reserve for warranty obligations by \$0.7 million due to lower than anticipated claims received to date on a large over-the-horizon microwave system contract whose warranty period is nearing expiration.

During the six months ended January 31, 2007 and 2006, we recorded favorable cumulative gross profit adjustments of \$4.7 million (of which \$3.6 million related to the mobile data communications segment and \$1.1 million related to the telecommunications transmission segment) and \$6.1 million (of which \$5.5 million related to the mobile data communications segment and \$0.6 million related to the RF microwave amplifiers segment), respectively, relating to our ongoing review of total estimated contract revenues and costs, and the related gross margin at completion, on long-term contracts. The adjustments in both periods were partially offset by a firmware-related warranty provision discussed below.

In our mobile data communications segment, during the six months ended January 31, 2007 and 2006, we increased the estimated gross profit at completion on the MTS contract, which resulted in a cumulative increase to the gross profit recognized in prior periods of \$3.6 million and \$5.5 million, respectively. These adjustments were the result of increased funding from the U.S. Army and Army National Guard, as well as improved operating efficiencies. Included in cost of sales for the six months ended January 31, 2007 and 2006 is a firmware-related warranty provision related to modifying units previously shipped to non-MTS customers of \$0.4 million and \$1.7 million, respectively. The ultimate amount of warranty expense relating to this firmware upgrade could differ from our current estimate and we may incur additional unanticipated costs or delays. As discussed in our Critical Accounting Policies Provision for Warranty Obligations, we periodically review and update our estimate of future warranty expense.

During the six months ended January 31, 2006, we increased the estimated gross profit at completion on a military contract in our RF microwave amplifiers segment as it was substantially completed. This adjustment resulted in a \$0.6 million cumulative increase to the gross profit recognized on the contract in prior periods.

Included in cost of sales for the six months ended January 31, 2007 and 2006 are provisions for excess and obsolete inventory of \$1.5 million and \$1.0 million, respectively. As discussed in our Critical Accounting Policies Provisions for Excess and Obsolete Inventory, we regularly review our inventory and record a provision for excess and obsolete inventory based on historical and projected usage assumptions.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$34.8 million and \$31.9 million for the six months ended January 31, 2007 and 2006, respectively, representing an increase of \$2.9 million, or 9.1%. The increase in expenses was primarily attributable to increased expenses (including higher payroll-related expenses) associated with the overall increase in net sales activity across our businesses. This increase was offset, in part, by lower expenses in our mobile data communications segment as we continue to de-emphasize stand-alone sales of low margin turnkey employee mobility solutions. The increase in payroll-related expenses is due, in part, to the increased headcount associated with the actual year-to-date and anticipated increase in sales for fiscal 2007 compared to fiscal 2006.

Amortization of stock-based compensation expense recorded as selling, general and administrative expenses increased to \$2.6 million from \$2.3 million for the six months ended January 31, 2007 and 2006, respectively. Amortization of stock-based compensation expense recorded as selling, general and administrative expenses for the six months ended January 31, 2007 was favorably impacted by a \$0.4 million reduction associated with an increase in the estimated forfeiture rate of stock-based awards. As a percentage of consolidated net sales, selling, general and administrative expenses were 16.7% and 15.8% for the six months ended January 31, 2007 and 2006, respectively.

Research and Development Expenses. Research and development expenses were \$14.8 million and \$12.8 million for the six months ended January 31, 2007 and 2006, respectively. Approximately \$10.0 million and \$9.6 million of such amounts, respectively, related to our telecommunications transmission segment, with the remaining expenses primarily related to our mobile data communications segment and, to a lesser extent, our RF microwave amplifiers segment.

As an investment for the future, we are continually enhancing our existing products and developing new products and technologies. Whenever possible, we seek customer funding for research and development to adapt our products to specialized customer requirements. During the six months ended January 31, 2007 and 2006, customers reimbursed us \$3.2 million and \$1.1 million, respectively, which is not reflected in the reported research and development expenses, but is included in consolidated net sales with the related costs included in cost of sales.

Amortization of stock-based compensation expense recorded as research and development expenses increased to \$0.5 million from \$0.3 million for the six months ended January 31, 2007 and 2006, respectively. Amortization of stock-based compensation expense recorded as research and development expenses for the six months ended January 31, 2007 was favorably impacted by a \$0.1 million reduction associated with an increase in the estimated forfeiture rate of stock-based awards. As a percentage of consolidated net sales, research and development expenses were 7.1% and 6.3% for the six months ended January 31, 2007 and 2006, respectively.

Amortization of Intangibles. Amortization of intangibles for the six months ended January 31, 2007 and 2006 was \$1.3 million and \$1.2 million, respectively. The amortization primarily relates to intangibles with finite lives that we acquired in connection with various acquisitions (including our acquisition of Insite).

Operating Income. Operating income for the six months ended January 31, 2007 and 2006 was \$38.3 million and \$35.5 million, respectively. The \$2.8 million, or 7.9% increase, was primarily the result of a higher sales and gross profit, partially offset by increased operating expenses (including research and development).

