

FREQUENCY ELECTRONICS INC
Form 10-Q
December 15, 2016

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

FORM 10-Q

(Mark one)

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

For the Quarterly Period ended October 31, 2016

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

TABLE OF CONTENTS

	Page No.
Part I. Financial Information:	
<u>Item 1 - Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets – October 31, 2016 (unaudited) and April 30, 2016</u>	3
<u>Condensed Consolidated Statements of Income and Comprehensive (Loss) Income (unaudited) Six Months Ended October 31, 2016 and 2015</u>	4
<u>Condensed Consolidated Statements of Income and Comprehensive (Loss) Income (unaudited) Three Months Ended October 31, 2016 and 2015</u>	5
<u>Condensed Consolidated Statements of Cash Flows (unaudited) Six Months Ended October 31, 2016 and 2015</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7-13
<u>Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	14-19
<u>Item 3 - Quantitative and Qualitative Disclosures About Market Risk</u>	19
<u>Item 4 - Controls and Procedures</u>	19
Part II. Other Information:	
<u>Item 6 - Exhibits</u>	20
<u>Signatures</u>	21

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Balance Sheets

	October 31, 2016	April 30, 2016
	(UNAUDITED)	
	(In thousands except par value)	
ASSETS:		
Current assets:		
Cash and cash equivalents	\$4,105	\$6,082
Marketable securities	10,285	11,111
Accounts receivable, net of allowance for doubtful accounts of \$187 at October 31, 2016 and \$189 at April 30, 2016	9,227	9,000
Costs and estimated earnings in excess of billings, net	10,710	12,377
Inventories, net	41,770	41,278
Deferred and prepaid income taxes	4,526	3,213
Prepaid expenses and other	1,185	1,250
Total current assets	81,808	84,311
Property, plant and equipment, at cost, net of accumulated depreciation and amortization	14,112	13,072
Deferred income taxes	6,928	7,702
Goodwill and other intangible assets	617	617
Cash surrender value of life insurance and cash held in trust	13,137	12,819
Other assets	1,677	1,693
Total assets	\$118,279	\$120,214
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable - trade	\$2,352	\$2,650
Accrued liabilities	4,027	6,108
Short term debt	280	-
Total current liabilities	6,659	8,758
Long term debt- noncurrent	6,000	6,000
Deferred compensation	12,224	11,773
Deferred rent and other liabilities	657	331
Total liabilities	25,540	26,862
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - \$1.00 par value; authorized 600 shares, no shares issued	-	-
Common stock - \$1.00 par value; authorized 20,000 shares, 9,164 shares issued and 8,794 outstanding at October 31, 2016; 8,753 outstanding at April 30, 2016	9,164	9,164
Additional paid-in capital	56,017	55,576

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Retained earnings	26,803	28,533
	91,984	93,273
Common stock reacquired and held in treasury - at cost (370 shares at October 31, 2016 and 411 shares at April 30, 2016)	(1,696)	(1,885)
Accumulated other comprehensive income	2,451	1,964
Total stockholders' equity	92,739	93,352
Total liabilities and stockholders' equity	\$118,279	\$120,214

See accompanying notes to condensed consolidated financial statement

3

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Income and Comprehensive (Loss) Income

Six Months Ended October 31,
(Unaudited)

	2016	2015
	(In thousands except per share data)	
Condensed Consolidated Statements of Income		
Revenues	\$25,622	\$32,684
Cost of revenues	17,395	21,686
Gross margin	8,227	10,998
Selling and administrative expenses	6,598	6,916
Research and development expenses	3,772	3,093
Operating (loss) profit	(2,143)	989
Other income (expense):		
Investment income	278	365
Interest expense	(67)	(56)
Other (expense) income, net	(2)	404
(Loss) income before provision for income taxes	(1,934)	1,702
Provision for income taxes	(204)	880
Net (loss) income	\$(1,730)	\$822
Net (loss) income per common share		
Basic	\$(0.20)	\$0.09
Diluted	\$(0.20)	\$0.09
Weighted average shares outstanding		
Basic	8,771	8,716
Diluted	8,771	8,959
Condensed Consolidated Statements of Comprehensive (Loss) Income		
Net (loss) income	\$(1,730)	\$822
Other comprehensive income:		
Foreign currency translation adjustment	369	792
Unrealized gain (loss) on marketable securities:		
Change in market value of marketable securities before reclassification, net of tax of (\$61) and \$148	118	(289)
Reclassification adjustment for realized gains included in net income, net of tax of \$47 in 2015	0	(90)
Total unrealized gain (loss) on marketable securities, net of tax	118	(379)
Total other comprehensive income	487	413
Comprehensive (loss) income	\$(1,243)	\$1,235

See accompanying notes to consolidated condensed financial statements.

