

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

FREQUENCY ELECTRONICS INC

Form 10-K/A

August 18, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10K/A

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year ended April 30, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-8061

FREQUENCY ELECTRONICS, INC.

(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

11-1986657  
(I.R.S. Employer Identification No.)

55 CHARLES LINDBERGH BLVD., MITCHEL FIELD, N.Y. 11553  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 516-794-4500

Securities registered pursuant to Section 12 (b) of the Act:

Title of each class -----	Name of each exchange on which registered -----
Common Stock (par value \$1.00 per share)	American Stock Exchange, Inc.

Securities registered pursuant to Section 12 (g) of the Act:

None

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 X No \_\_\_

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12 b-2). Yes  No

The aggregate market value of voting stock held by non-affiliates of the Registrant as of October 31, 2002 - \$48,000,000

### APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of Registrant's Common Stock, par value \$1.00 as of July 22, 2003 - 8,356,350.

DOCUMENTS INCORPORATED BY REFERENCE: PART III incorporates information by reference from the definitive proxy statement for the Annual Meeting of Stockholders to be held on or about October 16, 2003.

(Cover page 1 of 61 pages)

Exhibit Index at Page 51

### EXPLANATORY NOTE

This Amendment to Form 10K for the Fiscal Year Ended April 30, 2003 is filed solely to indicate that Frequency Electronics 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 and has been subject to such filing requirements for the past 90 days.

### PART I

#### Item 1. Business

-----

#### GENERAL DISCUSSION

-----

Frequency Electronics, Inc. (sometimes referred to as "Registrant", "Frequency Electronics" or "Company") was founded in 1961 as a research and development firm in the technology of time and frequency control. Unless the context indicates otherwise, references to the Registrant or the Company are to Frequency Electronics, Inc. and its subsidiaries. References to "FEI" are to the parent company alone and do not refer to any of the subsidiaries.

Frequency Electronics was incorporated in Delaware in 1968 and became the successor to the business of Frequency Electronics, Inc., a New York corporation, organized in 1961. The principal executive office of Frequency Electronics is located at 55 Charles Lindbergh Boulevard, Mitchel Field, New York 11553. Its telephone number is 516-794-4500 and its website is [www.frequencyelectronics.com](http://www.frequencyelectronics.com).

The current authorized capital of the Registrant consists of 20,000,000 shares of \$1.00 par value common stock, of which 8,339,201 shares were outstanding at April 30, 2003, and 600,000 shares of \$1.00 par value preferred stock, none of which have been issued to date.

The Company is a world leader in the design, development and manufacture of high-technology frequency, timing and synchronization products for satellite and

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

terrestrial voice, video and data telecommunications. The Company's technologies provide unique solutions that are essential building blocks for the next generation of broadband wireless and fiber optic communications systems, and for the ongoing expansion of existing wireless and wireline networks. The Company's mission is to provide the most advanced control of frequency and time- essential factors for synchronizing communication networks and for certain military and space applications.

The Company has segmented its operations into three principal industries: (1) products for commercial communications which are based either on the ground or in space, (2) the business of Gillam-FEI, principally wireline and network synchronization systems and (3) products used by the United States Government for defense or space applications. The Company's space and terrestrial commercial communications programs are produced by its wholly owned subsidiary, FEI Communications, Inc. ("FEIC"). FEIC was incorporated in Delaware in December 1991, and was created as a separate subsidiary company to provide ownership and management of assets and other services appropriate for commercial clients, both domestic and foreign. Gillam-FEI is the Company's Belgian subsidiary, acquired in September 2000, which currently sells its products in non-U.S. markets. During fiscal 2002, the Company formed three wholly-owned subsidiaries and made a strategic investment in a Russian crystal oscillator manufacturer to provide broader manufacturing capabilities and worldwide reach for the Company's proprietary products. FEI Government Systems, Inc. ("FEI-GSI") was formed to focus on supplying the Company's technology and legacy proprietary products to the United States military and other U.S. government agencies. This organizational step was taken in response to the increasing demand for the Company's products by the U.S. Government. Frequency Electronics, Inc. Asia ("FEI-Asia") was established as an Asian-based low cost manufacturer of certain of the Company's commercial communications products. FEI- Europe, GmbH Communications ("FEI-Europe") was established as a European sales and marketing office to promote the Company's new line of crystal oscillators as well as other proprietary products. The operations of FEI-Asia and FEI-Europe are included in the commercial communications segment. The Company's equity investment in Morion, Inc., a Russian manufacturer, permits the Company to secure a low cost source for high precision quartz resonators and crystal oscillators, many of which will be based on the Company's design and development work.

As described more fully below, shortly after the end of fiscal year 2003, the Company acquired the business and net assets of Zyfer, Inc. from Odetics, Inc., forming a new wholly-owned subsidiary, FEI-Zyfer, Inc. ("FZI"). FZI is a designer and manufacturer of precision time and frequency generation and synchronization products which incorporate global positioning systems ("GPS") technology. This

3

capability complements the Company's existing technologies and permits the combined entities to provide a broader range of embedded systems for a variety of timing functions.

In the mid-1990's, the Company transformed itself from a defense contract manufacturer into a high-tech provider of precision time and frequency products found in both ground-based communication stations and on-board commercial satellites. The Company also continues to support the United States government with products for defense and space applications with emphasis on Commercial Off-The-Shelf products. Products delivered by Gillam-FEI provide essential network monitoring and wireline synchronization products for a variety of industries and telecommunications providers in Europe, Africa, the Middle East and Asia.

FISCAL 2003 AND 2002 SIGNIFICANT EVENTS

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

### Goodwill Impairment

In the fourth quarter of 2003, the Company performed an impairment test of the Gillam-FEI reporting unit. The fair value of this reporting unit was determined based upon valuations utilized in recent industry acquisition transactions and current market values of publicly-traded competitors and customers in the same industry as Gillam-FEI. Based on this test, the Company further analyzed its investment in Gillam-FEI and concluded that the goodwill associated with this acquisition was impaired. Consequently, the Company recorded a non-cash charge of \$6.2 million against operating income for fiscal 2003 to reflect the write down of the full value of goodwill related to the Gillam-FEI acquisition.

### Inventory Adjustments

The Company reduced the value of its inventory by approximately \$3.6 million during the 4th quarter of fiscal 2003 due to events occurring at the end of the fiscal year. In April, the Company was notified by a customer it had cancelled an export-related contract which required the Company to write-off the related work-in-process inventory. Second, after experiencing modest improvement in telecommunications-related revenues earlier in the year, fourth quarter Commercial Communications segment revenue declined nearly 40% from the third quarter. As a consequence, noting the competitive environment, the Company reduced certain inventory to estimated realizable value based on lowered sales volume expectations. Finally, during the fourth quarter, the Company completed certain process and product improvement projects which resulted in re-valuation or disposal of certain products built under previous designs.

### Insurance Reimbursement

On April 30, 2002, the Company settled an arbitration proceeding FEI had commenced in June 2001 against The Home Insurance Company of Illinois ("Home") under an excess directors and officers liability insurance policy. FEI had asserted claims for its loss relating to, among other matters, sums it paid in connection with the Global Settlement and Disposition with the Government on June 19, 1998. (See Item 3. Legal Proceedings and Note 9 to the accompanying financial statements.) Under the terms of the settlement agreement, Home paid FEI \$1.5 million, FEI released its claims and the arbitration was discontinued.

### SUBSEQUENT EVENT

On May 9, 2003, the Company acquired the business and net assets of Zyfer, Inc., a wholly-owned subsidiary of Odetics, Inc., in a cash transaction. The Company paid \$2.3 million at closing, plus acquisition costs estimated at approximately \$400,000. According to the terms of the purchase agreement, the Company will pay up to a maximum of \$1 million in each of fiscal years 2004 and 2005 if the new subsidiary, FEI-Zyfer, Inc., achieves certain revenue levels in those years. The contingent payments are based on a percentage of revenues in excess of \$6 million in fiscal 2004 and as a percentage of revenues in excess of \$8 million in fiscal 2005. The acquired business recorded revenue of \$6.5 million for the year ended March 31, 2003 and \$4.5 million in the prior fiscal year. FEI-Zyfer, with its own management team, will be a fourth reportable segment in the Company's future financial statements.

4

### REPORTABLE SEGMENTS

The Company designs, develops, manufactures and markets precision time and frequency control products for three principal markets: (1) commercial

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

communications applications, either space- or ground-based, (2) wireline synchronization and network monitoring systems produced by Gillam-FEI, and (3) its heritage U.S. Government and military markets.

Wireline and network synchronization products manufactured by the Company's wholly-owned subsidiary, Gillam-FEI, are currently sold to non-U.S. customers. The products for the other two reportable segments are similar in function and are currently manufactured in the Company's production facility located in New York. The operations of its FEI-Asia facility are included in the Commercial Communications segment. The Company identifies the U.S Government business as a reportable segment based upon the regulatory environment (Federal Acquisition Regulations or "FAR") under which it operates when dealing with U.S. Government procurement contracts versus the less restrictive commercial environment.

During fiscal 2003, 2002 and 2001 approximately 47%, 63% and 74%, respectively, of the Company's sales were for products used for terrestrial or space-based commercial communications and foreign governments. Sales for Gillam-FEI, which was acquired in September 2000, were approximately 25%, 26% and 19% of fiscal 2003, 2002 and 2001 revenues, respectively. For the years ended April 30, 2003, 2002 and 2001, approximately 28%, 11% and 7%, respectively, of the Company's sales were for U.S. Government end-use. Sales summaries for the Commercial Communications, Gillam-FEI and U.S. Government markets during each of the last five years are set forth in Item 6 (Selected Financial Data). Segment information regarding revenues, operating profits, depreciation and assets is more fully disclosed in Note 14 to the accompanying financial statements.

Commercial Communications segment:

The Company provides high-tech precision time and frequency products that are found in both ground-based communication stations and on-board commercial satellites. The Company has made a substantial investment in research and development to apply its core technologies to the commercial markets. In previous years, the Company experienced accelerated growth in commercial communications revenues. However, under current overall market conditions in the telecommunications industry, the revenue growth trend has been interrupted. The Company anticipates that this industry will provide an opportunity for substantial future sales growth based on increased capital spending by telecommunication companies and new or replacement orders for commercial communication satellites.

### Terrestrial- Wireless

The development of new or improved technologies will bring expanded and more reliable telecommunications services to the public. As digital cellular systems and PCS networks grow they will require more base stations to meet the demand for better connectivity and quality of cell phone service. Cellular infrastructure original equipment manufacturing companies, consisting of some of the world's largest telecommunications companies, are building out existing networks even as they develop new technologies, such as EDGE (Enhanced Data rates for Global Evolution), 3G (3rd Generation) and other systems, to provide not only improved voice connectivity but also Internet, video and data transmission.

Wireless communication networks consist of numerous installations located throughout a service area, each with its own base station connected by wire or microwave radio through a network switch. Network operators are in the process of converting older networks from analog to digital technology in order to expand network coverage, increase capacity and improve transmission quality. This upgrade requires precise frequency control at the base stations to achieve a higher degree of services.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

With increased demand for wireless services on limited bandwidth, the requirement for precise timing becomes paramount. The Company manufactures a Rubidium Atomic Standard, a small, low cost,

5

stable atomic "clock" as well as temperature stable quartz crystal oscillators, which are ideally suited for use in advanced cellular communications base stations. Whether the network uses CDMA (Code Division Multiple Access), TDMA (Time Division Multiple Access) or GSM (Global System for Mobile Communications) or a hybrid, such as EDGE, timing to ensure signal synchronization, is of the essence.

### Terrestrial- Optical Networks

The Company has developed products that will enable greater utilization of the available spectrum in Fiber Optic systems. High-speed modems which convert electronic signals to light and back again require highly sophisticated signal synchronization. The Company provided prototypes and limited production models for such systems in calendar 2001. These products represent a new application of the Company's core technology. Since the products are just one of several competing technologies of a nascent industry, the ultimate market size cannot be determined at this time.

### Space-based

The commercial use of satellites launched for communications, navigation, weather forecasting, video and data transmissions has increased the need to transmit information to earth-based receivers. This requires precise timing and frequency control at the satellite. The Company manufactures the master clocks (quartz, rubidium and cesium) and other significant timing products for many satellite communication systems. The Company's space hybrid assemblies are used onboard spacecraft for command, control and power distribution. Efficient and reliable DC-DC power converters are also manufactured for the Company's own instruments and as stand-alone products for space applications. The Company's subminiature oven-controlled quartz crystal oscillator is a low cost, small size, precision crystal oscillator suited for high-end performance required in satellite transmissions, airborne telephony and geophysical survey positioning systems. Commercial satellite programs such as Globalstar, Eutelsat, Inmarsat and Worldstar have utilized the Company's space-qualified products.

### Gillam-FEI segment:

The acquisition of Gillam-FEI in September 2000 extended the Company's competencies into wire-line synchronization, network monitoring, specialized test equipment, and power supply products. With the advent of new digital broadband transmission technologies, reliable synchronization has become the warranty to quality of service for telecom operators. Gillam-FEI is among the world leaders in the field of wireline synchronization, and its products are targeted for telecommunication operators and network equipment manufacturers that utilize modular and flexible platforms to build reliable digital-network-systems worldwide. Telecommunications operators such as Belgacom, France Telecom, Telefonica and other service providers are among Gillam-FEI's major customers.

Network monitoring systems marketed under the brand name LYNX, are a flexible suite of complementary software modules that are arranged to satisfy the specific needs of telecom operators, electrical utilities, and other operators of distribution networks. The multi-task capability of the LYNX system allows operators to supervise and manage the distribution of electricity, gas, video cables, public lighting, and other networks. Deregulation of utilities, especially in Europe, has created a greater demand for the LYNX product. Major

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

customers presently using LYNX include SIG Electrical Services of Geneva, Switzerland; Electricity Distribution Management for the city of Lausanne, Switzerland; UEM Electricity Distribution Management for the city of Metz, France; Brussels International Airport and Belgian Railways.

Specialized test equipment and power supply products are mainly targeted for the telecommunications industry.

U.S. Government segment:

The Company's sales in the U.S. Government segment are made under fixed price contracts either directly with U.S. Government agencies or indirectly through subcontracts intended for government end-use. The price paid to the Company is not subject to adjustment by reason of the costs incurred by the Company in the performance of the contract, except for costs incurred due to contract changes ordered by the customer. These contracts are on a negotiated basis under which the Company bears the risk of cost overruns and derives the benefit from cost savings.

Negotiations on U.S. Government contracts are sometimes based in part on Certificates of Current Costs. An inaccuracy in such certificates may entitle the government to an appropriate recovery. From

6

time to time, the Defense Contracts Audit Agency ("DCAA") of the Department of Defense audits the Company's accounts with respect to these contracts. The Company is not aware of any basis for recovery with respect to past certificates.

All government end-use contracts are subject to termination by the purchaser for the convenience of the U.S. Government and are subject to various other provisions for the protection of the U.S. Government. In the event of such termination, the Company is entitled to receive compensation as provided under such contracts and in the applicable U.S. Government regulations.

The Company's proprietary products have been used in guidance, navigation, communications, radar, sonar surveillance and electronic countermeasure and timing systems. Products are built in accordance with Department of Defense standards and are in use on many of the United States' most sophisticated military aircraft, satellites and missiles. The Global Positioning Satellite System, as well as the MILSTAR Satellite System, are two examples of the programs in which the Company participates. The Company has manufactured the master clock for the Trident missile, the basic timing system for the Voyager I and Voyager II deep space exploratory missions and the quartz timing system for the Space Shuttle. The Company's cesium beam atomic clock is presently employed in low frequency secure communications, surveillance and positioning systems for the United States Air Force, Navy and Army.

### PRODUCTS

-----

The Company's products are manufactured from raw material which, when combined with conventional electronic parts available from multiple sources, become finished products used for commercial wireless and wireline communications, satellite applications, space exploration, position location, radar, sonar and electronic counter-measures. These products are employed in ground-based earth stations, fixed, transportable, portable and mobile communications installations, domestic and international satellites, as well as aircraft, ships, submarines and missiles. The Company's products are marketed as components, instruments, or complete systems. Prices are determined based upon the complexity, design requirement, purchased quantity and delivery schedule.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

COMPONENTS - The Company's key technologies utilize quartz, rubidium and cesium to manufacture precision time and frequency standards and higher level assemblies which allow the users to generate, transmit, and receive synchronous signals in order to communicate effectively, locate their position, secure a communications system, or guide a missile. The components class of the Company's products includes crystal filters and discriminators, surface acoustic wave resonators, and high-reliability thick and thin film hybrid assemblies for space and other applications.

