

COMTECH TELECOMMUNICATIONS CORP /DE/
Form 10-Q
December 09, 2013

Index

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, 2013

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

Commission File Number: 0-7928

(Exact name of registrant as specified in its charter)

Delaware

11-2139466

(State or other jurisdiction of incorporation
/organization)

(I.R.S. Employer Identification Number)

68 South Service Road, Suite 230,
Melville, NY

11747

(Address of principal executive offices)

(Zip Code)

(631) 962-7000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

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

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of December 5, 2013, the number of outstanding shares of Common Stock, par value \$.10 per share, of the registrant was 16,065,500 shares.

Index

COMTECH TELECOMMUNICATIONS CORP.
INDEX

	Page
PART I. FINANCIAL INFORMATION	
Item 1. <u>Condensed Consolidated Financial Statements</u>	<u>2</u>
<u>Condensed Consolidated Balance Sheets - October 31, 2013 (Unaudited) and July 31, 2013</u>	<u>2</u>
<u>Condensed Consolidated Statements of Operations - Three Months Ended October 31, 2013 and 2012 (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Stockholders' Equity - Three Months Ended October 31, 2013 and 2012 (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows - Three Months Ended October 31, 2013 and 2012 (Unaudited)</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>26</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>41</u>
Item 4. <u>Controls and Procedures</u>	<u>42</u>
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>43</u>
Item 1A. <u>Risk Factors</u>	<u>43</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>43</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>43</u>
Item 6. <u>Exhibits</u>	<u>44</u>
<u>Signature Page</u>	<u>45</u>

Index

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	October 31, 2013 (Unaudited)	July 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 346,553,000	356,642,000
Accounts receivable, net	62,020,000	49,915,000
Inventories, net	69,032,000	65,482,000
Prepaid expenses and other current assets	5,320,000	7,428,000
Deferred tax asset, net	10,135,000	10,184,000
Total current assets	493,060,000	489,651,000
Property, plant and equipment, net	19,620,000	20,333,000
Goodwill	137,354,000	137,354,000
Intangibles with finite lives, net	30,923,000	32,505,000
Deferred financing costs, net	736,000	1,093,000
Other assets, net	882,000	879,000
Total assets	\$ 682,575,000	681,815,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Convertible senior notes, current	\$ 200,000,000	200,000,000
Accounts payable	17,111,000	18,390,000
Accrued expenses and other current liabilities	26,183,000	29,892,000
Dividends payable	4,529,000	4,531,000
Customer advances and deposits	19,636,000	14,749,000
Interest payable	3,029,000	1,529,000
Income taxes payable	1,674,000	—
Total current liabilities	272,162,000	269,091,000
Other liabilities	4,064,000	3,958,000
Income taxes payable	3,068,000	2,963,000
Deferred tax liability, net	2,614,000	1,741,000
Total liabilities	281,908,000	277,753,000
Commitments and contingencies (See Note 19)		
Stockholders' equity:		
Preferred stock, par value \$.10 per share; shares authorized and unissued 2,000,000	—	—
Common stock, par value \$.10 per share; authorized 100,000,000 shares; issued 29,084,683 shares and 29,066,792 shares at October 31, 2013 and July 31, 2013, respectively	2,908,000	2,907,000
Additional paid-in capital	363,327,000	363,888,000
Retained earnings	404,148,000	403,398,000
	770,383,000	770,193,000
Less:		
Treasury stock, at cost (12,733,254 shares and 12,608,501 shares at October 31, 2013 and July 31, 2013, respectively)	(369,716,000)	(366,131,000)
Total stockholders' equity	400,667,000	404,062,000

Total liabilities and stockholders' equity	\$682,575,000	681,815,000
--	---------------	-------------

See accompanying notes to condensed consolidated financial statements.