4

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Income and Comprehensive (Loss) Income

Three Months Ended October 31,
(Unaudited)

	2016	2015
	(In thousands except per share data)	
Condensed Consolidated Statements of Income		
Revenues	\$12,914	\$16,003
Cost of revenues	8,801	10,779
Gross margin	4,113	5,224
Selling and administrative expenses	3,272	3,230
Research and development expenses	2,188	1,946
Operating (loss) profit	(1,347)	48
Other income (expense):		
Investment income	187	94
Interest expense	(26)	(32)
Other (expense) income, net	(2)	1
(Loss) income before provision for income taxes	(1,188)	111
Provision for income taxes	(164)	180
Net (loss)	\$(1,024)	\$(69)
Net (loss) per common share		
Basic	\$(0.12)	\$(0.01)
Diluted	\$(0.12)	\$(0.01)
Weighted average shares outstanding		
Basic	8,781	8,725
Diluted	8,781	8,725
Condensed Consolidated Statements of Comprehensive (Loss) Income		
Net (loss)	\$(1,024)	\$(69)
Other comprehensive income (loss):		
Foreign currency translation adjustment	984	91
Unrealized gain (loss) on marketable securities:		
Change in market value of marketable securities before reclassification, net of tax of \$100 and \$54	(194)	(104)
Reclassification adjustment for realized gains included in net income, net of tax of \$0 in both periods	-	-
Total unrealized (loss) on marketable securities, net of tax	(194)	(104)
Total other comprehensive income (loss)	790	(13)
Comprehensive income (loss)	\$(234)	\$(82)

See accompanying notes to consolidated condensed financial statements.

5

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

Six Months Ended October 31,
(Unaudited)

	2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net (loss) income	\$(1,730)	\$822
Non-cash charges to earnings	3,170	2,602
Net changes in operating assets and liabilities	(3,918)	(6,340)
Net cash used in operating activities	(2,478)	(2,916)
Cash flows from investing activities:		
Proceeds on redemption of marketable securities	1,000	713
Purchase of marketable securities	0	(172)
Purchase of fixed assets and other assets	(2,423)	(1,308)
Net cash used in investing activities	(1,423)	(767)
Cash flows from financing activities:		
Proceeds from credit line borrowings	280	-
Payment of credit line borrowings	-	-
Tax benefit from exercise of stock-based compensation	25	9
Net cash provided by financing activities	305	9
Net decrease in cash and cash equivalents before effect of exchange rate changes	(3,596)	(3,674)
Effect of exchange rate changes on cash and cash equivalents	1,619	560
Net decrease in cash and cash equivalents	(1,977)	(3,114)
Cash and cash equivalents at beginning of period	6,082	7,222
Cash and cash equivalents at end of period	\$4,105	\$4,108
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$76	\$56
Income Taxes	\$335	\$230

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE A – CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management of Frequency Electronics, Inc. (“the Company”), the accompanying unaudited condensed consolidated interim financial statements reflect all adjustments (which include only normal recurring adjustments) necessary to present fairly, in all material respects, the consolidated financial position of the Company as of October 31, 2016 and the results of its operations and cash flows for the six and three months ended October 31, 2016 and 2015. The April 30, 2016 condensed consolidated balance sheet was derived from audited financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended April 30, 2016, filed on July 29, 2016. The results of operations for such interim periods are not necessarily indicative of the operating results for the full fiscal year.

NOTE B – EARNINGS PER SHARE

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

	Six months		Three months	
	Periods ended October 31,			
	2016	2015	2016	2015
Weighted average shares outstanding:				
Basic	8,771,494	8,715,656	8,780,633	8,725,128
Effect of dilutive securities	**	243,494	**	**
Diluted	8,771,494	8,959,150	8,780,633	8,725,128

** For the six and three month periods ended October 31 2016, and for the three month period ended October 31, 2015, dilutive securities are excluded since the inclusion of such shares would be antidilutive due to the net loss for the period. The exercisable shares excluded are 1,265,375 and 1,112,375, respectively.