Operating income in our telecommunications transmission segment increased to \$32.3 million for the six months ended January 31, 2007 from \$25.3 million for the six months ended January 31, 2006 as a result of increased net sales and gross profit percentage, partially offset by higher operating expenses. As discussed above under *Gross Profit*, included in operating income for the six months ended January 31, 2007 is a cumulative adjustment related to a large over-the-horizon microwave systems contract which favorably impacted operating income by \$0.9 million.

Our mobile data communications segment generated operating income of \$14.3 million for the six months ended January 31, 2007 compared to \$11.8 million for the six months ended January 31, 2006. The increase in operating income was due to operating efficiencies achieved, including the benefit of lower selling, general and administrative expenses as we continue to de-emphasize stand-alone sales of low margin turnkey employee mobility solutions. As discussed above under *Gross Profit*, included in operating income for the six months ended January 31, 2007 and 2006, are the positive impacts from the cumulative adjustments, net of the respective firmware-related warranty provisions, of \$2.8 million and \$3.3 million, respectively.

Operating income in our RF microwave amplifier segment decreased to \$1.7 million for the six months ended January 31, 2007 from \$6.3 million for the six months ended January 31, 2006, due primarily to lower net sales during the six months ended January 31, 2007. As discussed above under *Gross Profit*, included in the six months ended January 31, 2006, is a cumulative adjustment relating to certain contracts which favorably impacted operating income by \$0.5 million.

Unallocated operating expenses increased to \$10.0 million for the six months ended January 31, 2007 from \$7.9 million for the six months ended January 31, 2006 due primarily to higher payroll-related expenses. Amortization of stock-based compensation expense increased to \$3.3 million from \$2.8 million for the six months ended January 31, 2007 and 2006, respectively. Amortization of stock-based compensation expense for the six months ended January 31, 2007 was favorably impacted by a \$0.5 million reduction associated with an increase in the estimated forfeiture rate of stock-based awards.

Interest Expense. Interest expense was \$1.4 million and \$1.3 million for the six months ended January 31, 2007 and 2006, respectively. Interest expense primarily represents interest associated with our 2.0% convertible senior notes issued in January 2004.

Interest Income. Interest income for the six months ended January 31, 2007 was \$6.5 million, as compared to \$3.9 million for six months ended January 31, 2006. The \$2.6 million increase was due primarily to an increase in interest rates and investable cash since January 31, 2006.

Provision for Income Taxes. The provision for income taxes was \$14.4 million and \$13.3 million for the six months ended January 31, 2007 and 2006, respectively. Our effective tax rate was 33.2% and 35.0% for the six months ended January 31, 2007 and 2006, respectively.

The decrease in the effective tax rate was primarily attributable to (i) the retroactive extension, in December 2006, of the Federal research and experimentation credit from December 31, 2005 until December 31, 2007; (ii) the approval by our stockholders of an amendment to the 2000 Stock Incentive Plan (the *Plan*) which will permit us to claim tax deductions for cash awards anticipated to be paid under the Plan without limitation under §162(m) of the Internal Revenue Code; and (iii) a tax benefit of \$0.2 million relating to disqualifying dispositions of incentive stock options. Included in the tax provision for the six months ended January 31, 2007 is a \$0.6 million tax benefit related to the retroactive application of the Federal research and experimentation credit to fiscal 2006. Our tax rate for the six months ended January 31, 2006, was favorably impacted by the recording of a net benefit of \$0.6 million primarily relating to the favorable settlement of a state tax matter. Excluding the tax benefit relating to fiscal 2006, we now estimate our effective tax rate for fiscal 2007 will approximate 35.0%.

In fiscal 2006, we were informed by the Internal Revenue Service that our Federal income tax return for the fiscal year ended July 31, 2004 was selected for audit. The audit is ongoing and additional income tax returns for other fiscal years may be examined. If the outcome of the audit differs materially from our original income tax provisions, it could have a material adverse impact on our results of operations and financial position.

LIQUIDITY AND CAPITAL RESOURCES

Our unrestricted cash and cash equivalents increased to \$266.2 million at January 31, 2007 from \$251.6 million at July 31, 2006.

Net cash provided by operating activities was \$17.2 million for the six months ended January 31, 2007, compared to \$6.3 million for the first six months of fiscal 2006, reflecting an increase in net income, partially offset by an increase in inventory that is currently anticipated to be reduced in the second half of fiscal 2007, as well as the timing of payments for accounts payable and certain accrued expenses that occurred in the first half of fiscal 2007.

Net cash used in investing activities for the six months ended January 31, 2007 was \$7.5 million, of which \$4.9 million was for purchases of property, plant and equipment including expenditures related to the continued expansion of our high-volume technology manufacturing center located in Tempe, Arizona and the continued enhancement of our network operations facility in Germantown, Maryland. During the six months ended January 31, 2007, we paid \$2.6 million of the \$3.2 million purchase price (including transaction costs) for Insite Consulting, Inc. We expect to make the remaining payments through the first quarter of fiscal 2008.