2

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

	Three months ended October 31,	
	2013	2012
Net sales	\$83,368,000	90,953,000
Cost of sales	46,990,000	49,150,000
Gross profit	36,378,000	41,803,000
Expenses:		
Selling, general and administrative	16,198,000	16,810,000
Research and development	8,499,000	10,049,000
Amortization of intangibles	1,582,000	1,582,000
	26,279,000	28,441,000
Operating income	10,099,000	13,362,000
Other expenses (income):		
Interest expense	2,018,000	2,111,000
Interest income and other	(273,000)	(276,000)
Income before provision for income taxes	8,354,000	11,527,000
Provision for income taxes	3,049,000	4,092,000
Net income	\$5,305,000	7,435,000
Net income per share (See Note 5):		
Basic	\$0.32	0.43
Diluted	\$0.28	0.36
Weighted average number of common shares outstanding – basic	16,454,000	17,379,000
Weighted average number of common and common equivalent shares outstanding – diluted	22,698,000	23,444,000
Dividends declared per issued and outstanding common share as of the applicable dividend record date	\$0.275	0.275

See accompanying notes to condensed consolidated financial statements.

Index

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
 THREE MONTHS ENDED OCTOBER 31, 2013 AND 2012

(Unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Treasury Stock		Stockholders' Equity
	Shares	Amount			Shares	Amount	
Balance as of July 31, 2012	28,931,679	\$2,893,000	\$361,458,000	\$404,227,000	11,564,059	\$(339,177,000)	\$429,401,000
Equity-classified stock award compensation	—	—	750,000	—	—	—	750,000
Proceeds from exercise of options	16,200	2,000	321,000	—	—	—	323,000
Proceeds from issuance of employee stock purchase plan shares	10,549	1,000	247,000	—	—	—	248,000
Cash dividends declared	—	—	—	(4,784,000)	—	—	(4,784,000)
Net income tax shortfall from settlement of stock-based awards	—	—	(5,000)	—	—	—	(5,000)
Reversal of deferred tax assets associated with expired and unexercised stock-based awards	—	—	(2,892,000)	—	—	—	(2,892,000)
Net income	—	—	—	7,435,000	—	—	7,435,000
Balance as of October 31, 2012	28,958,428	\$2,896,000	\$359,879,000	\$406,878,000	11,564,059	\$(339,177,000)	\$430,476,000
Balance as of July 31, 2013	29,066,792	\$2,907,000	\$363,888,000	\$403,398,000	12,608,501	\$(366,131,000)	\$404,062,000
Equity-classified stock award compensation	—	—	944,000	—	—	—	944,000
Equity-classified stock awards issued	—	—	139,000	—	—	—	139,000

Proceeds from exercise of options	4,050	—	79,000	—	—	—	79,000
Proceeds from issuance of employee stock purchase plan shares	10,345	1,000	213,000	—	—	—	214,000
Issuance of common stock for vested performance shares, net of minimum withholding tax and deferrals	3,496	—	(25,000	)	—	—	(25,000
Cash dividends declared	—	—	—	(4,529,000	)	—	(4,529,000
Accrual of dividend equivalents	—	—	—	(26,000	)	—	(26,000
Net excess income tax benefit from settlement of stock-based awards	—	—	10,000	—	—	—	10,000
Reversal of deferred tax assets associated with expired and unexercised stock-based awards	—	—	(1,921,000	)	—	—	(1,921,000
Repurchases of common stock	—	—	—	—	124,753	(3,585,000	(3,585,000
Net income	—	—	—	5,305,000	—	—	5,305,000
Balance as of October 31, 2013	29,084,683	\$2,908,000	\$363,327,000	\$404,148,000	12,733,254	\$(369,716,000)	\$400,667,000

See accompanying notes to condensed consolidated financial statements.

IndexCOMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended October 31,	
	2013	2012
Cash flows from operating activities:		
Net income	\$5,305,000	7,435,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization of property, plant and equipment	1,710,000	2,025,000
Amortization of intangible assets with finite lives	1,582,000	1,582,000
Amortization of stock-based compensation	947,000	745,000
Deferred financing costs	357,000	352,000
Change in fair value of contingent earn-out liability	(239,000)	) (2,378,000)
Loss on disposal of property, plant and equipment	30,000	9,000
Provision for allowance for doubtful accounts	104,000	211,000
Provision for excess and obsolete inventory	702,000	671,000
Deferred income tax (benefit) expense	(999,000)	) 1,058,000
Changes in assets and liabilities:		
Accounts receivable	(12,209,000)	) 9,104,000
Inventories	(4,111,000)	) 3,042,000
Prepaid expenses and other current assets	306,000	198,000
Other assets	(3,000)	) (40,000)
Accounts payable	(1,279,000)	) (6,757,000)
Accrued expenses and other current liabilities	(3,355,000)	) (7,273,000)
Customer advances and deposits	4,746,000	(2,586,000)
Other liabilities	75,000	518,000
Interest payable	1,500,000	1,500,000
Income taxes payable	3,591,000	2,462,000
Net cash (used in) provided by operating activities	(1,240,000)	) 11,878,000
Cash flows from investing activities:		
Purchases of property, plant and equipment	(1,027,000)	) (1,063,000)
Net cash used in investing activities	(1,027,000)	) (1,063,000)
Cash flows from financing activities:		
Repurchases of common stock	(3,585,000)) —
Cash dividends paid	(4,524,000)	) (4,773,000)
Proceeds from exercises of stock options	79,000	323,000
Proceeds from issuance of employee stock purchase plan shares	214,000	248,000
Payment of contingent consideration related to business acquisition	(6,000)	) (1,000)
Net cash used in financing activities	(7,822,000)	) (4,203,000)
Net (decrease) increase in cash and cash equivalents	(10,089,000)	) 6,612,000
Cash and cash equivalents at beginning of period	356,642,000	367,894,000
Cash and cash equivalents at end of period	\$346,553,000	374,506,000

See accompanying notes to condensed consolidated financial statements.

(Continued)

IndexCOMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Unaudited)

	Three months ended October 31,	
	2013	2012
Supplemental cash flow disclosures:		
Cash paid during the period for:		
Interest	\$90,000	87,000
Income taxes	\$456,000	570,000
Non-cash investing and financing activities:		
Cash dividends declared (including accrual of dividend equivalents)	\$4,555,000	4,784,000
Equity-classified stock awards issued	\$139,000	—

See accompanying notes to condensed consolidated financial statements.

Index

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

(1) General

The accompanying condensed consolidated financial statements of Comtech Telecommunications Corp. and Subsidiaries (“Comtech,” “we,” “us,” or “our”) as of and for the three months ended October 31, 2013 and 2012 are unaudited. In the opinion of management, the information furnished reflects all material adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the unaudited interim periods. Our results of operations for such periods are not necessarily indicative of the results of operations to be expected for the full fiscal year.

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

Our condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements, filed with the Securities and Exchange Commission (“SEC”), for the fiscal year ended July 31, 2013 and the notes thereto contained in our Annual Report on Form 10-K, and all of our other filings with the SEC.

(2) Adoption of Accounting Standards and Updates

We are required to prepare our consolidated financial statements in accordance with the Financial Accounting Standards Board's (“FASB”) Accounting Standards Codification (“ASC”) which is the source for all authoritative U.S. generally accepted accounting principles, which is commonly referred to as “GAAP.” The FASB ASC is subject to updates by FASB, which are known as Accounting Standards Updates (“ASUs”).

On August 1, 2013, we adopted FASB ASU No. 2011-11, which requires entities to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement. In addition, we also adopted ASU No. 2013-01, which clarifies that the scope of ASU No. 2011-11 applies to derivatives accounted for in accordance with Topic 815, "Derivatives and Hedging," including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar arrangement. Our adoption of this ASU, as amended, did not have any impact on our consolidated financial statements.

(3) Reclassifications

Certain reclassifications have been made to previously reported financial statements to conform to our current financial statement format.

(4) Fair Value Measurements and Financial Instruments

In accordance with FASB ASC 825, “Financial Instruments,” we determined that, as of October 31, 2013 and July 31, 2013, the fair value of our 3.0% convertible senior notes was approximately \$210,080,000 and \$208,080,000, respectively, based on quoted market prices in an active market. Our 3.0% convertible senior notes are not marked-to-market and are shown on the accompanying balance sheet at their original issuance value. As such, changes

in the estimated fair value of our 3.0% convertible senior notes are not recorded in our condensed consolidated financial statements.