The computation of diluted earnings per share in the other fiscal periods excludes those options and stock appreciation rights (“SARS”) with an exercise price in excess of the average market price of the Company’s common shares during the periods presented. The inclusion of such options and SARS in the computation of earnings per share would have been antidilutive. The number of excluded options and SARS were:

	Six months		Three months	
	Periods ended October 31,			
	2016	2015	2016	2015
Outstanding options and SARS excluded	**	330,500	**	**

NOTE C – COSTS AND ESTIMATED EARNINGS IN EXCESS OF BILLINGS, NET

At October 31, 2016 and April 30, 2016, costs and estimated earnings in excess of billings, net, consist of the following:

	October 31, 2016	April 30, 2016
	(In thousands)	
Costs and estimated earnings in excess of billings	\$11,387	\$12,460
Billings in excess of costs and estimated earnings	(677)	(83)
Net asset	\$10,710	\$12,377

Such amounts represent revenue recognized on long-term contracts that had not been billed at the balance sheet dates or represent a liability for amounts billed in excess of the revenue recognized. Amounts are billed to customers pursuant to contract terms, whereas the related revenue is recognized on the percentage of completion basis at the measurement date. In general, the recorded amounts will be billed and collected or revenue recognized within twelve months of the balance sheet date. Revenue on these long-term contracts is accounted for on the percentage of completion basis. During the six and three months ended October 31, 2016, revenue recognized under percentage of completion contracts was approximately \$12.4 million and \$5.1 million, respectively. During the six and three months ended October 31, 2015, such revenue was approximately \$18.5 million and \$9.2 million, respectively.

7

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

If contract losses are anticipated, costs and estimated earnings in excess of billings are reduced for the full amount of such losses when they are determinable. For the six months ended October 31, 2016 anticipated contract losses were approximately \$210,000, these non-material losses are expected to be contained within this fiscal year.

NOTE D – TREASURY STOCK TRANSACTIONS

During the six and three month periods ended October 31, 2016, the Company made contributions of 27,698 shares and 13,333 shares of its common stock held in treasury to the Company's profit sharing plan and trust under section 401(k) of the Internal Revenue Code. Such contributions are in accordance with the Company's discretionary match of employee voluntary contributions to this plan. During the same periods, the Company issued 13,568 shares and 12,901 shares from treasury upon the exercise of SARs by certain officers and employees of the Company.

NOTE E – INVENTORIES

Inventories, which are reported at the lower of cost or market, consist of the following:

	October 31, 2016	April 30, 2016
	(In thousands)	
Raw Materials and Component Parts	\$25,095	\$25,110
Work in Progress	12,149	12,042
Finished Goods	4,526	4,126
	\$41,770	\$41,278

As of October 31, 2016 and April 30, 2016, approximately \$35.9 million and \$35.3 million, respectively, of total inventory is located in the United States, approximately \$4.7 million and \$5.0 million, respectively, is located in Belgium and \$1.1 million and \$1.0 million, respectively, is located in China. The Company buys inventory in bulk quantities which may be used over significant time periods; due to its nature the inventory does not deteriorate.

NOTE F – SEGMENT INFORMATION

The Company operates under three reportable segments based on the geographic locations of its subsidiaries:

- (1) FEI-NY – operates out of New York and its operations consist principally of precision time and frequency control products used in three principal markets- communication satellites (both commercial and U.S. Government-funded); terrestrial cellular telephone or other ground-based telecommunication stations and other components and systems for the U.S. military.
- (2) Gillam-FEI - operates out of Belgium and France and primarily sells wireline synchronization and network management systems in non-U.S. markets. All sales from Gillam-FEI to the United States are to other segments of the Company.
- (3) FEI-Zyfer – operates out of California and its products incorporate Global Positioning System (GPS) technologies into systems and subsystems for secure communications, both government and commercial, and other locator applications. This segment also provides sales and support for the Company's wireline telecommunications family of

products, including US5G, which are sold in the United States market.

The FEI-NY segment also includes the operations of the Company's wholly-owned subsidiaries, FEI-Elcom Tech ("FEI-Elcom") and FEI-Asia. FEI-Asia functions primarily as a manufacturing facility for the Company's commercial product subsidiaries with historically minimal sales to outside customers. Beginning in late fiscal year 2014, FEI-Asia began shipping higher volumes of product to third parties as a contract manufacturer. FEI-Elcom, in addition to its own product line, provides design and technical support for the FEI-NY segment's satellite business.