Precision quartz oscillators use quartz resonators in conjunction with electronic circuitry to produce signals with accurate and stable frequency. The Company's products include several types of quartz oscillators, suited to a wide range of applications, including ultrastable units for satellite systems, and fast warm-up, low power consumption units for mobile applications, including wideband-CDMA voice and data communications.

The ovenized quartz oscillator is the most accurate type, wherein the oscillator crystal is enclosed in a temperature controlled environment called a proportional oven. The Company manufactures several varieties of temperature controlling devices and ovens.

The voltage-controlled quartz oscillator is an electronically controlled device wherein the frequency may be stabilized or modulated, depending upon the application.

The temperature compensated quartz oscillator is electronically controlled using a temperature sensitive device to directly compensate for the effect of temperature on the oscillator's frequency.

The rubidium lamp, filter and resonance cell provide the optical subassembly for the manufacture of the Company's optically pumped atomic rubidium frequency standards. The cesium tube resonator is used in the manufacture of the Company's cesium primary standard atomic clocks.

High reliability, MIL-M-38510 Class S and B, hybrid assemblies are manufactured in thick and thin film technologies for applications from DC to 44 GHz. These are used in manufacturing the Company's products and also supplied directly to customers, for space and other high reliability systems.

7

Efficient and reliable DC-DC power converters are manufactured for the Company's own instruments and as stand alone products, for space applications.

The Company manufactures filters and discriminators using its crystal resonators for its own radio-frequency and microwave receiver, signal conditioner and signal processor products.

INSTRUMENTS - The Company's instrument line consists of three basic time and frequency generating instruments and a number of instruments which test and distribute the time and frequency. The Company's time and frequency generating instruments are the quartz frequency standard, rubidium atomic standard and cesium beam atomic standard.

The quartz frequency standard is an electronically controlled solid-state device which utilizes a quartz crystal oscillator to produce a highly stable output signal at a standardized frequency. The Company's frequency standard is used in communications, guidance and navigation and time synchronization. The Company's products also include a precision frequency standard with battery back-up and memory capability enabling it to remain in operation if a loss of power has occurred.



## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

The optically pumped atomic rubidium frequency standard is a solid-state instrument which provides both timing and low phase noise frequency references used in commercial communications systems. Rubidium oscillators combine sophisticated glassware, light detection devices and electronics packages to generate a highly stable frequency output. Rubidium, when energized by a specific radio frequency, will absorb less light. The oscillator's electronics package generates this specific frequency and the light detection device ensures, through monitoring the decreased absorption of light by the rubidium and the use of feedback control loops, that this specific frequency is maintained. This highly stable frequency is then captured by the electronics package and generated as an output signal. Rubidium oscillators provide atomic oscillator stability, at lower costs and in smaller packages.

The cesium beam atomic standard utilizes the atomic resonance characteristics of cesium atoms to generate precise frequency several orders of magnitude more accurate and stable than other types of quartz frequency generators. The Company's atomic standard is a compact, militarized solid-state device which generates these precision frequencies for use with advanced communications and navigation equipment. A digital time-of-day clock is incorporated which provides visual universal time display and digital timing for systems use. The atomic standard manufactured by the Company is a primary standard, capable of producing time accuracies of better than one second in seven hundred thousand years.

As the demands on communications systems increase, the requirement for precise frequency signals to drive a multitude of electronic equipment is greatly expanded. To meet this requirement, the Company manufactures a distribution amplifier which is an electronically controlled solid-state device that receives a base frequency from a frequency standard and provides multiple signal outputs of the input frequency. A distribution amplifier enables many items of electronic equipment in a single facility, aircraft or ship to receive a standardized frequency and/or time signal from a quartz, rubidium or cesium atomic standard.

SYSTEMS - The systems portion of the Company's business includes manufacturing and integrating selections of its specialized components into higher level subsystems and systems that meet customer-defined needs. The Company has a unique knowledge of interfacing these technologies and experience in applying them to a wide range of systems. The systems generate electronic frequencies of predetermined value and then divide, multiply, mix, convert, modulate, demodulate, filter, distribute, combine, separate, switch, measure, analyze, and/or compare these signals depending on the system application.

This portion of the Company's business includes a complete line of time and frequency control systems, capable of generating many frequencies and time scales that may be distributed to widely dispersed users, or within the confines of a facility or platform, or for a single dedicated purpose. Time and frequency control systems combine the Company's cesium, rubidium and/or crystal instruments with its other components, to provide systems for wireless, wireline, space and defense applications.

For the wireless industry, the Company integrates its core components such as quartz oscillators and rubidium atomic standards with software applications, microprocessors, and other digital circuitry into complete subsystems. These subsystems supply frequency and time reference signals that facilitate

wireless communications and are necessary for the various wireless technologies to operate properly. The customers for these subsystems are global wireless infrastructure manufacturers.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

For the wireline industry, the Company integrates its core components with other electronic modules into high-level platforms that provide a total synchronization solution. These signal synchronization units or "SSUs," are primarily designed and manufactured by Gillam-FEI. SSUs are inserted into digital telecommunication networks and provide reliable synchronization for proper operation of the network. The systems are primarily sold to telecommunication operators and vary from a few SSUs for a simple network to hundreds of units for complex networks. For operators of distribution networks such as electrical utilities and telecommunications operators, the Company offers the LYNX system--a flexible suite of complementary software modules that are distinctively combined to satisfy the requirements of the users. With the advent of digital broadband transmission technologies, reliable synchronization has become the Quality of Service for telecommunications operators world-wide.

For the space and defense sectors the Company combines its core products in a wide range of diverse applications that provide systems for space and ground based communications, space exploration, satellite tracking stations, satellite-based navigation and position location, secure communication, submarine and ship navigation, calibration, and electronic counter-measures applications. These time and frequency control systems can provide up to quadruple redundancy to assure operational longevity and dependability.

The Company's new subsidiary, FEI-Zyfer, manufactures products incorporating GPS technology by utilizing GPS signals to derive time and frequency information. These systems and subsystems are used in Enhanced wireless 911 (E911), secure government and commercial communications and other applications.

### BACKLOG

-----

As of April 30, 2003, the Company's consolidated backlog amounted to approximately \$31 million (see Item 7). Approximately 60% of this backlog is expected to be filled during the Company's fiscal year ending April 30, 2004. The backlog, which reflects only firm purchase orders and contracts, is subject to change by reason of several factors including possible cancellation of orders, change orders, terms of the contracts and other factors beyond the Company's control. Accordingly, the backlog is not necessarily indicative of the revenues or profits (losses) which may be realized when the results of such contracts are reported.

### CUSTOMERS AND SUPPLIERS

-----

The Company markets its products both directly and through 27 independent sales representative organizations located principally in the United States and Europe. Sales to non-U.S. customers, including all of the sales of Gillam-FEI, totaled approximately 38%, 42% and 29% of net sales in fiscal years 2003, 2002 and 2001, respectively.

The Company's products are sold to a variety of customers, both commercial and governmental. For the years ended April 30, 2003, 2002 and 2001, approximately 28%, 11% and 7%, respectively, of the Company's sales were made under contracts to the U.S. Government or subcontracts for U.S. Government end-use.

The Company's consolidated sales for each of the years ended April 30, 2003, 2002 and 2001 included sales to Motorola Corp. ("Motorola") of approximately \$10.0 million, \$15.5 million and \$17.7 million, respectively. These amounts represent 32%, 38% and 36%, respectively, of consolidated sales for each of those years. Northrop Grumman Corporation ("Northrop") accounted for \$3.5 million of revenues in fiscal 2003 or 11% of consolidated sales. For the year

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

ended April 30, 2001, sales to Space Systems Loral ("SSL") were \$5.2 million or 11% of the Company's consolidated sales. During the three years ended April 30, 2003, sales to Motorola and SSL were made by the Company's Commercial Communications segment, accounting for 66% in fiscal 2003, 65% in fiscal 2002 and 63% in fiscal 2001 of that segment's total sales. During fiscal 2003 and 2002, France Telecom and Belgacom were major customers of the Gillam-FEI segment. France Telecom accounted for 13% and 18%, respectively, and

9

Belgacom accounted for 10% and 12%, respectively, of the segment's revenues in those fiscal years. In fiscal 2001, Itissalat al Maghrib and France Telecom accounted for 29% and 11%, respectively, of Gillam-FEI's revenues. Fiscal 2003 revenues in the U.S. Government segment included sales to three customers, Northrop, Raytheon Missile Systems, Inc. ("Raytheon") and BAE Systems Aerospace, Inc. ("BAE"), accounting for 40%, 22% and 14%, respectively of total segment sales. In fiscal 2002, Boeing Satellite Systems, Inc. ("Boeing"), Raytheon and BAE accounted for 32%, 26% and 19%, respectively, of total segment revenues. In fiscal 2001, two customers, Raytheon and Boeing, accounted for 68% of U.S. Government revenues. The loss by the Company of any one of these customers would have a material adverse effect on the Company's business. The Company believes its relationship with these companies to be mutually satisfactory and is not aware of any prospect for the cancellation or significant reduction of any of its commercial or existing U.S. Government contracts.

The Company purchases a variety of components such as transistors, resistors, capacitors, connectors and diodes for use in the manufacture of its products. The Company is not dependent upon any one supplier or source of supply for any of its component part purchases and maintains alternative sources of supply for all of its purchased components. The Company has found its suppliers generally to be reliable and price-competitive.

### RESEARCH AND DEVELOPMENT

-----

The Company's technological expertise continues to be an important factor to support future growth in revenues and earnings. The Company has focused its internal research and development efforts on improving the core physics and electronic packages in its time and frequency products; conducting research to develop new time and frequency technologies; improving product manufacturability by seeking to reduce its production costs through product redesign and process improvements and other measures to take advantage of lower cost components.

The Company continues to focus a significant portion of its own resources and efforts on developing hardware for satellite and terrestrial commercial communications systems, including wireless, wireline and fiber optic systems. During fiscal years 2003, 2002 and 2001, the Company expended \$4.6 million, \$6.6 million and \$4.8 million of its own funds, respectively, on such research and development activity. (See also Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.) For fiscal year 2004, the Company is targeting to spend from \$3.5 million to \$5.0 million on research and development in similar areas but will spend more or less as market conditions and opportunities warrant.

### PATENTS AND LICENSES

-----

The Company believes that for the most part, its business is not dependent on patent or license protection. Rather, it is primarily dependent upon the Company's technical competence, the quality of its products and its prompt and responsible contract performance. However, the rights to inventions of employees working for the Company are assigned to the Company and the Company presently

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

holds such patents and licenses. In certain limited circumstances, the U.S. Government may use or permit the use by the Company's competitors, certain patents or licenses the government has funded. During fiscal 2003, the Company received a broad and significant patent for new, proprietary quartz oscillator technology which the Company will exploit in both legacy and new applications.

### COMPETITION

-----

The Company experiences competition in all areas of its business. The Company competes primarily on the basis of the accuracy, performance and reliability of its products; the ability of its products to function under severe conditions, such as in space or other extreme hostile environments; prompt and responsive contract performance; technical competence and price. The Company has a unique and broad product line which includes all three frequency standards - quartz, rubidium, and cesium. Because of the very high precision of certain of its components, the Company has few competitors. For lower precision components there is significant competition from a number of suppliers.

10

In recent years, the Company has successfully outsourced certain component manufacturing processes to third parties and more recently to its wholly-owned subsidiary, FEI-Asia in Tianjin, China and to Russian-based Morion, Inc., in which the Company is a minority shareholder. The Company expects this outsourcing to enhance its competitive position on cost while maintaining its high quality standards. The Company believes its ability to obtain raw materials, manufacture finished products, integrate them into systems and sub-systems, and interface these systems with end-user applications provides a strong competitive advantage.

Certain of the Company's competitors are larger, have greater financial resources and have larger research and development and marketing staffs.

With respect to its instruments and systems, the Company competes with Hewlett-Packard Company, Symmetricom, Inc, E. G. and G., Inc. and others. Systems for the wireline industry produced by the Gillam-FEI segment compete with Symmetricom, Inc. which recently merged with another competitor. The Company's principal competition for space products is the in-house capability of its major customers.

### EMPLOYEES

-----

The Company employs approximately 340 persons worldwide. None of the U.S. employees are represented by labor unions while in Europe, approximately 20 employees in one facility are represented by a French labor union.

### OTHER ASPECTS

-----

The Company's business is not seasonal although it expects to experience some fluctuation in revenues during the second fiscal quarter as a result of extended holiday periods in August. No unusual working capital requirements exist.

### Item 2. Properties

-----

The Company operates out of several facilities located around the world. Each facility is used for manufacturing its products and for administrative activities. The following table presents the location, size and terms of

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

ownership/occupation:

Location -----	Size (sq. ft.) -----	Own or Lease -----
Long Island, NY	93,000	Lease
Liege, Belgium	34,000	Own
Chalon Sur Saone, France	37,000	Own
Tianjin, China	6,000	Lease

The Company's facility located in Mitchel Field, Long Island, New York, is part of the building that the Company constructed in 1981 and expanded in 1988 on land leased from Nassau County. In January 1998, the Company sold this building and the related land lease to Reckson Associates Realty Corp. ("Reckson"), leasing back the space that it presently occupies.

The Company leases its manufacturing and office space from Reckson under an 11-year lease at an annual rental of \$400,000 per year with the Company paying its pro rata share of real estate taxes along with the costs of utilities and insurance. The lease provides for two 5-year renewal periods, exercisable at the option of the Company, with annual rentals of \$600,000 during the first renewal period and \$800,000 during the second renewal period. Under the terms of the lease, new office and engineering facilities for the Company were constructed at the cost of Reckson. The leased space is adequate to meet the Company's domestic operational needs.

The sale of its building to Reckson, a real estate investment trust ("REIT") whose shares are traded on the New York Stock Exchange, was effected through a tax-deferred exchange of the building for approximately 486,000 participation units of Reckson Operating Partnership, L.P. ("REIT units") which

11

were valued at closing at \$12 million. Each REIT unit is convertible into one share of the common stock of the REIT. In addition, approximately 27,000 REIT units have been placed in escrow which may be released to the Company based upon the price per share of the REIT on the date of conversion of REIT units. Under the accounting provisions for sale and leaseback transactions, the sale of this building is considered a financing and the REIT units received are reflected as a noncurrent liability while the related building continues to be reflected as an asset. Upon liquidation of the REIT units, a portion of the resulting gain on this sale will be deferred and recognized into income over the term of the leaseback with the balance recognized in income on the date of liquidation. (See Note 6 to the accompanying financial statements.)

The properties located in Belgium and France were acquired upon completion of the Gillam S.A. acquisition. These facilities are adequate to meet the present and future operational requirements of Gillam-FEI. During the year ended April 30, 2003, the Company sold a portion of the building owned by its subsidiary in France, receiving proceeds of \$275,000 and realizing a gain of \$152,000 which amount is included in other income and expense.

The Tianjin, China facility is the location of the Company's newly established subsidiary, FEI-Asia. Space has been leased within a manufacturing facility located in the Trade-Free Zone. The lease is renewable annually with rent of \$9,850 payable quarterly. The amount of space is adequate for the near-term manufacturing expectations for the Company.

### Item 3. Legal Proceedings

-----

A judgment in favor of the Company, dated September 3, 2002, was entered by the United States District Court for the Eastern District of New York in

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

connection with its dismissal of a qui tam action which was brought in March 1994 by Ralph Muller, a former FEI employee. A qui tam action is an action wherein an individual may, under certain circumstances, bring a legal action against one or more third persons on behalf of the Government for damages and other relief by reason of one or more alleged wrongs perpetrated against the Government by such third persons. The judgment is based on the Court's decision on the merits in favor of Frequency Electronics, Inc. and its CEO, Martin B. Bloch, dated August 23, 2002. The judgment preserves all of FEI's rights to recover costs and its causes of action against the plaintiff and third party defendants. (For a more complete description of the litigation brought against the Company and the related settlement actions, see Item 3. Legal Proceedings in the Company's Annual Report on Form 10-K for the year ended April 30, 2001, a copy of which is on file with the Securities and Exchange Commission.)