As of October 31, 2013 and July 31, 2013, we had approximately \$45,187,000 and \$50,182,000, respectively, of money market mutual funds which are classified as cash and cash equivalents in our Condensed Consolidated Balance Sheets. These money market mutual funds are recorded at their current fair value. FASB ASC 820, "Fair Value Measurements and Disclosures," requires us to define fair value as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, using the fair value hierarchy described in FASB ASC 820, we valued our money market mutual funds using Level 1 inputs that were based on quoted market prices.

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

As of October 31, 2013 and July 31, 2013, other than our cash and cash equivalents, we have no other significant assets or liabilities included in our Condensed Consolidated Balance Sheets recorded at current fair value. If we acquire different types of assets or incur different types of liabilities in the future, we might be required to use different FASB ASC fair value methodologies.

(5) Earnings Per Share

Our basic earnings per share ("EPS") is computed based on the weighted average number of shares, including vested but unissued stock units, share units, performance shares and restricted stock units ("RSUs"), outstanding during each respective period. Our diluted EPS reflects the dilution from potential common stock issuable pursuant to the exercise of equity-classified stock-based awards and convertible senior notes, if dilutive, outstanding during each respective period. Pursuant to FASB ASC 260, "Earnings Per Share," equity-classified stock-based awards that are subject to performance conditions are not considered in our diluted EPS calculations until the respective performance conditions have been satisfied. When calculating our diluted earnings per share, we consider (i) the amount a recipient must pay upon assumed exercise of stock-based awards; (ii) the amount of stock-based compensation cost attributed to future services and not yet recognized; and (iii) the amount of excess tax benefits, if any, that would be credited to additional paid-in capital assuming exercise of in-the-money stock-based awards. This excess tax benefit is the amount resulting from a tax deduction for compensation in excess of compensation expense based on the Black Scholes option pricing model, recognized for financial reporting purposes.

Equity-classified stock-based awards to purchase 2,750,000 and 2,382,000 weighted average stock options for the three months ended October 31, 2013 and 2012, respectively, were not included in our diluted EPS calculation because their effect would have been anti-dilutive.

Our EPS calculations exclude 49,000 and 35,000 weighted average RSUs with performance measures (which we refer to as performance shares) outstanding for the three months ended October 31, 2013 and 2012, respectively, as the respective performance conditions had not yet been satisfied. However, the compensation expense related to these awards is included in net income (the numerator) for EPS calculations for each respective period.

In addition, the weighted average basic and diluted shares outstanding for the three months ended October 31, 2013 reflects a reduction of approximately 14,000 shares as a result of the repurchase of our common shares during the respective period. There were no repurchases of our common stock during the three months ended October 31, 2012. See Note (18) – "Stockholders' Equity" for more information on our stock repurchase program.

Liability-classified stock-based awards do not impact and are not included in the denominator for EPS calculations.

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

	Three months ended October 31,	
	2013	2012
Numerator:		
Net income for basic calculation	\$5,305,000	7,435,000
Effect of dilutive securities:		
Interest expense (net of tax) on 3.0% convertible senior notes	1,117,000	1,117,000
Numerator for diluted calculation	\$6,422,000	8,552,000

Denominator:		
Denominator for basic calculation	16,454,000	17,379,000
Effect of dilutive securities:		
Stock-based awards	75,000	159,000
Conversion of 3.0% convertible senior notes	6,169,000	5,906,000
Denominator for diluted calculation	22,698,000	23,444,000

8

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

(6) Accounts Receivable

Accounts receivable consist of the following at:

	October 31, 2013	July 31, 2013
Billed receivables from commercial customers	\$46,722,000	40,005,000
Billed receivables from the U.S. government and its agencies	8,353,000	8,114,000
Unbilled receivables on contracts-in-progress	7,652,000	2,399,000
Total accounts receivable	62,727,000	50,518,000
Less allowance for doubtful accounts	707,000	603,000
Accounts receivable, net	\$62,020,000	49,915,000

Unbilled receivables on contracts-in-progress include \$2,041,000 and \$699,000 at October 31, 2013 and July 31, 2013, respectively, due from the U.S. government and its agencies. We had virtually no retainage included in unbilled receivables at both October 31, 2013 and July 31, 2013. In the opinion of management, a substantial portion of the unbilled balances will be billed and collected within one year.

As of October 31, 2013, one customer, that is also the prime contractor that we perform work for on our two North African country end-customer over-the-horizon microwave system contracts, accounts for 20.3% of total accounts receivable.