The Company's chief executive officer measures segment performance based on total revenues and profits generated by each geographic location rather than on the specific types of customers or end-users. Consequently, the Company determined that the segments indicated above most appropriately reflect the way the Company's management views the business.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

The tables below present information about reported segments with reconciliation of segment amounts to consolidated amounts as reported in the statement of income or the balance sheet for each of the periods (in thousands):

	Six months		Three months	
	Periods ended October 31,			
	2016	2015	2016	2015
Revenues:				
FEI-NY	\$17,715	\$25,587	\$7,733	\$12,094
Gillam-FEI	2,669	2,285	1,501	878
FEI-Zyfer	6,596	5,497	4,249	3,396
less intersegment revenues	(1,358)	(685)	(569)	(365)
Consolidated revenues	\$25,622	\$32,684	\$12,914	\$16,003

Operating (loss) profit:

FEI-NY	\$(1,750)	\$944	\$(1,683)	\$(143)
Gillam-FEI	(690)	(562)	(196)	(344)
FEI-Zyfer	463	833	648	710
Corporate	(166)	(226)	(116)	(175)
Consolidated operating (loss) profit	\$(2,143)	\$989	\$(1,347)	\$48

	October 31, 2016	April 30, 2016
Identifiable assets:		
FEI-NY (approximately \$1.9 and \$2.5 million in China)	\$65,226	\$62,992
Gillam-FEI (all in Belgium or France)	9,231	9,610
FEI-Zyfer	12,508	13,275
less intersegment balances	(9,291)	(7,651)
Corporate	40,605	41,988
Consolidated identifiable assets	\$118,279	\$120,214

NOTE G – INVESTMENT IN MORION, INC.

The Company has an investment in Morion, Inc., (“Morion”) a privately-held Russian company, which manufactures high precision quartz resonators and crystal oscillators. The Company’s investment consists of 4.6% of Morion’s outstanding shares, accordingly, the Company accounts for its investment in Morion on the cost basis. This investment is included in other assets in the accompanying balance sheets.

During the six months ended October 31, 2016 and 2015, the Company acquired product from Morion in the aggregate amount of approximately \$204,000 and \$61,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately \$10,000 and \$435,000, respectively. (See discussion of revenues recognized under the license agreement in the paragraph below.) During the three months ended October 31, 2016 and 2015, the Company acquired product from Morion in the aggregate amount of approximately \$123,000 and \$29,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately \$0 and \$12,000, respectively. At October 31, 2016, approximately \$58,000 was payable to Morion and

accounts receivable from Morion was approximately \$33,000. During the six months ended October 31, 2016 and 2015, the Company received a dividend from Morion of approximately \$100,000 and \$30,000, respectively.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

On October 22, 2012, the Company entered into an agreement to license its rubidium oscillator production technology to Morion. The agreement required the Company to sell certain fully-depreciated production equipment previously owned by the Company and to provide training to Morion employees to enable Morion to produce a minimum of 5,000 rubidium oscillators per year. Morion will pay the Company approximately \$2.7 million for the license and the equipment plus 5% royalties on third party sales for a 5-year period following an initial production run. During the same 5-year period, the Company commits to purchase from Morion a minimum of approximately \$400,000 worth of rubidium oscillators per year although Morion is not obligated to sell that amount to the Company.

On March 29, 2016, the Company renegotiated the \$1 million dollar amendment under the original agreement dated October 22, 2012 to \$602,000 due to the U.S. Government easing of export regulations. Of this amount \$392,500 was billed and paid during fiscal year 2016. During the six months ended October 31, 2016, sales to Morion included \$10,000 under this agreement. The remaining amount will be billed in December 2016.

NOTE H – FAIR VALUE OF FINANCIAL INSTRUMENTS

The cost, gross unrealized gains, gross unrealized losses and fair market value of available-for-sale securities at October 31, 2016 and April 30, 2016 are as follows (in thousands):

	October 31, 2016			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Fixed income securities	\$2,402	\$ 139	\$ -	\$2,541
Equity securities	7,197	1,117	(570)	7,744
	\$9,599	\$ 1,256	\$ (570)	\$10,285
	April 30, 2016			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Fixed income securities	\$3,407	\$ 121	\$ (6)	\$3,522
Equity securities	7,197	974	(582)	7,589
	\$10,604	\$ 1,095	\$ (588)	\$11,111

The following table presents the fair value and unrealized losses, aggregated by investment type and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	Less than 12 months		12 Months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>October 31, 2016</u>						