### Directors' and Officers' Insurance Coverage

-----

On April 30, 2002, FEI settled the arbitration proceeding it had commenced in June 2001 before the American Arbitration Association against The Home Insurance Company ("Home") under a \$2.0 million excess directors and officers liability insurance policy. FEI had asserted claims for its loss relating to, among other matters, sums it paid in connection with the Settlement Agreement and Global Disposition with the Government on June 19, 1998. (For a description of these litigations, the Settlement Agreement and Global Disposition, refer to Item 3 of the Registrant's Annual Report on Form 10-K for the year ended April 30, 1998, a copy of which is on file with the Securities and Exchange Commission.) Under the terms of the settlement agreement, Home paid FEI \$1.5 million, FEI released its claims and the arbitration was discontinued.

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

-----

No matters were required to be submitted by Registrant to a vote of security holders during the fourth quarter of fiscal 2003.

12

## PART II

-----

### Item 5. Market for the Company's Common Equity and Related Stockholder Matters

-----

The Common Stock of the Company is listed on the American Stock Exchange under the symbol "FEI". The following table shows the high and low sale price for the Company's Common Stock for the quarters indicated, as reported by the American Stock Exchange.

FISCAL QUARTER	HIGH SALE	LOW SALE
-----	-----	-----
2003 -		
FIRST QUARTER	\$13.04	\$ 5.62
SECOND QUARTER	8.00	5.00
THIRD QUARTER	11.50	7.34
FOURTH QUARTER	10.25	8.16

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

2002 -

FIRST QUARTER	\$19.20	\$12.90
SECOND QUARTER	17.90	9.00
THIRD QUARTER	15.40	11.10
FOURTH QUARTER	14.00	11.10

As of July 22, 2003, the approximate number of holders of record of common stock was 600. The closing share price of the Company's stock on July 22, 2003 was \$9.85.

### DIVIDEND POLICY

On March 24, 1997, the Company announced a policy of distributing a cash dividend to shareholders of record on April 30 and October 31, payable on June 1 and December 1, respectively. The Board of Directors will determine dividend amounts prior to each declaration based on the Company's financial condition and financial performance.

### EQUITY COMPENSATION PLAN INFORMATION

Plan Category	Number of Securities to be Issued upon exercise of Outstanding Options Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options Warrants and Rights
	(a)	(b)
Equity Compensation Plans Approved by Security Holders	343,750	\$ 7.76
Equity Compensation Plans Not Approved by Security Holders	824,162	\$12.52

13

### Item 6. Selected Financial Data

The following table sets forth selected financial data including net sales and operating profit (loss) for the five-year period ended April 30, 2003. The information has been derived from the audited financial statements of the Company for the respective periods.

### CONSOLIDATED STATEMENTS OF OPERATIONS DATA

	2003	2002	Years Ended April 2001
	----	----	----
Net Sales			(in thousands, except s

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Commercial Communications	\$ 15,051	\$ 26,663	\$ 36,2
U.S. Government	8,906	4,513	3,7
Gillam-FEI	8,137	11,223	9,2
less intersegment sales	(567)	(1,220)	(
	-----	-----	-----
Total Net Sales	\$ 31,527	\$ 41,179	\$ 49,2
	=====	=====	=====
Operating Profit (Loss)	(\$12,490) (1)	\$ 89 (2)	\$ 5,9
	=====	=====	=====
Net (Loss) Income	(\$ 8,860)	\$ 1,378 (3)	\$ 5,6
	=====	=====	=====
Average Common Shares Outstanding			
Basic	8,331,785	8,350,735	8,198,5
Diluted	8,331,785	8,529,175	8,431,8
Earnings per Common Share			
Basic	(\$ 1.06)	\$ 0.17	\$ 0.
	=====	=====	=====
Diluted	(\$ 1.06)	\$ 0.16	\$ 0.
	=====	=====	=====

CONSOLIDATED BALANCE SHEET DATA

Total Assets	\$ 85,729	\$ 96,011	\$ 102,0
	=====	=====	=====
Long-Term Obligations and Deferred Items	\$17,903	\$ 17,796	\$ 18,0
	=====	=====	=====
Cash dividend declared per common share	\$ 0.20	\$ 0.20	\$ 0.
	=====	=====	=====

- (1) Includes writedown of Goodwill of \$6.2 million and adjustments to inventory of \$3.6 million
- (2) Includes insurance reimbursement of \$1.5 million for expenses related to certain litigation with the U.S. Government less inventory reserves and writeoffs aggregating \$1.0 million.
- (3) In addition to items in (2) above, includes \$300,000 investment loss for an other than temporary value in a marketable security.
- (4) Includes insurance reimbursement of \$2.8 million (net of professional fees) for expenses related to litigation with the U.S. Government, inventory reserves of \$2.0 million related to certain litigation, and \$300,000 of acquisition-related nonrecurring costs.
- (5) In addition to items in (4) above, includes \$287,000 investment loss for an other than temporary value in a marketable security.
- (6) Includes insurance reimbursement of \$4.5 million for legal fees related to certain litigation with the U.S. Government.



## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

### Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements. The Company believes its most critical accounting policies to be the recognition of revenue and costs on production contracts and the valuation of inventory. Each of these areas requires the Company to make use of reasoned estimates including estimating the cost to complete a contract, the realizable value of its inventory or the market value of its products. Changes in estimates can have a material impact on the Company's financial position and results of operations.

#### Revenue Recognition

-----

Revenues under larger, long-term contracts, generally defined as orders in excess of \$100,000, are reported in operating results using the percentage of completion method. For U.S. Government and other fixed-price contracts that require initial design and development of the product, revenue is recognized on the cost-to-cost method. Under this method, revenue is recorded based upon the ratio that incurred costs bear to total estimated contract costs with related cost of sales recorded as the costs are incurred. Each month management reviews estimated contract costs. The effect of any change in the estimated gross margin percentage for a contract is reflected in revenues in the period in which the change is known. Provisions for anticipated losses on contracts are made in the period in which they become determinable.

On production-type contracts, revenue is recorded as units are delivered with the related cost of sales recognized on each shipment based upon a percentage of estimated final contract costs. Changes in job performance may result in revisions to costs and income and are recognized in the period in which revisions are determined to be required. Provisions for anticipated losses on contracts are made in the period in which they become determinable.

For contracts in the Company's Gillam-FEI segment, and smaller contracts or orders in the other business segments, sales of products and services to customers are reported in operating results based upon shipment of the product or performance of the services pursuant to contractual terms. When payment is contingent upon customer acceptance of the installed system, revenue is deferred until such acceptance is received.

#### Costs and Expenses

-----

Contract costs include all direct material, direct labor costs, manufacturing overhead and other direct costs related to contract performance. Selling, general and administrative costs are charged to expense as incurred.

#### Inventory

-----

In accordance with industry practice, inventoried costs contain amounts relating to contracts and programs with long production cycles, a portion of which will not be realized within one year. Inventory reserves are established for slow-moving and obsolete items and are based upon management's experience and expectations for future business. Any changes in reserves arising from revised expectations are reflected in cost of sales in the period the revision is made.

#### Equity-based Compensation

-----

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

The Company applies the disclosure-only provisions of FAS No. 123, "Accounting for Stock-Based Compensation," and continues to measure compensation cost in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Historically, this has not resulted in compensation cost upon the grant of options under a qualified stock option plan. However, in accordance with FAS No. 123, the Company provides pro forma disclosures of net earnings (loss) and earnings (loss) per share as if the fair value method had been applied beginning in fiscal 1996.

15

The following table illustrates the effect on the Company's consolidated statements of operations had compensation cost for stock option awards under the plans been determined based on the fair value at the grant dates consistent with the provisions of FAS No. 123:

	(in thousands, except per share data)		
	2003	2002	2001
	----	----	----
Net (Loss) Income, as reported	(\$8,860)	\$1,378	\$5,644
	=====	=====	=====
Net (Loss) Income - pro forma	(\$9,574)	\$474	\$5,233
	=====	=====	=====
 (Loss) Earnings per share, as reported:			
Basic	(\$ 1.06)	\$0.17	\$ 0.69
	=====	=====	=====
Diluted	(\$ 1.06)	\$0.16	\$ 0.67
	=====	=====	=====
 (Loss) Earnings per share- pro forma			
Basic	(\$ 1.15)	\$0.06	\$ 0.64
	=====	=====	=====
Diluted	(\$ 1.15)	\$0.06	\$ 0.62
	=====	=====	=====

The weighted average fair value of each option has been estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions used for grants in 2003, 2002 and 2001, respectively, dividend yield of 1.83%, 1.83% and 3.0%; expected volatility of 63%, 65%, and 70%; risk free interest rate (ranging from 5.5% to 8.0%); and expected lives ranging from seven to ten years.

### RESULTS OF OPERATIONS

-----

The table below sets forth for the fiscal years ended April 30 the percentage of consolidated net sales represented by certain items in the Company's consolidated statements of operations:

	2003	2002	2001
	----	----	----
Net Sales			
Commercial Communications	46.9%	63.4%	73.6%
U.S. Government	28.3	11.0	7.6
Gillam-FEI	24.8	25.6	18.8
	-----	-----	-----
	100.0	100.0	100.0
Cost of Sales	81.5	65.8	65.4
	-----	-----	-----
Gross Margin	18.5	34.2	34.6
Selling and Administrative expenses	24.0	21.7	17.9

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Goodwill writedown	19.5	-	-
Insurance Reimbursement, net	-	(3.6)	(5.2)
Research and Development expenses	14.6	15.9	9.8
	-----	-----	-----
Operating (Loss) Profit	(39.6)	0.2	12.1
Other Income (Expense)	5.8	3.9	4.7
(Benefit) Provision for Income Taxes	(5.6)	0.8	5.3
	-----	-----	-----
Net (Loss) Income	(28.2%)	3.3%	11.5%
	=====	=====	=====

### Significant Events

-----

As more thoroughly described elsewhere in this Form 10-K and in the notes to the financial statements, the Company's fiscal 2003, 2002 and 2001 results of operations were materially impacted by several specific events. In fiscal 2003, the Company determined that the goodwill associated with its investment in Gillam-FEI had become impaired and wrote off the full amount of goodwill in the amount of \$6.2 million. In fiscal 2002 and 2001, the Company recovered \$1.5 million and \$2.8 million (net of \$200,000 in expenses in 2001), respectively, from two insurance companies related to expenses incurred

16

in defense and settlement of the Company's litigation with the U.S. Government. (See Item 3. Legal Proceedings and Note 9 to the financial statements.) In October 2000, the Company also settled a derivative suit stemming from its U.S. Government litigation and paid approximately \$224,000 in attorneys' fees and expenses.

Without these significant events, the Company's operating (loss) profit, pre-tax earnings and net earnings would be materially different from that reported in the financial statements. The table below illustrates the impact of the special income and expense items on the results of operations for each of the three years ended April 30:

	2003	2002
	----	----
Operating (loss) profit - as reported	(\$12,490)	\$ 89
Add back:		
Goodwill impairment charge/amortization	6,158	-
Less:		
Insurance reimbursement, net	-	(1,500)
	-----	-----
Operating (loss) profit, excluding special items	\$ (6,332)	\$ (1,411)
	=====	=====

### Operating (Loss) Profit

-----

The operating (loss) profit for the year ended April 30, 2003, decreased by \$12.5 million from the operating profit reported in the prior fiscal year. In addition to the special items listed above, the Company wrote-off or reserved against certain work-in-process and component inventory in the amount of \$3.6 million in fiscal 2003 and \$1.0 million in fiscal 2002. Excluding the special items identified above and the inventory adjustments in both fiscal years, the

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

operating loss in fiscal 2003 increased by \$2.3 million compared to the operating loss for fiscal 2002. Revenues declined by 23% while gross margins, exclusive of inventory adjustments, decreased to 30% of revenue from 37% a year ago. These results reflect the continuing low level of telecommunication-related business. Although the Company has reduced costs in all categories, it has maintained its core operational capabilities while continuing to invest in new products, efficient manufacturing processes and development of non-US manufacturing capacity.

During fiscal 2002, the operating profit decreased by \$5.8 million from the operating profit recorded for the year ended April 30, 2001. In each year, the Company wrote-off or reserved against certain work-in-process and component inventory in the amount of \$1.0 million in fiscal 2002 and \$2.0 million in fiscal 2001. Excluding the inventory adjustments and special items as described in the table above, the operating loss was \$6.3 million lower than the operating profit recorded in fiscal 2001. Revenues declined by 16% and gross margins, exclusive of inventory adjustments, were lower, reflective of the more challenging market faced by the Company beginning in fiscal 2002. Despite the near-term slowdown in the telecommunications industry, the Company believed it was critical to its future success to continue making strategic investments. Funds were provided to the manufacturing facility in China to qualify it for expected new business opportunities in Asia, the costs of which are included in selling and administrative expenses. In addition, the Company developed new products, including Gillam-FEI's wireline synchronization product for the US market, and improved product designs and manufacturing processes, many of which were not completed until fiscal 2003.

### Net Sales

-----

Net sales for fiscal 2003 decreased by \$9.7 million (23%) from fiscal 2002 sales. The principal cause for the decline is attributable to the world-wide slowdown in capital spending in the telecommunications industry which the Company serves. Revenues for the Commercial Communications segment decreased by \$11.6 million (44%) and Gillam-FEI revenues decreased by \$3.1 million (28%). Offsetting these declines, revenues for the US Government segment almost doubled from the fiscal 2002 levels, to \$8.9 million, as the Company responded to the US Government's need for more sophisticated secure communications and weaponry.

Fiscal 2002 revenues decreased by \$8.0 million (16%) over fiscal 2001 sales. The decline in telecommunication spending began during fiscal 2002. Revenues for the Commercial Communications

17

segment declined by \$9.6 million (27%), while revenues increased by 21% for both the U.S. Government (\$786,000) and Gillam-FEI (\$1.9 million) over fiscal 2001. (Gillam-FEI's fiscal 2001 revenues are from the date of acquisition by the Company.)

Given the uncertainties in telecommunications markets, the Company is unable to make any assessment for near-term future sales in the Commercial Communications or Gillam-FEI segments of its business. The Company anticipates revenues for its U.S. Government segment will continue to increase as more funding is provided by the government for such projects as secure radios, new communication satellites, unmanned aerial vehicles and weapons guidance systems. Over the long-term, the Company continues to believe that the telecommunications markets, including cellular network infrastructure and wireline synchronization world-wide, will be important growth areas of its business.

### Gross Margins

-----

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

The gross margin rate for fiscal year 2003 decreased to 19% of net sales compared to 34% in fiscal 2002 and 35% in fiscal 2001. Excluding the inventory adjustments described above, gross margin rates as a percentage of sales in each fiscal year would have been 30%, 37% and 39%, respectively. Decreasing sales account for much of the decline as a lower level of sales absorbed a greater percentage of fixed overhead costs. In addition, in fiscal 2003 gross margin rates were reduced by approximately 3% as the Company experienced a high level of warranty expenses.

In addition to lower sales in fiscal 2002, a greater percentage of consolidated sales (27%) were made from the Gillam-FEI segment than in fiscal 2001 (19%). Costs in this segment are generally higher than in the U.S. segments. In both fiscal 2003 and 2002, Gillam-FEI gross margin rates were 30% compared to 15% in fiscal 2001.

The Company's target is to achieve an overall gross margin rate of 40% or better through greater sales volume, continued process improvements and utilization of lower cost manufacturers in Russia and China.

### Selling and Administrative expenses

-----

Selling and administrative costs in fiscal 2003 decreased by \$1.4 million (15%) from fiscal 2002 as the Company responded to the lower level of business volume. During the year, Gillam-FEI lowered its administrative support costs by 18% in euros but the savings were reduced to \$175,000 (7%) when translated to US dollars due to the 13% increase in the value of the Euro to the US dollar during fiscal 2003. Costs associated with the establishment of the Company's FEI-Asia facility were halved (approximately \$250,000 lower) as less time was required by US-based personnel to support that operation and more costs were borne in the China facility where operating expenses are much lower than in the US. Offsetting those cost reductions was an increase in the costs to support the new European sales office. In the US subsidiaries, cost savings in fiscal 2003 of \$1.1 million were related to personnel reductions, lower charges to deferred compensation expense, reduced sales commissions and reduction in legal and other professional fees.