(7) Inventories

Inventories consist of the following at:

	October 31, 2013	July 31, 2013
Raw materials and components	\$53,572,000	52,169,000
Work-in-process and finished goods	32,169,000	29,539,000
Total inventories	85,741,000	81,708,000
Less reserve for excess and obsolete inventories	16,709,000	16,226,000
Inventories, net	\$69,032,000	65,482,000

At October 31, 2013 and July 31, 2013, the amount of inventory directly related to long-term contracts (including contracts-in-progress) was \$1,543,000 and \$1,910,000, respectively.

At October 31, 2013 and July 31, 2013, \$647,000 and \$592,000, respectively, of the inventory above related to contracts from third party commercial customers who outsource their manufacturing to us.

(8) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following at:

	October 31, 2013	July 31, 2013
Accrued wages and benefits	\$8,092,000	11,526,000
Accrued warranty obligations	7,935,000	7,797,000
Accrued commissions and royalties	4,324,000	4,206,000
Accrued business acquisition payments	43,000	288,000
Other	5,789,000	6,075,000

Accrued expenses and other current liabilities	\$26,183,000	29,892,000
--	--------------	------------

9

IndexCOMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(Unaudited)Accrued Warranty Obligations

We provide warranty coverage for most of our products for a period of at least one year from the date of shipment. We record a liability for estimated warranty expense based on historical claims, product failure rates and other factors. Some of our product warranties are provided under long-term contracts, the costs of which are incorporated into our estimates of total contract costs.

Changes in our product warranty liability were as follows:

	Three months ended October 31,	
	2013	2012
Balance at beginning of period	\$7,797,000	7,883,000
Provision for warranty obligations	1,983,000	2,237,000
Charges incurred	(1,845,000	) (1,610,000
Balance at end of period	\$7,935,000	8,510,000

Accrued Business Acquisition Payments

In October 2010, we acquired the WAN optimization technology assets and assumed certain liabilities of Stampede for an estimated total purchase price of approximately \$5,303,000, including the initial fair value of contingent earn-out payments which aggregated \$3,803,000. Almost all of the purchase price for Stampede was allocated to the estimated fair value of technologies acquired and was assigned an estimated amortizable life of five years.

During the three months ended October 31, 2013, the fair value of the contingent earn-out liability was reduced by \$239,000 and, in November 2013, we made our final payment of \$43,000. During the three months ended October 31, 2012, the fair value of the contingent earn-out liability was reduced by \$2,378,000. These adjustments are reflected as a reduction to selling, general and administrative expenses in our Condensed Consolidated Statement of Operations for the respective periods.

There was no interest accreted on the contingent earn-out liability for the three months ended October 31, 2013. Interest accreted on the contingent earn-out liability was \$108,000 for the three months ended October 31, 2012. Total interest accreted through October 31, 2013 was \$986,000. As of October 31, 2013, we paid \$1,822,000 of the total purchase price in cash, including \$322,000 of earn-out payments.

(9) Cost Reduction ActionsWind-Down of Microsatellite Product Line

During fiscal 2013, we completed our fiscal 2012 plan to wind-down our mobile data communications segment's microsatellite product line. In connection with this plan, we recorded a net pre-tax restructuring charge of \$822,000 in the three months ended October 31, 2012, almost all of which was recorded in selling, general and administrative expenses in our Condensed Consolidated Statements of Operations. There was no such charge in the three months ended October 31, 2013.

The activity pertaining to the accruals with respect to this plan, since July 31, 2013, is summarized as follows:

	Facility exit costs	Other	Total
Balance as of July 31, 2013	\$413,000	50,000	\$463,000
Additions/(reversals)	—	—	—

Payments made	(39,000	) —	(39,000)
Balance as of October 31, 2013	\$374,000	50,000	\$424,000	

Of the total remaining microsatellite product line wind-down liabilities of \$424,000, \$278,000 is included in accrued expenses and other current liabilities and \$146,000 is included in other long-term liabilities in our Condensed Consolidated Balance Sheet as of October 31, 2013.