Net cash provided by financing activities was \$4.9 million for the six months ended January 31, 2007, due primarily to proceeds from stock option exercises and employee stock purchase plan shares aggregating \$3.1 million and a \$1.9 million excess income tax benefit from the exercise of stock options.

FINANCING ARRANGEMENT

On January 27, 2004, we issued \$105.0 million of our 2.0% convertible senior notes in a private offering pursuant to Rule 144A of the Securities Act of 1933, as amended. The net proceeds from this transaction were \$101.2 million after deducting the initial purchaser's discount and other transaction costs. For further information concerning this financing, see Notes to Condensed Consolidated Financial Statements Note (9) *2.0% Convertible Senior Notes*.

COMMITMENTS

In the normal course of business, we routinely enter into binding and non-binding purchase obligations primarily covering anticipated purchases of inventory and equipment. We do not expect that these commitments as of January 31, 2007 will materially adversely affect our liquidity.

At January 31, 2007, we had contractual cash obligations to repay our 2.0% convertible senior notes, capital lease and operating lease obligations (including satellite lease expenditures relating to our mobile data communications segment contracts) and the financing of a purchase of proprietary technology. Payments due under these long-term obligations, excluding interest on the 2% convertible senior notes, are as follows:

	Obligations due by fiscal year (in thousands)				
	Total	Remainder of 2007	2008 and 2009	2010 and 2011	After 2011
2.0% convertible senior notes	\$ 105,000				105,000
Operating lease commitments	28,029	13,667	10,194	3,369	799
Other obligations	338	75	263		
Total contractual cash obligations	\$ 133,367	13,742	10,457	3,369	105,799

As further discussed in Notes to Condensed Consolidated Financial Statements Note (9) *2.0% Convertible Senior Notes*, we may, at our option, redeem some or all of the notes on or after February 4, 2009. Holders of our 2% convertible senior notes will have the right to require us to repurchase some or all of the outstanding notes on February 1, 2011, February 1, 2014 and February 1, 2019 and upon certain events.

We have entered into standby letter of credit agreements with financial institutions relating to the guarantee of our future performance on certain contracts. At January 31, 2007, the balance of these agreements was \$5.2 million.

We believe that our cash and cash equivalents will be sufficient to meet our operating cash requirements for the foreseeable future. In the event that we identify a significant acquisition that requires additional cash, we would seek to borrow funds or raise additional equity capital.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our earnings and cash flows are subject to fluctuations due to changes in interest rates primarily from our investment of available cash balances. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. If the interest rate we receive on our investment of available cash balances were to change by 10%, our annual interest income would be impacted by approximately \$1.3 million.

Our 2.0% convertible senior notes bear a fixed rate of interest. As such, our earnings and cash flows are not sensitive to changes in interest rates on our long-term debt. As of January 31, 2007, we estimate the fair market value of our 2.0% convertible senior notes to be \$130.1 million based on recent trading activity.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was carried out by the Company under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures have been designed and are being operated in a manner that provides reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. There have been no changes in the Company's internal controls over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

See Note (14) of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q for information regarding legal proceedings.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the Company's Form 10-K for the fiscal year ended July 31, 2006 or the Company's Form 10-Q/A (filed on December 18, 2006), except as discussed below.

On November 30, 2006, KPMG, our independent registered public accounting firm, advised us that it believed that one of its staff accountants who worked on the engagement to audit our financial statements made an investment in our common stock. On December 16, 2006, following an assessment of the matter, both KPMG and the Audit Committee of our Board of Directors separately concluded that KPMG's independence was not 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; (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; and (v) the absence of any indication of independence matters with respect to other members of the audit engagement team.

The Company and KPMG reported their conclusions regarding this matter to the SEC Staff, who did not object to those conclusions.

Item 4. Submission of Matters to a Vote of Security Holders

At the Company's Annual Stockholders Meeting, held on December 5, 2006, Mr. Richard L. Goldberg was elected as Director for a three-year term. The votes were as follows: shares for 19,881,798; shares withheld 1,948,376. Mr. Gerard R. Nocita and Mr. Ira Kaplan continued on as Directors for terms expiring in two years and Mr. Fred Kornberg and Mr. Edwin Kantor continued on as Directors for terms expiring in one year.

The stockholders approved the adoption of the amendment to the Company's 2000 Stock Incentive Plan by a vote of 17,036,357 shares for and 919,936 shares against, with 93,199 shares abstaining and 3,780,681 broker non-votes.

The stockholders ratified the selection of KPMG LLP as the Company's auditors for its 2007 fiscal year by a vote of 21,670,399 shares for and 147,871 shares against, with 11,902 shares abstaining.

Item 6. Exhibits

(a) Exhibits

Exhibit 31.1 - Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 - Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 - Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 - Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMTECH TELECOMMUNICATIONS CORP.

(Registrant)

Date: March 8, 2007

By: /s/ Fred Kornberg

Fred Kornberg
Chairman of the Board
Chief Executive Officer and President
(Principal Executive Officer)

Date: March 8, 2007

By: /s/ Michael D. Porcelain

Michael D. Porcelain
Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)