Selling and administrative costs for the year ended April 30, 2002, increased by \$112,000 or 1% over fiscal 2001. As a percentage of sales, these costs increased from 18% in fiscal 2001 to 22% in fiscal 2002. (The Company targets selling and administrative expenses to be less than 20% of sales.) The 2002 amounts include approximately \$500,000 attributable to start-up operating costs of the Company's new China manufacturing facility. Excluding this expense, selling and administrative costs would have been 20% of sales. For fiscal 2002, significant increases in selling and administrative expenses aggregating \$1.4 million over the prior year, resulted from a full year of expenses for Gillam-FEI compared to the partial year in fiscal 2001 and an increase in the accrual for certain long-term compensation programs as a result of benefit adjustments authorized during fiscal 2002. These increases were offset by substantial cost reductions aggregating \$1.7 million related to lower incentive compensation accruals due to reduced profitability in fiscal 2002, lower employee recruitment expenses, reduced travel-related costs, elimination of amortization of goodwill and a decrease in amortization expense related to independent contractor stock options awarded in prior years.

18

### Research and Development expenses

-----

Research and development expenses in fiscal 2003 were \$2.0 million lower

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

(30%) than fiscal 2002 spending and were approximately 15% of revenues. During fiscal 2003, the Company completed development of certain manufacturing process improvements and new product designs. Related personnel and other resources were refocused on production activities as development projects were concluded. Other research and development activities are on-going and involve further product and process improvements, development of a common platform for time and frequency generators which will enable the interchange of a crystal or rubidium oscillator, and to maintain the Company's competitive position in the markets it serves.

Research and development expenditures for the year ended April 30, 2002, increased by \$1.7 million or 36% over the amounts incurred in fiscal 2001 and were approximately 16% of sales. Of this amount, approximately \$1.0 million was incurred to develop wireline synchronization products for the U.S. market. Other development efforts were focused on manufacturing process improvements, completion of a high precision quartz oscillator as well as next-generation products for cellular network infrastructure markets.

The Company will continue to focus its research and development activities on those products which it expects will provide the best return on investment and greatest prospects for the future growth of the Company. For fiscal year 2004, the Company will complete its initial development of the enhanced Gillam-FEI wireline synchronization product and will make further investment in new designs and manufacturing process improvements. The Company's target is to spend approximately 10% of revenues on research and development activities, although the actual level of spending is dependent on new opportunities and the rate at which it succeeds in bringing new products to market. Internally generated cash and cash reserves will be adequate to fund these development efforts.

Other Income, net  
-----

Other income, net, increased by \$216,000 (13%) in fiscal 2003 compared to fiscal 2002 and decreased by \$718,000 (31%) in fiscal 2002 compared to fiscal 2001.

Investment income during the year ended April 30, 2003 decreased by \$34,000 compared to fiscal 2002 and fiscal 2002 was lower by \$791,000 (30%) compared to fiscal 2001. In all three years, the Company recorded realized gains and losses on marketable securities. In fiscal 2003, realized losses on marketable securities of \$130,000 were partially offset by realized gains of \$90,000. Similarly, during fiscal 2002 the Company recorded a \$300,000 writedown to market value of a certain marketable security whose decline in value was deemed to be other than temporary which loss was offset by realized gains on sales of marketable securities of \$172,000. This is compared to fiscal 2001 when the Company had realized gains of \$469,000 on the sale of marketable securities less a \$287,000 writedown to market value of a marketable security whose decline in value was deemed to be other than temporary. Excluding these net gains and losses, investment income in fiscal 2003 was \$122,000 (6%) lower than fiscal 2002 and fiscal 2002 was lower by \$480,000 (19%) than fiscal 2001. This decline is attributable to a combination of lower interest rates and a decreased level of invested assets as a result of the Gillam acquisition in the first half of fiscal 2001. In addition to interest income, the Company also realizes quarterly dividend income on its REIT units. The Company anticipates that investment income in 2004 will decrease as a result of cash used to acquire and support FEI-Zyfer (see Note 17 to the financial statements), and a lower interest rate environment.

Interest expense for the year ended April 30, 2003 decreased by \$19,000 (6%) compared to fiscal 2002 which decreased by \$31,000 (9%) from fiscal 2001. As the Company retires its short and long-term financing obligations, interest expense

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

will continue to decline. The Company incurs interest expense on Gillam-FEI's credit obligations, the financing arrangement for the leaseback of the U.S. manufacturing facility and for certain deferred compensation payments. The Company anticipates that interest expense in fiscal 2004 will be approximately the same as the expense for fiscal 2003.

During the year ended April 30, 2003, other income, net, increased by \$231,000 over the prior fiscal year. The largest component of this increase was the realized gain of approximately \$150,000 on the sale of a portion of real property owned by the Company's French subsidiary. In fiscal 2002, other income, net, increased by \$42,000 over fiscal 2001. Gillam-FEI contributed \$127,000 and \$76,000 of this

19

growth in fiscal years 2002 and 2001, respectively. The Company anticipates that in future years other income, net, will not be a significant contributor to pretax earnings.

### Income Taxes

-----

The Company is subject to taxation in several countries. The statutory federal rates vary from 34% in the United States to 35% in Europe. The effective rate for the Company for the year ended April 30, 2003 was 17% (benefit) compared to 19% in fiscal 2002 and 31% in fiscal 2001. In fiscal 2003, the tax benefit rate is impacted by the non-deductibility of the goodwill writedown. In the two prior years, the effective rate is lower than the statutory rate primarily due to the availability of Research and Development Tax Credits in the United States. (See Note 13 to the Consolidated Financial Statements.)

The Company's European subsidiaries have available net operating loss carryforwards of approximately \$2.0 million to offset future taxable income. These loss carryforwards have no expiration date.

### LIQUIDITY AND CAPITAL RESOURCES

-----

The Company's balance sheet continues to reflect a highly liquid position with working capital of \$62.0 million at April 30, 2003. Included in working capital at April 30, 2003 is \$33.8 million consisting of cash, cash equivalents and short-term investments, including approximately \$9.7 million representing the fair market value of REIT units which are convertible to Reckson Associates Realty Corp. common stock. (See Note 6 to the financial statements.) The Company's current ratio at April 30, 2003 is 11.5 to 1.

Net cash provided by operating activities for the year ended April 30, 2003, was \$2.4 million compared to \$4.9 million provided in fiscal 2002. The Company recorded an \$8.9 million net loss for fiscal 2003, which included substantial non-cash charges, such as the writedown of goodwill for \$6.2 million and certain adjustments to inventory. Additionally, cash was provided by collections on accounts receivable and reductions of inventory offset by payments against accounts payable and other liabilities. Fiscal 2002 cash from operations was partially derived from \$4.5 million received during the year for reimbursement of expenses under directors' and officers' liability insurance coverage. (See Item 3. Legal Proceedings and Note 9 to the financial statements.) This inflow was offset by payment of income taxes of \$3.3 million, of which approximately 45% was attributable to the insurance reimbursements.

Net cash provided by investing activities for the year ended April 30, 2003, was \$506,000. Approximately \$1.2 million was generated by the sale and maturity of certain marketable securities, net of purchases. Approximately \$834,000 was

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

used to acquire additional property, plant and equipment while approximately \$275,000 was received from the sale of a portion of real property owned by the Company's French subsidiary. An additional \$120,000 was recorded as capitalized investment costs related to the Company's May 2003 acquisition of FEI-Zyfer. (See Note 16 to the accompanying financial statements.) Investing activities in fiscal 2002 resulted in cash inflow of \$607,000 consisting of net transactions in marketable securities of \$2.5 million offset by capital expenditures of \$1.5 million and an investment in a Russian crystal manufacturer of \$300,000. In fiscal 2001, net cash used in investing activities was \$5.0 million. The major transaction during fiscal 2001 was the acquisition of Gillam-FEI for which the Company utilized cash of \$8.9 million, including transaction costs. This purchase was partially funded by the redemption of certain marketable securities of approximately \$6.2 million and was also offset by the acquired cash of Gillam-FEI of \$758,000. The Company acquired and sold other marketable securities that resulted in a net outflow of cash in the amount of \$1.1 million. The Company may continue to invest cash equivalents in longer-term securities or to convert short-term investments to cash equivalents as dictated by its investment and acquisition strategies. The Company will continue to acquire more efficient equipment to automate its production process. It intends to spend less than \$2 million on capital equipment during fiscal 2004. Internally generated cash will be adequate to acquire this capital equipment.

Net cash used by financing activities for the year ended April 30, 2003, was \$2.7 million. Of this amount, \$1.7 million was used to pay the Company's semi-annual cash dividends to shareholders and \$741,000 was used to make regularly scheduled long-term liability payments. During the year, the

20

Company also acquired 80,000 shares of its common stock for treasury at a cost of \$501,000. These outflows were partially offset by proceeds of \$111,000 from new borrowings and payments of \$67,000 received from the sale of shares of common stock from treasury to satisfy the exercise of stock options granted to certain officers and employees in prior years. The Company will continue to use treasury shares to satisfy the future exercise of stock options granted to officers and employees. The Company may repurchase shares of its common stock for treasury whenever appropriate opportunities arise but it has neither a formal repurchase plan nor commitments to purchase additional shares in the future.

The Company will continue to expend resources to develop and improve products for wireless and wireline communication systems which management believes will result in future growth and continued profitability. During fiscal 2004, the Company intends to make a substantial investment of capital and technical resources to develop new products to meet the needs of the commercial communications marketplace and to invest in more efficient product designs and manufacturing procedures. Where possible, the Company will secure partial customer funding for such development efforts but is targeting to spend its own funds at a rate of approximately 10% of revenues to achieve its development goals. Internally generated cash will be adequate to fund these development efforts.

As of April 30, 2003

Contractual Obligations	Total (in thousands)	Less than 1 Year	1 to 3 Years
Long-Term Debt Obligations	\$ 78	\$ 20	\$ 58
Operating Lease Obligations	2,267	400	1,200
Other Long -Term Liabilities Reflected in			



## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

the Registrant's Balance Sheet under GAAP

	17,845**		
	-----	-----	-----
Total	\$20,190	\$ 420	\$1,258
	=====	=====	=====

\*\* Consists of Deferred Compensation liability (See Note 12 in the accompanying financial statements) and liabilities, deferred income and deferred taxes related to the REIT units received on sale of the Company's building to Reckson Associates in 1998. (See Item 2. Properties and Note 6. Property, Plant and Equipment in the accompanying financial statements.) These liabilities have no defined maturity.

As of April 30, 2003, the Company's consolidated backlog amounted to approximately \$31 million (see Item 1). Approximately 60% of this backlog is expected to be filled during the Company's fiscal year ending April 30, 2004.

\*\*\*\*\*

The Company's liquidity is adequate to meet its foreseeable operating and investment needs, including the acquisition and support of its new FEI-Zyfer subsidiary. In addition, with its available cash and marketable securities, the Company is able to continue paying semi-annual dividends, subject to the review and approval of its Board of Directors.

#### Recent Accounting Pronouncements

-----

In July 2002, the FASB issued Statement No. 146 ("FAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities." FAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force ("EITF") has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS 146 revises the accounting for certain lease termination costs and employee termination benefits, which are generally recognized in connection with restructuring activities. The provisions of FAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not anticipate that the adoption of FAS 146 will have a material impact on its consolidated financial statements.

21

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"), effective prospectively for guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for periods ending after December 15, 2002. Under FIN 45, a guarantor is required to recognize, at the inception of certain guarantees, a fair value liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. All guarantees subject to the disclosure provisions of FIN 45, such as product warranties, have been disclosed in the accompanying notes to the consolidated financial statements. At April 30, 2003, the Company does not have any outstanding guarantees required to be disclosed or recorded as obligations upon adoption of FIN 45.

In December 2002, the FASB issued Statement No. 148 ("FAS 148"), "Accounting

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

for Stock-Based Compensation - Transition and Disclosure." FAS 148 amends FAS 123, "Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of this Standard are effective for fiscal years beginning after December 15, 2002 and have been incorporated into these financial statements and accompanying footnotes.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"). This Interpretation changes the method of determining whether certain entities should be included in the Company's consolidated financial statements. An entity is subject to FIN 46 and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation under FAS No. 94, Consolidation of All Majority-Owned Subsidiaries. The provisions of FIN 46 are to be applied immediately to VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. For VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003, FIN 46 applies in the first fiscal period beginning after June 15, 2003. The Company does not expect the adoption of FIN 46 to have a material effect on its financial position, results of operations or cash flows.

In April 2003, the FASB issued Statement No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("FAS 149"). FAS 149 amends FAS 133 for certain decisions made by the FASB as part of the Derivatives Implementation Group process. FAS 149 also amends FAS 133 to incorporate clarifications of the definition of a derivative. FAS 149 is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and requires prospective application. The Company does not expect the effect of adopting FAS 149 to be material to its results of operations or financial condition.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("FAS 150"). This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. In accordance with the standard, financial instruments that embody obligations for the issuer are required to be classified as liabilities. FAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company does not expect the provisions of this statement to have a significant impact on the Company's results of operations or financial position.

22

### Quantitative and Qualitative Disclosures about Market Risk

---

#### Interest Rate Risk

The Company is exposed to market risk related to changes in interest rates and market values of securities, including participation units in the Reckson Operating Partnership, L.P. (REIT units, see Item 2. Properties and Note 6 to

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

the financial statements). The Company's investments in fixed income and equity securities were \$17.8 million and \$10.0 million, respectively, at April 30, 2003. The investments are carried at fair value with changes in unrealized gains and losses recorded as adjustments to stockholders' equity. The fair value of investments in marketable securities is generally based on quoted market prices. Typically, the fair market value of investments in fixed interest rate debt securities will increase as interest rates fall and decrease as interest rates rise. Based on the Company's overall interest rate exposure at April 30, 2003, a 10% change in market interest rates would not have a material effect on the fair value of the Company's fixed income securities or results of operations (investment income).

### Foreign Currency Risk

With its investment in Gillam-FEI, the Company is subject to foreign currency translation risk. For each of these investments, the Company does not have any near-term intentions to repatriate its invested cash. For this reason, the Company does not intend to initiate any exchange rate hedging strategies which could be used to mitigate the effects of foreign currency fluctuations. The effects of foreign currency rate fluctuations will be recorded in the equity section of the balance sheet as a component of other comprehensive income. As of April 30, 2003, the amount related to foreign currency exchange rates is a \$2,565,000 unrealized gain.

The results of operations of foreign subsidiaries, when translated into US dollars, will reflect the average rates of exchange for the periods presented. As a result, similar results in local currency can vary significantly upon translation into US dollars if exchange rates fluctuate significantly from one period to the next.

### OTHER MATTERS

-----

The financial information reported herein is not necessarily indicative of future operating results or of the future financial condition of the Company. Except as noted, management is unaware of any impending transactions or events that are likely to have a material adverse effect on results from operations.

### INFLATION

-----

During fiscal 2003, as in the two prior fiscal years, the impact of inflation on the Company's business has not been materially significant.

### Item 7a. Quantitative and Qualitative Disclosures about Market Risk

-----

The information required by this item is included in the text in response to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, above and is incorporated herein by reference.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995:

The statements in this Annual Report on Form 10K regarding future earnings and operations and other statements relating to the future constitute "forward-looking" statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to, continued

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

acceptance of the Company's products in the marketplace, competitive factors, new products and technological changes, product prices and raw material costs, dependence upon third-party vendors, competitive developments, changes in manufacturing and transportation costs, the availability of capital, and the outcome of certain litigation and arbitration proceedings. By making these forward-looking statements, the Company undertakes no obligation to update these statements for revisions or changes after the date of this report.