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

Radyne Acquisition-Related Restructuring Plan

In connection with our August 1, 2008 acquisition of Radyne, we adopted a restructuring plan for which we recorded \$2,713,000 of estimated restructuring costs. Of this amount, \$613,000 related to severance for Radyne employees which was paid in fiscal 2009. The remaining estimated amounts relate to facility exit costs and were determined as follows:

	At August 1, 2008
Total non-cancelable lease obligations	\$12,741,000
Less: Estimated sublease income	8,600,000
Total net estimated facility exit costs	4,141,000
Less: Interest expense to be accreted	2,041,000
Present value of estimated facility exit costs	\$2,100,000

Our total non-cancelable lease obligations were based on the actual lease term which runs from November 1, 2008 through October 31, 2018. We estimated sublease income based on (i) the terms of a fully executed sublease agreement, whose lease term runs from November 1, 2008 through October 31, 2015 and (ii) our assessment of future uncertainties relating to the commercial real estate market. Based on our assessment of commercial real estate market conditions, we currently believe that it is not probable that we will be able to sublease the facility beyond the current sublease terms. As such, in accordance with grandfathered accounting standards that were not incorporated into the FASB's ASC, we recorded these costs, at fair value, as assumed liabilities as of August 1, 2008, with a corresponding increase to goodwill.

As of October 31, 2013, the amount of the acquisition-related restructuring reserve is as follows:

	Cumulative Activity Through October 31, 2013
Present value of estimated facility exit costs at August 1, 2008	\$2,100,000
Cash payments made	(5,585,000)
Cash payments received	6,028,000
Accreted interest recorded	895,000
Net liability as of October 31, 2013	3,438,000
Amount recorded as prepaid expenses in the Condensed Consolidated Balance Sheet	450,000
Amount recorded as other liabilities in the Condensed Consolidated Balance Sheet	\$3,888,000

As of July 31, 2013, the present value of the estimated facility exit costs was \$3,331,000. During the three months ended October 31, 2013, we made cash payments of \$258,000 and we received cash payments of \$306,000. Interest accreted for the three months ended October 31, 2013 and 2012 was \$59,000 and \$52,000, respectively, and is included in interest expense for each respective fiscal period.

As of October 31, 2013, future cash payments associated with our restructuring plan are summarized below:

	As of October 31, 2013
Future lease payments to be made in excess of anticipated sublease payments	\$3,888,000
Less net cash to be received in next twelve months	(450,000)
Interest expense to be accreted in future periods	1,145,000
Total remaining net cash payments	\$4,583,000

Index

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

(10) Credit Facility

We have a committed \$100,000,000 secured revolving credit facility (the “Credit Facility”) with a syndicate of bank lenders, as amended. The Credit Facility, as amended December 6, 2013, expires on October 31, 2014 but may be extended by us to December 31, 2016, subject to certain conditions relating primarily to the repurchase, redemption or conversion of our 3.0% convertible senior notes and compliance with all other Credit Facility covenants.

The Credit Facility provides for the extension of credit to us in the form of revolving loans, including letters of credit, at any time and from time to time during its term, in an aggregate principal amount at any time outstanding not to exceed \$100,000,000 for both revolving loans and letters of credit, with sub-limits of \$15,000,000 for commercial letters of credit and \$35,000,000 for standby letters of credit. Subject to covenant limitations, the Credit Facility may be used for acquisitions, equity securities repurchases, dividends, working capital and other general corporate purposes. Since the inception of our Credit Facility in 2009, we have had no revolving loans under the Credit Facility. At October 31, 2013, we had \$1,871,000 of standby letters of credit outstanding related to our guarantees of future performance on certain customer contracts and no outstanding commercial letters of credit.

At our election, borrowings under the Credit Facility will bear interest either at LIBOR plus an applicable margin or at the base rate plus an applicable margin, as amended. The interest rate margin over LIBOR ranges from 1.75 percent up to a maximum amount of 2.50 percent. The base rate is a fluctuating rate equal to the highest of (i) the Prime Rate; (ii) the Federal Funds Effective Rate from time to time plus fifty (50) basis points; and (iii) two hundred (200) basis points in excess of the floating rate of interest determined, on a daily basis, in accordance with the terms of the agreement. The interest rate margin over the base rate ranges from 0.75 percent up to a maximum amount of 1.50 percent. In both cases, the applicable interest rate margin is based on the ratio of our consolidated total indebtedness to our consolidated earnings before interest, taxes, depreciation and amortization (“Consolidated Adjusted EBITDA”). As defined in the Credit Facility, Consolidated Adjusted EBITDA is adjusted for certain items and, in the event of an acquisition with a purchase price in excess of \$10,000,000, provides for the inclusion of the last twelve months of consolidated EBITDA of a target.