23

### Item 8. Financial Statements and Supplementary Data

-----

#### REPORT OF INDEPENDENT AUDITORS

-----

To the Board of Directors and Stockholders of Frequency Electronics, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 16(a)(1) on page 49 present fairly, in all material respects, the financial position of Frequency Electronics, Inc. and its subsidiaries as of April 30, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended April 30, 2003 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 16(a)(2) on page 49 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 1 and 11 to the consolidated financial statements, on May 1, 2001, the Company adopted the provisions of Statement of Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

PRICEWATERHOUSECOOPERS LLP  
Melville, New York  
July 11, 2003

24

April 30, 2003 and 2002  
FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
Consolidated Balance Sheets

April 30, 2003 and 2002  
-----

ASSETS:	2003	2002
---------	------	------

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

	-----	-----
	(In thousands)	
Current assets:		
Cash and cash equivalents	\$ 5,952	\$ 5,383
Marketable securities	27,829	30,848
Accounts receivable, net of allowance for doubtful accounts of \$124	9,565	11,725
Inventories	17,734	19,601
Deferred income taxes	4,435	3,645
Income taxes receivable	1,223	1,328
Prepaid expenses and other	1,198	1,350
	-----	-----
Total current assets	67,936	73,880
Property, plant and equipment, at cost, less accumulated depreciation and amortization	11,105	11,361
Deferred income taxes	436	280
Goodwill	-	4,938
Cash surrender value of life insurance	4,869	4,373
Other assets	1,383	1,179
	-----	-----
Total assets	\$ 85,729	\$ 96,011
	=====	=====

25

Continued

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
Consolidated Balance Sheets

April 30, 2003 and 2002

(Continued)

LIABILITIES AND STOCKHOLDERS' EQUITY:	2003	2002
	-----	-----
	(In thousands)	
Current liabilities:		
Current portion of debt	\$ 179	\$ 384
Accounts payable - trade	1,294	2,359
Accrued liabilities	3,615	4,073
Dividend payable	834	833
	-----	-----

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Total current liabilities	5,922	7,649
Deferred compensation	6,752	6,496
REIT liability and other liabilities	11,151	11,300
	-----	-----
Total liabilities	23,825	25,445
	-----	-----
Minority interest in subsidiary	195	224
	-----	-----
Commitments and contingencies (Notes 6 and 9)		
Stockholders' equity:		
Preferred stock - authorized 600,000 shares of \$1.00 par value; no shares issued	-	-
Common stock - authorized 20,000,000 shares of \$1.00 par value; issued - 9,163,940 shares	9,164	9,164
Additional paid-in capital	43,806	43,077
Retained earnings	10,415	20,939
	-----	-----
	63,385	73,180
Common stock reacquired and held in treasury - at cost (824,739 shares in 2003 and 830,074 shares in 2002)	(3,062)	(2,806)
Other stockholders' equity	(116)	(116)
Accumulated other comprehensive income	1,502	84
	-----	-----
Total stockholders' equity	61,709	70,342
	-----	-----
Total liabilities and stockholders' equity	\$ 85,729	\$ 96,011
	=====	=====

The accompanying notes are an integral part of these financial statements.

26

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
Consolidated Statements of Operations

Years ended April 30, 2003, 2002 and 2001

	2003	2002	2001
	----	----	----
	(In thousands, except share data)		
Net sales	\$31,527	\$41,179	\$49,210
Cost of sales	25,681	27,090	32,180
	-----	-----	-----
Gross margin	5,846	14,089	17,030
Selling and administrative expenses	7,573	8,932	8,820
Research and development expenses	4,605	6,568	4,847

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Insurance reimbursement, net	-	(1,500)	(2,576)
Goodwill writedown	6,158	-	-
	-----	-----	-----
Operating (loss) profit	(12,490)	89	5,939
Other income (expense):			
Investment income	1,830	1,864	2,655
Interest expense	(283)	(302)	(333)
Other, net	277	46	4
	-----	-----	-----
(Loss) income before minority interest and (benefit) provision for income taxes	(10,666)	1,697	8,265
Minority interest in (loss) income of consolidated subsidiary	(33)	(1)	29
	-----	-----	-----
(Loss) income before (benefit) provision for income taxes	(10,633)	1,698	8,236
(Benefit) provision for income taxes	(1,773)	320	2,592
	-----	-----	-----
Net (loss) income	(\$ 8,860)	\$ 1,378	\$ 5,644
	=====	=====	=====
Net (loss) income per common share:			
Basic	(\$ 1.06)	\$ 0.17	\$ 0.69
	=====	=====	=====
Diluted	(\$ 1.06)	\$ 0.16	\$ 0.67
	=====	=====	=====
Average shares outstanding:			
Basic	8,331,785	8,350,735	8,198,569
	=====	=====	=====
Diluted	8,331,785	8,529,175	8,431,823
	=====	=====	=====

The accompanying notes are an integral part of these financial statements.

FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES  
Consolidated Statements of Changes in Stockholders' Equity  
Years ended April 30, 2003, 2002 and 2001  
(In thousands, except share data)

	Common Stock		Additional
	Shares	Amount	paid in capital
	-----	-----	-----
Balance at May 1, 2000	9,009,259	\$9,009	\$37,929
Exercise of stock options			510
Tax benefit from stock option exercise			809

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Amortization of independent contractor stock options			310
Contribution of stock to 401(k) plan			(8)
Issuance of stock for Gillam acquisition	154,681	155	3,310
Amortization of unearned compensation			
Cash dividend			
Increase in market value of marketable securities			
Foreign currency translation adjustment			
Net income			
Comprehensive income- 2001	-----	-----	-----
Balance at April 30, 2001	9,163,940	9,164	42,860
-----			
Exercise of stock options			52
Amortization of independent contractor stock options			45
Contribution of stock to 401(k) plan			120
Amortization of unearned compensation			
Cash dividend			
Increase in market value of marketable securities			
Foreign currency translation adjustment			
Net income			
Comprehensive income- 2002	-----	-----	-----
Balance at April 30, 2002	9,163,940	9,164	43,077
-----			
Exercise of stock options			29
Issuance of stock for Gillam acquisition			447
Contribution of stock to 401(k) plan			253
Repurchase of stock for treasury			
Cash dividend			
Decrease in market value of marketable securities			
Foreign currency translation adjustment			
Net loss			
Comprehensive loss- 2003	-----	-----	-----
Balance at April 30, 2003	9,163,940	\$9,164	\$43,806
-----	=====	=====	=====

(TABLE CONTINUED)

FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES  
 Consolidated Statements of Changes in Stockholders' Equity  
 Years ended April 30, 2003, 2002 and 2001  
 (In thousands, except share data)

	Treasury stock (at cost)		Other Stockholders' equity
	Shares	Amount	
	-----	-----	-----
Balance at May 1, 2000	1,016,552	(\$3,644)	(\$135)



Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

-----			
Exercise of stock options	(129,288)	206	
Tax benefit from stock option exercise			
Amortization of independent contractor stock options			
Contribution of stock to 401(k) plan	(14,595)	311	
Issuance of stock for Gillam acquisition			
Amortization of unearned compensation			13
Cash dividend			
Increase in market value of marketable securities			
Foreign currency translation adjustment			
Net income			
Comprehensive income- 2001	-----	-----	-----
Balance at April 30, 2001	872,669	(3,127)	(122)
-----			
Exercise of stock options	(14,375)	43	
Amortization of independent contractor stock options			
Contribution of stock to 401(k) plan	(28,220)	278	
Amortization of unearned compensation			6
Cash dividend			
Increase in market value of marketable securities			
Foreign currency translation adjustment			
Net income			
Comprehensive income- 2002	-----	-----	-----
Balance at April 30, 2002	830,074	(2,806)	(116)
-----			
Exercise of stock options	(11,000)	38	
Issuance of stock for Gillam acquisition	(35,000)	88	
Contribution of stock to 401(k) plan	(39,335)	119	
Repurchase of stock for treasury	80,000	(501)	
Cash dividend			
Decrease in market value of marketable securities			
Foreign currency translation adjustment			
Net loss			
Comprehensive loss- 2003	-----	-----	-----
Balance at April 30, 2003	824,739	(\$3,062)	(\$116)
-----	=====	=====	=====

The accompanying notes are an integral part of these financial statements.

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

	-----	-----
		(In thou
Cash flows from operating activities:		
Net (loss) income	(\$8,860)	\$ 1,37
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Goodwill writedown		
Deferred tax expense (benefit)	(247)	35
Depreciation and amortization	1,600	1,46
Provision for losses on accounts receivable and inventories	3,634	1,00
Loss (gain) on marketable securities and other assets- net	(67)	12
Tax benefit from stock option exercise	-	
Minority interest in (loss) earnings of subsidiary	(34)	
Changes in assets and liabilities, exclusive of assets and liabilities acquired:		
Accounts receivable	4,515	3,36
Inventories	(1,115)	(1
Prepaid and other	370	30
Other assets	(548)	(34
Accounts payable trade	(2,209)	(2
Insurance reimbursement receivable	-	3,00
Accrued liabilities	(823)	(2,52
Liability for employee benefit plans	973	1,42
Income taxes receivable	105	(3,69
Other liabilities	(1,004)	(93
	-----	-----
Net cash provided by operating activities	2,448	4,89
	-----	-----
Cash flows from investing activities:		
Payment for acquisition, net of cash acquired of \$758 in 2001	-	
Purchase of minority interest in manufacturing partner	-	(31
Purchase of marketable securities	(7,378)	(21,15
Proceeds from sale or redemption of marketable securities	8,598	23,61
Capital expenditures	(834)	(1,54
Other- net	120	
	-----	-----
Net cash provided by (used in) investing activities	506	60
	-----	-----

Continued

29

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
Consolidated Statements of Cash Flows  
Years ended April 30, 2003, 2002 and 2001  
(Continued)

2003	2002
-----	-----
	(In thou

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Cash flows from financing activities:		
Principal payments of long-term debt and other long-term obligations	(741)	(758)
Proceeds from short-term debt	111	8
Payment of cash dividend	(1,664)	(1,664)
Repurchase of stock for treasury	(501)	9
Exercise of stock options	67	
	-----	-----
Net cash used in financing activities	(2,728)	(2,228)
	-----	-----
Net increase (decrease) in cash and cash equivalents before effect of exchange rate changes	226	3,278
Effect of exchange rate changes on cash and cash equivalents	343	(1,664)
	-----	-----
Net increase (decrease) in cash and cash equivalents	569	3,262
Cash and cash equivalents at beginning of year	5,383	2,122
	-----	-----
Cash and cash equivalents at end of year	\$5,952	\$ 5,384
	=====	=====
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ 264	\$ 28
	=====	=====
Income taxes	\$ 0	\$ 3,35
	=====	=====
Other activities which affect assets or liabilities but did not result in cash flow during the fiscal years:		
Declaration of cash dividend	\$ 834	\$ 83
	=====	=====

The accompanying notes are an integral part of these financial statements.

30

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Accounting Policies

Principles of Consolidation:

The consolidated financial statements include the accounts of Frequency Electronics, Inc. and its wholly-owned subsidiaries (the "Company" or "Registrant"). References to "FEI" are to the parent company alone and do not refer to any of its subsidiaries). The Company is principally engaged in the design, development and manufacture of precision time and frequency control products and components for microwave integrated circuit applications. See Note 14 for information regarding the Company's Commercial Communications, Gillam-FEI and U.S. Government business segments. Intercompany accounts and significant intercompany transactions are eliminated in consolidation. To accommodate the

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

different fiscal periods of Gillam-FEI, the company recognizes its share of net income or loss on a one month lag.

These financial statements have been prepared in conformity with generally accepted accounting principles and require management to make estimates and assumptions that affect amounts reported and disclosed in the financial statements and related notes. Actual results could differ from these estimates.

### Reclassifications:

Certain prior year amounts have been reclassified to conform to current year presentation. These reclassifications had no effect on reported consolidated earnings.

### Inventories:

Inventories, which consist of finished goods, work-in-process, raw materials and components, are accounted for at the lower of cost (specific and average) or market.

### Property, Plant and Equipment:

Property, plant and equipment are recorded at cost and include interest on funds borrowed to finance construction. Expenditures for renewals and betterments are capitalized; maintenance and repairs are charged to income when incurred. When fixed assets are sold or retired, the cost and related accumulated depreciation and amortization are eliminated from the respective accounts and any gain or loss is credited or charged to income.

If events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the Company estimates the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the long-lived asset, an impairment loss is recognized. To date, no impairment losses have been recognized.

### Depreciation and Amortization:

Depreciation of fixed assets is computed on the straight-line method based upon the estimated useful lives of the assets (40 years for buildings and 3 to 10 years for other depreciable assets). Leasehold improvements are amortized on the straight-line method over the shorter of the term of the lease or the useful life of the related improvement.

### Goodwill:

The Company records goodwill as the excess of purchase price over the fair value of identifiable net assets acquired. Through April 30, 2001, goodwill was amortized on a straight-line basis over the estimated useful life of 15 years. As a result of the adoption of Statement of Financial Accounting Standards ("FAS") No. 142 "Goodwill and Other Intangible Assets," goodwill is no longer amortized but is tested for impairment on at least an annual basis. When it is determined that the carrying value of investments may not be recoverable, the Company measures impairment based on revenue projections, recent transactions involving similar businesses and price/revenue multiples at which they were bought and sold, price/revenue multiples of competitors, and the present market value of publicly-traded companies in the Company's industry.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

### Revenue and Cost Recognition:

Revenues under larger, long-term contracts, generally defined as orders in excess of \$100,000, are reported in operating results using the percentage of completion method. For U.S. Government and other fixed-price contracts that require initial design and development of the product, revenue is recognized on the cost-to-cost method. Under this method, revenue is recorded based upon the ratio that incurred costs bear to total estimated contract costs with related cost of sales recorded as the costs are incurred.

On production-type contracts, revenue is recorded as units are delivered with the related cost of sales recognized on each shipment based upon a percentage of estimated final contract costs. Changes in job performance may result in revisions to costs and revenue and are recognized in the period in which revisions are determined to be required. Provisions for anticipated losses are made in the period in which they become determinable.

For contracts in the Company's Gillam-FEI segment, and smaller contracts or orders in the other business segments, sales of products and services to customers are reported in operating results upon shipment of the product or performance of the services pursuant to contractual terms.

Contract costs include all direct material, direct labor costs, manufacturing overhead and other direct costs related to contract performance. Selling, general and administrative costs are charged to expense as incurred.

In accordance with industry practice, inventoried costs contain amounts relating to contracts and programs with long production cycles, a portion of which will not be realized within one year.

### Income Taxes:

The Company recognizes deferred tax liabilities and assets based on the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

### Earnings Per Share:

Basic earnings per share are computed by dividing net earnings by the weighted average number of shares of common stock outstanding. Diluted earnings per share are computed by dividing net earnings by the sum of the weighted average number of shares of common stock and the if-converted effect of unexercised stock options.

### Marketable Securities:

Marketable securities consist of investments in common stocks, mutual funds, and debt securities of U.S. government agencies. In addition, as a result of the sale of the Company's real estate holdings (Note 6), marketable securities include participation units in the Reckson Operating Partnership, L.P. ("REIT units") which are convertible to common shares of Reckson Associates Realty Corp. Except for the REIT units and certain investments in common stock, substantially all other marketable securities at April 30, 2003 and 2002 were held in the custody of two financial institutions. Investments in debt and equity securities are categorized as available for sale and are carried at fair value, with unrealized gains and losses excluded from income and recorded directly to stockholders' equity. The Company recognizes gains or losses when

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

securities are sold using the specific identification method.

### Cash Equivalents:

The Company considers certificates of deposit and other highly liquid investments with original maturities of three months or less to be cash equivalents. The Company places its temporary cash investments with high credit quality financial institutions. Such investments may be in excess of the FDIC insurance limit. No losses have been experienced on such investments.

32

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

### Research and Development expenses:

The Company engages in research and development activities to identify new applications for its core technologies, to improve existing products and to improve manufacturing processes to achieve cost reductions and manufacturing efficiencies. Research and development costs include direct labor, manufacturing overhead, direct materials and contracted services. Such costs are expensed as incurred.

### Equity-based Compensation:

The Company applies the disclosure-only provisions of FAS No. 123, "Accounting for Stock-Based Compensation," and continues to measure compensation cost in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Historically, this has not resulted in compensation cost upon the grant of options under a qualified stock option plan. However, in accordance with FAS No. 123, the Company provides pro forma disclosures of net earnings (loss) and earnings (loss) per share as if the fair value method had been applied beginning in fiscal 1996.

The following table illustrates the effect on the Company's consolidated statements of operations had compensation cost for stock option awards under the plans been determined based on the fair value at the grant dates consistent with the provisions of FAS No. 123:

	(in thousands, except per share data)		
	2003	2002	2001
	-----	-----	-----
Net (Loss) Income, as reported	(\$8,860)	\$1,378	\$5,644
	=====	=====	=====
Net (Loss) Income - pro forma	(\$9,574)	\$474	\$5,233
	=====	=====	=====
(Loss) Earnings per share, as reported:			
Basic	(\$ 1.06)	\$0.17	\$ 0.69
	=====	=====	=====
Diluted	(\$ 1.06)	\$0.16	\$ 0.67
	=====	=====	=====
(Loss) Earnings per share- pro forma			
Basic	(\$ 1.15)	\$0.06	\$ 0.64
	=====	=====	=====
Diluted	(\$ 1.15)	\$0.06	\$ 0.62
	=====	=====	=====

The weighted average fair value of each option has been estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions used for grants in 2003, 2002 and 2001, respectively, dividend yield of 1.83%, 1.83% and 3.0%; expected volatility of

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

63%, 65%, and 70%; risk free interest rate (ranging from 5.5% to 8.0%); and expected lives ranging from seven to ten years.

### Fair Values of Financial Instruments:

Cash and cash equivalents and loans payable are reflected in the accompanying consolidated balance sheets at amounts considered by management to reasonably approximate fair value based upon the nature of the instrument and current market conditions. Management is not aware of any factors that would significantly affect the value of these amounts.

### New Accounting Pronouncements:

In July 2002, the FASB issued Statement No. 146 ("FAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities." FAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force ("EITF") has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS 146 revises the accounting for certain lease termination costs and employee termination benefits, which are generally recognized in connection with restructuring activities. The provisions of FAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not anticipate that the adoption of FAS 146 will have a material impact on its consolidated financial statements.

33

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"), effective prospectively for guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for periods ending after December 15, 2002. Under FIN 45, a guarantor is required to recognize, at the inception of certain guarantees, a fair value liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. All guarantees subject to the disclosure provisions of FIN 45, such as product warranties, have been disclosed in the accompanying notes to the consolidated financial statements. At April 30, 2003, the Company does not have any outstanding guarantees required to be disclosed or recorded as obligations upon adoption of FIN 45.

In December 2002, the FASB issued Statement No. 148 ("FAS 148"), "Accounting for Stock-Based Compensation - Transition and Disclosure." FAS 148 amends FAS 123, "Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of this Standard are effective for fiscal years beginning after December 15, 2002 and have been incorporated into these financial statements and accompanying footnotes.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"). This Interpretation changes the method of

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

determining whether certain entities should be included in the Company's consolidated financial statements. An entity is subject to FIN 46 and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation under FAS No. 94, Consolidation of All Majority-Owned Subsidiaries. The provisions of FIN 46 are to be applied immediately to VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. For VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003, FIN 46 applies in the first fiscal period beginning after June 15, 2003. The Company does not expect the adoption of FIN 46 to have a material effect on its financial position, results of operations or cash flows.

In April 2003, the FASB issued Statement No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("FAS 149"). FAS 149 amends FAS 133 for certain decisions made by the FASB as part of the Derivatives Implementation Group process. FAS 149 also amends FAS 133 to incorporate clarifications of the definition of a derivative. FAS 149 is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and requires prospective application. The Company does not expect the effect of adopting FAS 149 to be material to its results of operations or financial condition.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("FAS 150"). This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. In accordance with the standard, financial instruments that embody obligations for the issuer are required to be classified as liabilities. FAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company does not expect the provisions of this statement to have a significant impact on the Company's results of operations or financial position.

34

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### 2. Earnings Per Share

-----

Reconciliations of the weighted average shares outstanding for basic and diluted Earnings Per Share are as follows:

	Years ended April 30,		
	2003	2002	2001
	----	----	----
Basic EPS Shares outstanding (weighted average)	8,331,785	8,350,735	8,198,569
Effect of Dilutive Securities	***	178,440	233,254
	-----	-----	-----
Diluted EPS Shares outstanding	8,331,785	8,529,175	8,431,823
	=====	=====	=====

\*\*\* Dilutive securities are excluded for the year ended April 30, 2003 since the inclusion of such shares would be antidilutive due to the net loss for the



## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

year then ended

Options to purchase 483,250 and 419,750 shares of common stock were outstanding during the years ended April 30, 2002 and 2001, respectively, but were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the Company's common shares during the respective periods. Since the inclusion of such options would have been antidilutive they are excluded from the computation.

### 3. Accounts Receivable

-----

Accounts receivable include costs and estimated earnings in excess of billings on uncompleted contracts accounted for on the percentage of completion basis of approximately \$3,023,000 at April 30, 2003 and \$2,027,000 at April 30, 2002. Such amounts represent revenue recognized on long-term contracts that has not been billed, pursuant to contract terms, and was not billable at the balance sheet date.

### 4. Marketable Securities

-----

Marketable securities at April 30, 2003 and 2002 are summarized as follows (in thousands):

	April 30, 2003		
	Cost	Market Value	Unrealized Holding Gain (Loss)
	-----	-----	-----
REIT units	\$ 12,000	\$ 9,675	(\$2,325)
Fixed income securities	17,298	17,841	543
Equity securities	306	313	7
	-----	-----	-----
	\$ 29,604	\$ 27,829	(\$ 1,775)
	=====	=====	=====
	April 30, 2002		
	Cost	Market Value	Unrealized Holding Gain (Loss)
	-----	-----	-----
REIT units	\$ 12,000	\$ 12,000	\$ -
Fixed income securities	16,714	16,691	(23)
Equity securities	2,174	2,157	(17)
	-----	-----	-----
	\$ 30,888	\$ 30,848	(\$ 40)
	=====	=====	=====

35

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Maturities of fixed income securities classified as available-for-sale at April 30, 2003 are as follows (in thousands):

Current	\$ 1,524
Due after one year through five years	7,017
Due after five years through ten years	8,757

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

-----  
 \$17,298  
 =====

During fiscal years 2002 and 2001, the decline in market value of certain fixed income securities was deemed to be other than temporary. Accordingly, the Company charged \$300,000 in fiscal 2002 and \$287,000 in fiscal 2001 against investment income to record the impairment in value of these securities.

5. Inventories  
 -----

Inventories, which are reported net of reserves of \$3,598,000 and \$2,941,000 at April 30, 2003 and 2002, respectively, consisted of the following (in thousands):

	2003	2002
	----	----
Raw Materials and Component Parts	\$ 7,349	\$ 8,946
Work in Progress and Finished Goods	10,385	10,655
	-----	-----
	\$ 17,734	\$ 19,601
	=====	=====

6. Property, Plant and Equipment  
 -----

Property, plant and equipment consists of the following (in thousands):

	2003	2002
	----	----
Buildings and building improvements	\$ 12,250	\$ 11,615
Machinery, equipment and furniture	27,647	25,933
	-----	-----
	39,897	37,548
Less, accumulated depreciation and amortization	28,792	26,187
	-----	-----
	\$ 11,105	\$ 11,361
	=====	=====

Depreciation and amortization expense for the years ended April 30, 2003, 2002 and 2001 was \$1,600,000, \$1,460,000 and \$1,253,000, respectively.

Maintenance and repairs charged to operations for the years ended April 30, 2003, 2002 and 2001 was approximately \$242,000, \$440,000 and \$485,000, respectively.

In January 1998, in two transactions, the Company sold two buildings to Reckson Associates Realty Corp., a real estate investment trust ("REIT") whose shares are traded on the New York Stock Exchange. In one sale transaction, the Company sold the building which it had leased to Laboratory Corporation of America ("LCA"), receiving cash of approximately \$15.6 million and realizing a gain of approximately \$5.4 million after selling expenses which amount was included in "Other income, net" in fiscal year 1998.

In the other sale, the Company effected a tax-deferred exchange of the building which it occupies for approximately 486,000 participation units of Reckson Operating Partnership, L.P. ("REIT units") which were valued at closing at \$12 million. Each REIT unit is convertible into one share of the common stock of the REIT. In addition, approximately 27,000 REIT units have been placed in escrow which may be released to the Company based upon the price per share of the REIT on the date of conversion of REIT units.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

The Company leased back approximately 43% of the latter building from the purchaser (the "Reckson lease"). Under the accounting provisions for sale and leaseback transactions, the sale of this building is considered a financing and the REIT units received are reflected as a noncurrent liability of \$10,820,000 and \$11,088,000 at April 30, 2003 and 2002, respectively. The related building continues to be reflected as an asset. Upon liquidation of the REIT units, a portion of the resulting gain on this sale will be deferred and recognized into income over the term of the leaseback with the balance recognized in

36

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

income on the date of liquidation. The Company's annual rental payment of \$400,000 is characterized as repayment of the financing with a portion allocated to interest expense at an assumed interest rate of 6.5% and the balance is considered repayment of principal. During the years ended April 30, 2003, 2002 and 2001, the Company charged \$132,000, \$149,000 and \$165,000, respectively, to interest expense under the financing agreement.

The Reckson lease contains two five-year renewal periods at the option of the Company. Annual rental payments are \$400,000 for the initial 11-year term which ends in January 2009. Under the terms of the lease the Company is required to pay its proportional share of real estate taxes, insurance and other charges. The lease for the FEI-Asia facility is for a one-year term with rent of \$9,850 payable quarterly. .

Future minimum lease payments required by the leases are as follows (in thousands):

Years ending April 30, -----	
2004	400
2005	400
2006	400
2007	400
2008	400
2009	267
	-----
	\$2,267
	=====

#### 7. Debt Obligations

-----

The Company's European subsidiaries have available approximately \$7.6 million in bank credit lines to meet short-term cash flow requirements. As of April 30, 2003 and 2002, \$144,000 and \$213,000, respectively, was outstanding under such lines of credit. One of the credit lines is collateralized by the accounts receivable of the Company's French subsidiary. All other credit lines are unsecured. Interest on these credit lines varies from 0.5% to 1.5% over the EURO Interbank Offered rate (EURIBOR). At April 30, 2003, the rate was 3.574% based on the 1 month EURIBOR.

The Company also has one long-term debt obligation of approximately \$78,000 which is secured primarily by the Company's European buildings. The loan matures in 2004 through 2007, and is payable in monthly installments of \$1,973, including interest at 5.34%. Other long-term debt obligations of the Company were paid during fiscal 2003.

Debt scheduled to mature in each of the subsequent years ending April 30,

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

are as follows: (in thousands)

2004	\$ 179
2005	21
2006	22
2007	15
	-----
	\$ 237
	=====

### 8. Accrued Liabilities

-----

Accrued liabilities at April 30, 2003 and 2002 consist of the following (in thousands):

	2003	2002
	----	----
Due customers	\$ 766	\$ 751
Other compensation including payroll taxes	1,456	1,490
Vacation accrual	456	491
Other	937	1,341
	-----	-----
	\$ 3,615	\$ 4,073
	=====	=====

37

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

### 9. Commitments and Contingencies

-----

#### Qui Tam Action:

A judgment in favor of the Company, dated September 3, 2002, was entered by the United States District Court for the Eastern District of New York in connection with its dismissal of a qui tam action. The qui tam action was served upon FEI and Martin Bloch, its President, in March 1994 by Ralph Muller, a former FEI employee. A qui tam action is an action wherein an individual may, under certain circumstances, bring a legal action against one or more third persons on behalf of the Government for damages and other relief by reason of one or more alleged wrongs perpetrated against the Government by such third persons. The judgment is based on the Court's decision on the merits in favor of Frequency Electronics, Inc. and its President, dated August 23, 2002. The judgment preserves all of FEI's rights to recover costs and its causes of action against the plaintiff and third party defendants.

#### Directors' and Officers' Insurance Coverage:

On April 30, 2002, FEI settled the arbitration proceeding it had commenced in June 2001 before the American Arbitration Association against The Home Insurance Company of Illinois ("Home") under an excess directors and officers liability insurance policy. FEI had asserted claims for its loss relating to, among other matters, sums it paid in connection with certain litigation with the US government which was settled in 1998. Under the terms of the settlement agreement, Home paid FEI \$1.5 million, FEI released its claims and the arbitration was discontinued.

On March 14, 2000, FEI commenced an action in the state court against National Union Fire Insurance of Pittsburgh, PA ("National"). The complaint set forth causes of action for declaratory judgment and breach of contract relating

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

to certain directors and officers' liability insurance policies in connection with the Muller qui tam action and certain other litigations which the Company had previously settled. Pursuant to a Settlement Agreement dated April 18, 2001, the action against National was settled, FEI was paid \$3.0 million (excluding related legal costs) representing the full amount of the available coverage under the applicable National policy, FEI released its claims and the action was discontinued.

### Legal Fees:

Included in selling and administrative expenses are legal fees incurred in connection with the above matters of approximately \$64,000, \$150,000 and \$614,000 for fiscal years 2003, 2002 and 2001, respectively.

### 10. Notes Receivable - Common Stock

-----

In October 1994, certain officers and employees acquired an aggregate of 375,000 shares of the Company's common stock in the open market. The purchase price of these shares of approximately \$822,000 was financed by advances from the Company to such officers and employees. The notes, collateralized by the shares of common stock purchased, accrue interest at 1/2% above prime (6.0% at April 30, 2003) which is payable and adjusted annually. The principal was due in its entirety at the earlier of termination of employment or October 1999. Certain officers, who owed an aggregate of \$115,500 at April 30, 2003 and 2002, requested and received an extension of the due date of the notes to October 2004. No payments were received during fiscal 2003 or 2002.

### 11. Acquisition of Gillam S.A.

-----

On September 13, 2000, the Company completed its acquisition of substantially all of the outstanding shares of Gillam S.A. ("Gillam"), a privately-held company organized under the laws of Belgium. Gillam's business is based in the telecommunications market and targeted to four main areas:

(i) "Wireline Network Synchronization"--managing timing and interconnectivity for communication networks; (ii) "Remote Control"--consisting of network monitoring systems; (iii) "Rural Telephony"--equipment designed to connect isolated subscribers to a telephone network via satellite and (iv) "Power Supplies" --produced through a subsidiary, for telecom service providers. The acquired company has been renamed Gillam-FEI.

38

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

The Gillam acquisition was consummated pursuant to the terms of a Share Purchase Agreement dated as of August 29, 2000. Under terms of the agreement, the Company paid \$8,400,264 in cash and issued 154,681 shares of common stock ("FEI stock") to acquire the outstanding stock of Gillam. Based upon the market value of FEI's stock on July 25, 2002, the Share Purchase Agreement may require the Company to issue to the Gillam shareholders up to 35,000 additional shares of FEI stock. In addition, the Company paid approximately \$496,000 in direct transaction costs. Thus, the total purchase price is approximately as follows:

	(in thousands)
Cash paid for Gillam shares	\$ 8,400
Fair value of restricted shares issued	3,465
Direct transaction costs	496
	-----
Total purchase price	\$12,361

=====

The Gillam acquisition is treated as a purchase. The purchase price is allocated to net assets acquired of approximately \$7,282,000 and to goodwill of approximately \$5,079,000. Goodwill amortization in fiscal 2001 was \$193,000 and was computed on the straightline method using a 15-year life. As of May 1, 2001, under the provisions of Statement 142 of the Financial Accounting Standards Board, "Goodwill and Other Intangible Assets", goodwill is no longer amortized but is tested periodically for impairment.

Goodwill Impairment

-----

In the fourth quarter of 2003, the Company performed an impairment test of the Gillam-FEI reporting unit. The fair value of this reporting unit was determined based upon valuations utilized in recent industry acquisition transactions and current market values of publicly-traded competitors and customers in the same industry as Gillam-FEI. Based on this test, the Company further analyzed its investment in Gillam-FEI and concluded that the goodwill associated with this acquisition was impaired. Consequently, the Company recorded a non-cash charge of \$6.2 million against operating income for fiscal 2003 to reflect the write down of the full value of goodwill related to the Gillam-FEI acquisition.

12. Employee Benefit Plans

-----

Profit Sharing Plan:

The Company adopted a profit sharing plan and trust under section 401(k) of the Internal Revenue Code. This plan allows all eligible employees to defer a portion of their income through voluntary contributions to the plan. In accordance with the provisions of the plan, the Company can make discretionary matching contributions in the form of cash or common stock. For the years ended April 30, 2003, 2002 and 2001, the Company contributed 39,335, 28,220 and 14,592 shares of common stock, respectively. The approximate value of these shares at the date of issuance was \$370,000 in fiscal 2003, \$400,000 in fiscal 2002 and \$300,000 in fiscal 2001.

Income Incentive Pool:

The Company maintains incentive bonus programs for certain employees which are based on operating profits of the Company. The Company also adopted a plan for the President and Chief Executive Officer of the Company, which formula is based on pre-tax profits. For fiscal 2003 and 2002, no amount for bonuses was recorded in selling and administrative expenses due to the lack of earnings, exclusive of the insurance reimbursement in fiscal 2002. The Company charged \$1,073,000 to operations under these plans for the fiscal year ended April 30, 2001.

Independent Contractor Stock Option Plan:

The Company has an Independent Contractor Stock Option Plan under which up to 350,000 shares may be granted. An Independent Contractor Stock Option Committee determines to whom options may be granted from among eligible participants, the timing and duration of option grants, the option price, and the number of shares of common stock subject to each option. Each of the option grants in fiscal 2001, as indicated in the table below, were granted to certain independent contractors at a price equal to the then fair market value of the Company's common stock. Each option grant permitted immediate exercise of a portion of the options (24% to 34% of the total grant) with the balance exercisable proportionately

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

over the next two to three years. For the years ended April 30, 2002 and 2001, the Company recognized compensation expense of \$45,000 and \$310,000, respectively, as a result of these stock option grants. No compensation expense was recognized during the year ended April 30, 2003 as no new grants were made in fiscal 2003 or 2002 and previous grants have been fully expensed.

Transactions under this plan, including the weighted average exercise prices of the options, are as follows:

	2003		2002	
	Shares	Wtd Avg Price	Shares	Wtd Avg Price
	-----	-----	-----	-----
Outstanding at beginning of year	114,350	\$15.31	114,350	\$15.31
Granted	-	-	-	-
Exercised	-	-	-	-
	-----		-----	
Outstanding at end of year	114,350	\$15.31	114,350	\$15.31
	=====		=====	
Exercisable at end of year	111,350	\$15.29	109,350	\$15.32
	=====		=====	
Available for grant at end of year	219,500		219,500	
	=====		=====	
Weighted average fair value of options granted during the year	\$ -		\$ -	
	=====		=====	

Employee Stock Option Plans:

The Company has various stock option plans for key management employees, including officers and directors who are employees. The plans are both Nonqualified Stock Option ("NQSO") plans and Incentive Stock Option ("ISO") plans. Under both types of plans options are granted at the discretion of the Stock Option committee at an exercise price not less than the fair market value of the Company's common stock on the date of grant. Under one NQSO plan the options are exercisable one year after the date of grant. Under the remaining plans the options are exercisable over a four-year period beginning one year after the date of grant. The options expire ten years after the date of grant and are subject to certain restrictions on transferability of the shares obtained on exercise. As of April 30, 2003, eligible employees had been granted options to purchase 955,500 shares of Company stock under ISO plans of which 206,750 options are outstanding and 38,125 are exercisable. Through April 30, 2003, eligible employees have been granted options to acquire 1,090,000 shares of Company stock under NQSO plans. Of the NQSO options, approximately 824,000 are outstanding and approximately 627,000 are exercisable (see tables below).

The excess of the consideration received over the par value of the common stock or cost of treasury stock issued under both types of option plans has been recognized as an increase in additional paid-in capital. No charges are made to income with respect to the ISO or NQSO plans.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Transactions under these plans, including the weighted average exercise prices of the options, are as follows:

	2003		2002	
	Shares	Wtd Avg Price	Shares	Wtd Avg Price
Outstanding at beginning of year	969,062	\$13.14	861,437	\$13.30
Granted	83,500	\$6.62	122,000	\$11.25
Exercised	(3,500)	\$7.27	(14,375)	\$6.76
Expired or canceled	(18,000)	\$12.91	-	
	-----		-----	
Outstanding at end of year	1,031,062	\$12.63	969,062	\$13.14
	=====		=====	
Exercisable at end of year	665,562	\$11.64	514,000	\$10.23
	=====		=====	
Available for grant at end of year	278,000		342,000	
	=====		=====	
Weighted average fair value of options granted during the year	\$6.62		\$7.00	
	=====		=====	

40

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

The following table summarizes information about stock options outstanding at April 30, 2003:

Actual Range of Exercise Prices	Options Outstanding			Options Exe
	Number Outstanding at 4/30/03	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at 4/30/03
\$3.333 - 7.813	472,375	5.9	\$ 6.75	354,125
10.167 - 16.625	476,687	7.2	12.60	274,370
23.75	82,000	7.3	23.75	41,000

#### Restricted Stock Plan:

During fiscal 1990, the Company adopted a Restricted Stock Plan which provides that key management employees may be granted rights to purchase an aggregate of 375,000 shares of the Company's common stock. The grants, transferability restrictions and purchase price are determined at the discretion of a special committee of the board of directors. The purchase price may not be less than the par value of the common stock.



Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

	2003		2002	
	Shares	Wtd Avg Price	Shares	Wtd Avg Price
Outstanding at beginning of year	30,000	\$4.00	30,000	\$4.00
Granted	-	-	-	-
Expired	-	-	-	-
Exercised	(7,500)	\$4.00	-	-
Outstanding at end of year	22,500	\$4.00	30,000	\$4.00
Exercisable at end of year	22,500	\$4.00	30,000	\$4.00
Balance of shares available for grant at end of year	98,250		98,250	

Transferability of shares is restricted for a four-year period, except in the event of a change in control as defined. Amounts shown as unearned compensation in stockholders' equity represent the excess of the fair market value of the shares over the purchase price at the date of grant which is being amortized as compensation expense over the period in which the restrictions lapse.

Employee Stock Ownership Plan/Stock Bonus Plan:

During 1990 the Company amended its Stock Bonus Plan to become an Employee Stock Ownership Plan ("ESOP"). By means of a bank note, subsequently repaid, the Company reacquired 561,652 shares of its common stock during fiscal 1990. These shares plus approximately 510,000 additional shares issued by the Company from its authorized, unissued shares were sold to the ESOP in May 1990. Shares were released for allocation to participants based on a formula as specified in the ESOP document. By the end of fiscal 2000, all shares (1,071,652) had been allocated to participant accounts of which 661,004 shares remain in the ESOP.

Deferred Compensation Plan:

The Company has a program for key employees providing for the payment of benefits upon retirement or death. Under the plan, each key employee receives specified retirement payments for the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

remainder of the employee's life with a minimum payment of ten years' benefits to either the employee or his beneficiaries. The plan also provides for reduced benefits upon early retirement or termination of employment. The Company pays the benefits out of its working capital but has also purchased whole life insurance policies on the lives of certain of the participants to cover the optional lump sum obligations of the plan upon the death of the participant.

Deferred compensation expense charged to operations during the years ended April 30, 2003, 2002 and 2001 was approximately \$602,000, \$982,000 and \$620,000, respectively. During fiscal 2002, the Company made modifications to the benefits of certain employees and added two new participants. Accordingly, deferred

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

compensation expense in fiscal 2002 included approximately \$400,000 to account for the benefit modifications.

### 13. Income Taxes -----

The (loss) income before (benefit) provision for income taxes consisted of (in thousands):

	Year Ended	
	2003	2002
U.S.	(\$ 3,680)	\$ 1,650
Foreign	(6,986)	(1,650)
	(\$10,666)	\$ 1,650

The (benefit) provision for income taxes consists of the following (in thousands):

	2003	
Current:		
Federal	(\$ 1,650)	\$ 1,650
Foreign	-	-
State	-	-
Current (benefit) provision	(1,650)	
Deferred:		
Federal	(352)	(352)
Foreign	(171)	(171)
State	(200)	(200)
Valuation allowance- foreign	600	600
Deferred (benefit) provision	(123)	
Total (benefit) provision	(\$ 1,773)	\$ 1,650

The following table reconciles the reported income tax expense with the amount computed using the statutory income tax rate (in thousands)

	2003	
Computed "expected" tax (benefit) expense	(\$ 3,626)	\$ 3,626
State and local tax, net of federal benefit	(139)	(139)
Valuation allowance on foreign deferred taxes	600	600
Foreign taxes	-	-
Nondeductible goodwill writedown	2,094	2,094
Nondeductible expenses	164	164
Nontaxable life insurance cash value increase	(51)	(51)
Tax credits	(768)	(768)
Other items, net, none of which individually exceeds 5% of federal taxes at statutory rates	(47)	(47)
	(\$ 1,773)	\$ 1,650

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

The components of deferred taxes are as follows (in thousands):

	2003 ----	2002 ----
Deferred tax assets:		
Employee benefits	\$ 3,289	\$ 3,279
Inventory	1,505	995
Accounts receivable	50	50
Marketable securities	710	16
Credit and loss carryforwards	400	-
Foreign research & development	510	603
Other liabilities	214	372
Foreign net operating loss carryforwards	970	539
Miscellaneous (116)	(116)	
-----	-----	-----
Total deferred tax asset	7,532	5,737
Deferred tax liabilities:		
Property, plant and equipment	2,061	1,812
-----		
Net deferred tax asset	5,471	3,925
Valuation allowance	(600)	-
-----		
	\$ 4,871	\$ 3,925
	=====	=====

At April 30, 2003, the Company has available approximately \$2.2 million in net operating loss carryforwards at its European subsidiaries. In fiscal 2003, the Company recorded a \$600,000 valuation allowance against a deferred tax asset of a foreign subsidiary.

#### 14. Segment Information

-----

The Company operates under three reportable segments:

- (1) Commercial communications - consists principally of time and frequency control products used in two principal markets- commercial communication satellites and terrestrial cellular telephone or other ground-based telecommunication stations.
- (2) U.S. Government - consists of time and frequency control products used for national defense or space-related programs.
- (3) Gillam-FEI - the Company's Belgian subsidiary primarily sells wireline synchronization and network monitoring systems.

The accounting policies of the three segments are the same as those described in the "Summary of Significant Accounting Policies." The Company evaluates the performance of its segments and allocates resources to them based on operating profit which is defined as income before investment income, interest expense and taxes. The Company's Commercial Communications and U.S. Government segments operate principally out of a U.S.-based manufacturing facility with both segments sharing the same managers, manufacturing personnel, and machinery and equipment. Consequently, data for these two segments includes allocations of depreciation and corporate-wide general and administrative charges. The assets of these two segments consist principally of inventory and accounts receivable. All other U.S.-based assets are assigned to the corporation for the benefit of all three segments.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

The Company's European-based director manages the assets of the Gillam-FEI segment. All acquired assets, including intangible assets, are included in the assets of this segment.

43

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

The table below presents information about reported segments for each of the years ended April 30 with reconciliation of segment amounts to consolidated amounts as reported in the statement of operations or the balance sheet for each of the years:

	(in thousands)		
	2003	2002	2001
	----	----	----
<b>Net sales:</b>			
Commercial Communications	\$15,051	\$26,663	\$36,290
U.S. Government	8,906	4,513	3,727
Gillam-FEI	8,137	11,223	9,276
less intersegment sales	(567)	(1,220)	(83)
	-----	-----	-----
Consolidated Sales	\$31,528	\$41,179	\$49,210
	=====	=====	=====
<b>Operating (loss) profit:</b>			
Commercial Communications	(\$7,123)	(\$1,394)	\$ 4,316
U.S. Government	1,887	733	462
Gillam-FEI	(6,972)	516	(238)
Corporate	(282)	234	1,401
	-----	-----	-----
Consolidated Operating (Loss) Profit	(\$12,490)	\$ 89	\$ 5,939
	=====	=====	=====
<b>Identifiable assets:</b>			
Commercial Communications	\$14,733	\$21,101	\$ 25,025
U.S. Government	6,147	3,176	1,580
Gillam-FEI	12,305	17,956	19,237
less intersegment balances	(964)	(1,575)	(234)
Corporate	53,508	55,353	56,431
	-----	-----	-----
Consolidated Identifiable Assets	\$85,729	\$96,011	\$102,039
	=====	=====	=====
<b>Depreciation (allocated):</b>			
Commercial Communications	\$ 930	\$ 995	\$ 956
U.S. Government	327	166	112
Gillam-FEI	324	280	166
Corporate	19	19	19
	-----	-----	-----
Consolidated Depreciation Expense	\$1,600	\$1,460	\$1,253
	=====	=====	=====

#### Major Customers

-----

During fiscal year 2003, sales to one customer accounted for approximately \$10.0 million of the Commercial Communications segment's total sales. This amount represents 66% of Commercial Communications' total revenues and 32% of consolidated sales. In the U.S. Government segment, sales to three customers accounted for \$6.7 million of sales or 76% of the segment's revenue and 21% of consolidated revenue. One of the U.S. Government segment's customers accounted

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

\$3.5 million or 11% of consolidated revenue. Sales to two customers, aggregating \$1.9 million, accounted for 24% of the revenues of the Gillam-FEI segment. None of the customers in the Gillam-FEI segment accounted for more than 10% of consolidated revenues.

During fiscal year 2002, sales to one customer of the Commercial Communications segment were \$15.5 million or 58% of that segment's sales and 38% of consolidated revenue. In the U.S. Government segment, sales to three customers aggregated \$3.5 million or 78% of that segment's revenues. Sales to two customers, aggregating \$3.3 million, accounted for 30% of the revenues of the Gillam-FEI segment. None of the customers in the U.S. Government segment or the Gillam-FEI segment accounted for more than 10% of consolidated revenues.

44

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

In fiscal year 2001, sales to three customers of the Commercial Communications segment aggregated \$26.7 million or 73% of that segment's total sales. Two of these customers accounted for 36% and 11%, respectively, of the Company's consolidated sales for the year. In the U.S. Government segment, sales to two customers aggregated \$2.5 million or 68% of that segment's revenues in fiscal 2002. In the Gillam-FEI segment, sales to three customers aggregated \$4.6 million or 49% of that segment's revenues for the period that the Company owned the segment. None of the customers in the U.S. Government segment or the Gillam-FEI segment accounted for more than 10% of consolidated revenues.

The loss by the Company of any one of these customers would have a material adverse effect on the Company's business. The Company believes its relationship with these companies to be mutually satisfactory.

#### Foreign Sales

Revenues in the Commercial Communications and Gillam-FEI segments include sales to foreign governments or to companies located in foreign countries. Revenues, based on the location of the procurement entity, were derived from the following countries:

	(in thousands)		
	2003	2002	2001
	----	----	----
Belgium	\$ 3,514	\$ 5,113	\$ 2,401
France	2,483	5,645	2,480
China	1,814	1,129	-
Brazil	-	1,074	2,825
United Kingdom	910	261	1,020
Morocco	-	-	2,636
Other	3,414	3,881	3,000
	-----	-----	-----
	\$12,135	\$17,103	\$14,362
	=====	=====	=====

#### 15. Product Warranties

The Company generally provides its customers with a one-year warranty regarding the manufactured quality and functionality of its products. For some limited products, the warranty period has been extended. The Company establishes warranty reserves based on its product history, current information on repair costs and annual sales levels. At April 30, 2003 and 2002, the warranty reserve

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

was \$300,000. During fiscal 2003, the Company incurred approximately \$900,000 in warranty expenses. The higher than expected warranty expense level was primarily related to a unique manufacturing defect in one of the Company's products which occurred over a limited period of time. The defect was identified and corrected and, as of April 30, 2003, the Company had substantially completed the warranty rework related to this product.

45

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### 16. Interim Results (Unaudited)

-----

Quarterly results for fiscal years 2003 and 2002 are as follows:

	(in thousands, except per share data)			
	2003 Quarter			
	1st	2nd	3rd	4th
	---	---	---	---
Net sales	\$6,828	\$8,300	\$9,390	\$7,009
Gross margin	2,055	2,621	3,073	(1,903)
Net income (loss)	(489)	251	239	(8,861)
*Earnings (loss) per share				
Basic	(\$0.06)	\$0.03	\$0.03	(\$1.06)
Diluted	(\$0.06)	\$0.03	\$0.03	(\$1.06)

During the fourth quarter of fiscal 2003, the Company wrote down the goodwill associated with the acquisition of Gillam-FEI in the amount of \$6.2 million. In addition, the Company wrote off or reserved \$3.6 million of certain excess component inventory and work-in-progress inventory due to contract cancellations and revaluation related to market conditions and from manufacturing process improvements.

\*Quarterly earnings per share data do not equal the annual amount due to changes in the average common equivalent shares outstanding.

	(in thousands, except per share data)			
	2002 Quarter			
	1st	2nd	3rd	4th
	---	---	---	---
Net sales	\$11,070	\$11,465	\$9,565	\$9,079
Gross margin	4,070	4,441	3,626	1,952
Net income (loss)	820	812	326	(580)
*Earnings (loss) per share				
Basic	\$0.10	\$0.10	\$0.04	(\$0.07)
Diluted	\$0.10	\$0.10	\$0.04	(\$0.07)

During the fourth quarter of fiscal 2002, the Company received \$1.5 million for reimbursement of certain expenses under applicable directors' and officers' liability insurance. In addition, the Company wrote off or reserved \$1.0 million of certain work-in-progress and excess component inventory.

\*Quarterly earnings per share data do not equal the annual amount due to changes in the average common equivalent shares outstanding.

#### 17. Subsequent Event

-----

On May 9, 2003, the Company acquired the business and net assets of Zyfer,

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Inc., a wholly-owned subsidiary of Odetics, Inc., in a cash transaction. The Company paid \$2.3 million at closing, plus acquisition costs estimated at approximately \$400,000. According to the terms of the purchase agreement, the Company will pay up to a maximum of \$1 million in each of fiscal years 2004 and 2005 if the new subsidiary, FEI-Zyfer, Inc., achieves certain revenue levels in those years. The contingent payments are based on a percentage of revenues in excess of \$6 million in fiscal 2004 and as a percentage of revenues in excess of \$8 million in fiscal 2005. The acquired business recorded revenue of \$6.5 million for the year ended March 31, 2003 and \$4.5 million in the prior fiscal year.

46

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

Column A ----- Description	Column B ----- Balance at beginning of period -----	Column C ----- Additions ----- Charged to costs and expenses -----		Charged to other accounts-- describe -----	Column ----- Deductio -descri -----
Year ended April 30, 2003 -----					
Allowance for doubtful accounts	\$124	-			-
Inventory reserves	\$2,941	\$3,634		\$35 (c)	\$3,012 (b)
Year ended April 30, 2002 -----					
Allowance for doubtful accounts	\$190	\$9			\$75 (a)
Inventory reserves	\$2,537	\$1,000		\$ (1) (c)	\$595 (b)
Year ended April 30, 2001 -----					
Allowance for doubtful accounts \$190					\$190
Inventory reserves	\$1,188	\$2,001		\$1 (c)	\$653 (b)
(a) Accounts written off (b) Inventory disposed or written off (c) Foreign currency translation adjustments					

47

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure  
-----

NONE

# Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

## PART III

### Item 10. Directors and Executive Officers of the Company

-----

#### Directors of the Company

-----

Information regarding Directors of the Company is incorporated herein by reference from the Company's definitive proxy statement for the annual meeting of stockholders to be held on or about October 16, 2003.

#### Executive Officers of the Company

-----

The executive officers hold office until the annual meeting of the Board of Directors following the annual meeting of stockholders, subject to earlier removal by the Board of Directors.

The names of all executive officers of the Company and all positions and offices with the Company which they presently hold are as follows:

Joseph P. Franklin	-	Chairman of the Board of Directors
Martin B. Bloch	-	President, Chief Executive Officer and Director
Markus Hechler	-	Executive Vice President, President of FEI Government Systems, Inc. and Assistant Secretary
Michel Gillard	-	President, Gillam-FEI
Charles S. Stone	-	Vice President, Low Noise Development
Leonard Martire	-	Vice President, Marketing and Sales
Oleandro Mancini	-	Vice President, Business Development
Thomas McClelland	-	Vice President, Commercial Products
Alan Miller	-	Treasurer and Chief Financial Officer
Harry Newman	-	Secretary and Assistant to the Executive Vice President

None of the officers and directors are related.

Joseph P. Franklin, age 69, has served as a Director of the Company since March 1990. In December 1993 he was elected Chairman of the Board of Directors. He also served as Chief Executive Officer from December 1993 through October 1998 and as Chief Financial Officer from September 1996 through October 1998. From August 1987 to November 1993, he was the Chief Executive Officer of Franklin S.A., a Spanish business consulting company located in Madrid, Spain, specializing in joint ventures, and was a director of several prominent Spanish companies. General Franklin was a Major General in the United States Army until he retired in July 1987.

Martin B. Bloch, age 67, has been a Director of the Company and of its predecessor since 1961. Mr. Bloch is the Company's President and Chief Executive Officer. Previously, he served as chief electronics engineer of the Electronics Division of Bulova Watch Company.



## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

Markus Hechler, age 57, joined the Company in 1967. He was elected to the position of Executive Vice President in February 1999, prior to which he served as Vice President, Manufacturing since 1982. In October 2001, he was named President of the recently formed subsidiary, FEI Government Systems, Inc. He has served as Assistant Secretary since 1978.

48

Michel Gillard, age 62, became an officer and director of the Company when Gillam S.A. was acquired in September 2000. Gillam S.A., a company engaged in the design, manufacture and marketing of wireline and network synchronization systems, was founded by Mr. Gillard in 1974.

Charles S. Stone, age 72, joined the Company in 1984, and has served as its Vice President since that time. Prior to joining the Company, Mr. Stone served as Senior Vice President of Austron Inc., from 1966 to 1979, and Senior Scientist of Tracor Inc., from 1962 to 1966.

Leonard Martire, age 66, joined the Company in August 1987 and served as Executive Vice President of FEI Microwave, Inc., the Company's wholly-owned subsidiary until May 1993 when he was elected Vice President, Marketing and Sales.

Oleandro Mancini, age 54, joined the Company in August 2000 as Vice President, Business Development. Prior to joining the Company, Mr. Mancini served from 1998 as Vice President, Sales and Marketing at Satellite Transmission Systems, Inc. and from 1995 to 1998 as Vice President, Business Development at Cardion, Inc., a Siemens A.G. company. From 1987 to 1995, he held the position of Vice President, Engineering at Cardion, Inc.

Thomas McClelland, age 48, joined the Company as an engineer in 1984 and was elected Vice President, Commercial Products in March 1999.

Alan Miller, age 54, joined the Company in November 1995 as its corporate controller and was elected to the position of Treasurer and Chief Financial Officer in October 1998. Prior to joining the Company, Mr. Miller served as an operations manager and a consultant to small businesses from 1992 through 1995 and as a Senior Audit Manager with Ernst & Young, L.L.P. from 1980 to 1991.

Harry Newman, age 56, Secretary and Assistant to the Executive Vice President, has been employed by the Company since 1979, prior to which he served as Divisional Controller of Jonathan Logan, Inc., apparel manufacturers, from 1976 to 1979, and as supervising Senior Accountant with Clarence Rainess and Co., Certified Public Accountants, from 1971 to 1975.

### Item 11. Executive Compensation

-----

This item is incorporated herein by reference from the Company's definitive proxy statement for the annual meeting of stockholders to be held on or about October 16, 2003.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

-----

This item is incorporated herein by reference from the Company's definitive proxy statement for the annual meeting of stockholders to be held on or about October 16, 2003.

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

### Item 13. Certain Relationships and Related Transactions -----

This item is incorporated herein by reference from the Company's definitive proxy statement for the annual meeting of stockholders to be held on or about October 16, 2003.

### Item 14. Controls and Procedures -----

Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer, Martin B. Bloch and Chief Financial Officer, Alan L. Miller, of the effectiveness of disclosure controls and procedures pursuant to Exchange Act Rules 13a-14 and 15d-14. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic SEC reports. There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation.

### Item 15. Principal Accountant Fees and Services -----

This item is incorporated herein by reference from the Company's definitive proxy statement for the annual meeting of stockholders to be held on or about October 16, 2003.

49

## PART IV

### Item 16. Exhibits, Financial Statement Schedules, and Reports on Form 8-K -----

#### (a) Index to Financial Statements, Financial Statement Schedule and Exhibits -----

The financial statements, financial statement schedule and exhibits are listed below and are filed as part of this report.

#### (1) FINANCIAL STATEMENTS

Included in Part II of this report:

	Page(s) -----
Report of Independent Auditors	24
Consolidated Balance Sheets April 30, 2003 and 2002	25-26
Consolidated Statements of Operations -years ended April 30, 2003, 2002 and 2001	27
Consolidated Statements of Changes in Stockholders' Equity - years ended April 30, 2003, 2002 and 2001	28
Consolidated Statements of Cash Flows	

## Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

- years ended April 30, 2003, 2002 and 2001 29-30

Notes to Consolidated Financial Statements 31-46

(2) Financial Statement Schedule

Included in Part II of this report:

Schedule II - Valuation and Qualifying Accounts 46

Other financial statement schedules are omitted because they are not required, or the information is presented in the consolidated financial statements or notes thereto.

(3) EXHIBITS

Exhibit 23.1 - Consent of Independent Auditors 57

Exhibit 31 - Certifications Pursuant to Section 302  
of the Sarbanes-Oxley Act of 2002 58-59

Exhibit 32 - Certifications Pursuant to Section 906  
of the Sarbanes-Oxley Act of 2002 60-61

The exhibits listed on the accompanying Index to Exhibits beginning on page 57 are filed as part of this annual report.

(b) REPORTS ON FORM 8-K

Registrant's Form 8-K, dated March 6, 2003, containing disclosure under Item 5 thereof (dividend declaration), was filed with the Securities and Exchange Commission during the quarter ended April 30, 2003.

Registrant's Form 8-K, dated May 9, 2003, containing disclosure under Item 2 thereof (acquisition of business and net assets of Zyfer, Inc.), was filed with the Securities and Exchange Commission on May 19, 2003.

50

### INDEX TO EXHIBITS

#### ITEM 14(a)(3)

Certain of the following exhibits were filed with the Securities and Exchange Commission as exhibits, numbered as indicated below, to the Registration Statement or report specified below, which exhibits are incorporated herein by reference:

Exhibit No. in this Form 10-K -----	Identification per Reg. 229.601(b) -----	Description of Exhibit -----	Exhibit No. as filed with Registration Statement or report specified below -----
1	(3)	Copy of Certificate of Incorporation of the Registrant filed with the Secretary of State of Delaware (1)	3.1
2	(3)	Amendment to Certificate	

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

		of Incorporation of the Registrant filed with the Secretary of State of Delaware on March 27, 1981 (2)	3.2
3	(3)	Copy of By-Laws of the Registrant, as amended to date (3)	3.3
4	(4)	Specimen of Common Stock certificate (1)	4.1
5	(10)	Stock Bonus Plan of Registrant and Trust Agreement thereunder (4)	10.2
6	(10)	Employment agreement between Registrant and Martin B. Bloch (4)	10.3
7	(10)	Employment agreement between Registrant and Abraham Lazar (4)	10.4
8	(10)	Employment agreement between Registrant and John C. Ho (4)	10.5
9	(10)	Employment agreement between Registrant and Marvin Meirs (4)	10.6

51

Exhibit No. in this Form 10-K	Identification per Reg. 229.601(b)	Description of Exhibit	Exhibit No. as filed with Registration Statement or report specified below
10	(10)	Employment agreement between Registrant and Alfred Vulcan (4)	10.7
11	(10)	Employment agreement between Registrant and Harry Newman (4)	10.8
12	(10)	Employment agreement between Registrant and Marcus Hechler (4)	10.9
13	(10)	Form of stock escrow agreement between Vincenti & Schickler as escrow agent and certain officers of Registrant (4)	10.10

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

14	(10)	Form of Agreement concerning Executive Compensation (2)	10.11
15	(10)	Registrant's 1982 Incentive Stock Option Plan (5)	15
16	(10)	Amendment dated April 19, 1981 to Stock Bonus Plan of Registrant and Trust Agreement (3)	20.1
17	(3)	Amendment to Certificate of Incorporation of the Registrant filed with Secretary of State of Delaware on October 26, 1984 (6)	17
18	(10)	Registrant's 1984 Incentive Stock Option Plan (6)	18
19	(10)	Registrant's Cash or Deferral Profit Sharing Plan and Trust under Internal Revenue Code Section 401, dated April 1, 1985 (7)	19
20	(10)	Computation of Earnings per Share of Common Stock	Included in the Financial Statements

Exhibit No. in this Form 10-K -----	Identification per Reg. 229.601(b) -----	Description of Exhibit -----	Exhibit No. as filed with Registration Statement or report specified below -----
21	(10)	Amendment Restated Effective as of May 1, 1984 of the Stock Bonus Plan and Trust Agreement of Registrant (7)	21
22	(3)	Amendment to Certificate of Incorporation of the Registrant filed with the Secretary of State of Delaware on October 22, 1986 (8)	22
23	(10)	Amendment Restated Effective as of May 1, 1984 of the Stock Bonus Plan and Trust Agreement of Registrant (8)	23
24	(3)	Amended and Restated Certificate of Incorporation of the	

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

		Registrant filed with the Secretary of State of Delaware on October 26, 1987 (10)	24
25	(22)	List of Subsidiaries of Registrant (10)	25
26	(10)	Employment agreement between Registrant and Charles Stone (9)	26
27	(10)	Employment agreement between Registrant and Jerry Bloch (9)	27
28	(10)	Registrant's 1987 Incentive Stock Option Plan (9)	28
29	(10)	Registrant's Senior Executive Stock Option Plan (9)	29
30	(10)	Amendment dated Jan. 1, 1988 to Registrant's Cash or Deferred Profit Sharing Plan and Trust under Section 401 of Internal Revenue Code (9)	30

53

Exhibit No. in this Form 10-K -----	Identification per Reg. 229.601(b) -----	Description of Exhibit -----	Exhibit No. as filed with Registration Statement or report specified below -----
31	(10)	Executive Incentive Compensation Plan between Registrant and various employees (9)	31
32	(10)	Amended Certificate of Incorporation of the Company filed with the Secretary of State of Delaware on November 2, 1989 (10)	32
33	(10)	Registrant's Employee Stock Option Plan (10)	33
34	(10)	Loan agreement between Registrant and Nat West Dated May 22, 1990 (10)	34
35	(10)	Loan Agreement between Registrant's Employee	

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

		Stock Ownership Plan and Registrant dated May 22, 1990 (10)	35
36	(23)	Consent of Independent Accountants to incorporation by reference of 2002 audit report in Registrant's Form S-8 Registration Statement.	23.1
37	(10)	Registrant's 1997 Independent Contractor Stock Option Plan (11)	4.14
38	(10)	Contribution Agreement between Registrant and Reckson Operating Partnership L.P. dated January 6, 1998 (12)	10.12
39	(10)	Lease agreement between Registrant and Reckson Operating Partnership, L.P. dated January 6, 1998 (12)	10.13
40	(10)	Plea Agreement, Civil Settlement and Related Documents dated June 19, 1998 (12)	10.14
41	(99)	Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	99.1

NOTES:

- (1) Filed with the SEC as an exhibit, numbered as indicated above, to the registration statement of Registrant on Form S-1, File No. 2-29609, which exhibit is incorporated herein by reference.
- (2) Filed with the SEC as an exhibit, numbered as indicated above, to the registration statement of Registrant on Form S-1, File No. 2-71727, which exhibit is incorporated herein by reference.
- (3) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061 for the year ended April 30, 1981, which exhibit is incorporated herein by reference.
- (4) Filed with the SEC as an exhibit, numbered as indicated above, to the registration statement of Registrant on Form S-1, File No. 2-69527, which exhibit is incorporated herein by reference.
- (5) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1982, which exhibit is incorporated herein by reference.
- (6) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1985, which exhibit is incorporated herein by reference.

Edgar Filing: FREQUENCY ELECTRONICS INC - Form 10-K/A

- (7) Filed with the SEC as exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1986, which exhibit is incorporated herein by reference.
- (8) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1987, which exhibit is incorporated herein by reference.
- (9) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1989, which exhibit is incorporated herein by reference.
- (10) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1990, which exhibit is incorporated herein by reference.
- (11) Filed with the SEC as an exhibit, numbered as indicated above, to the registration statement of Registrant on Form S-8, File No. 333-42233, which exhibit is incorporated herein by reference.
- (12) Filed with the SEC as an exhibit, numbered as indicated above, to the annual report of Registrant on Form 10-K, File No. 1-8061, for the year ended April 30, 1998, which exhibit is incorporated herein by reference.

-----

55

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FREQUENCY ELECTRONICS, INC.

/s/ Alan L. Miller

-----  
Name: Alan L. Miller  
Title: Chief Financial Officer  
and Controller

Dated: August 18, 2003