As amended December 6, 2013, the Credit Facility contains covenants, including covenants limiting certain debt, certain liens on assets, certain sales of assets and receivables, certain payments (including dividends), certain repurchases of equity securities, certain sale and leaseback transactions, certain guaranties, certain investments and certain minimum levels of cash and cash equivalents. Under certain conditions, the Credit Facility also contains financial condition covenants requiring that we (i) not exceed a maximum ratio of consolidated total indebtedness to Consolidated Adjusted EBITDA (each as defined in the Credit Facility and compliance with which was waived as of October 31, 2013); (ii) not exceed a maximum ratio of consolidated senior secured indebtedness to Consolidated Adjusted EBITDA (each as defined in the Credit Facility); (iii) maintain a minimum fixed charge ratio (as defined in the Credit Facility); (iv) maintain a minimum consolidated net worth; in each case measured on the last day of each fiscal quarter and (v) in the event total consolidated indebtedness (as defined in the Credit Facility) is less than \$200,000,000, we must maintain a minimum level of Consolidated Adjusted EBITDA (as defined in the Credit Facility).

At October 31, 2013, had borrowings been outstanding under the Credit Facility, the interest rate would have been approximately 2.70 percent (LIBOR plus 2.50 percent). We are also subject to an undrawn line fee based on the ratio of our consolidated total indebtedness to our Consolidated Adjusted EBITDA, as defined and adjusted for certain items specified in the Credit Facility. Interest expense, including amortization of deferred financing costs, related to

our credit facility recorded during the three months ended October 31, 2013 was \$186,000, compared to \$179,000 during the three months ended October 31, 2012.

As of October 31, 2013, based on our Consolidated Adjusted EBITDA (as defined in the Credit Facility) and our business outlook and related business plans, we believe we will be able to meet or obtain waivers for the applicable financial covenants that we are required to maintain.

12

Index

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

(11) 3.0% Convertible Senior Notes

In May 2009, we issued \$200,000,000 of our 3.0% convertible senior notes in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from this transaction were \$194,541,000 after deducting the initial purchasers' discount and other transaction costs of \$5,459,000.

Our 3.0% convertible senior notes bear interest at an annual rate of 3.0%. Pursuant to the terms of the 3.0% convertible senior notes indenture, cash dividends require an adjustment to the conversion rate, effective on the record date. Effective October 18, 2013 (the record date of our dividend declared on October 3, 2013), our 3.0% convertible senior notes are convertible into shares of our common stock at a conversion price of \$32.15 per share (a conversion rate of 31.1038 shares per \$1,000 original principal amount of notes) at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date, subject to adjustment in certain circumstances.

We may, at our option, redeem some or all of our 3.0% convertible senior notes on or after May 5, 2014. Holders of the 3.0% convertible senior notes will have the right to require us to repurchase some or all of our outstanding 3.0% convertible senior notes, solely for cash, on May 1, 2014, May 1, 2019 and May 1, 2024 and upon certain events, including a change in control. If not redeemed by us or repaid pursuant to the holders' right to require repurchase, our 3.0% convertible senior notes mature on May 1, 2029.

Because it is possible that the holders of our 3.0% convertible senior notes will require us to repurchase some or all of the outstanding notes on May 1, 2014, our 3.0% convertible senior notes are reflected as a current liability in our condensed consolidated balance sheet at October 31, 2013 and July 31, 2013.

The 3.0% convertible notes are senior unsecured obligations of Comtech.

(12) Income Taxes

Our effective tax rate for the three months ended October 31, 2013 was 36.5% and does not assume that the federal research and experimentation credit will be extended past December 31, 2013. Excluding the impact of any potential discrete tax items, our fiscal 2014 effective tax rate is expected to approximate 36.5%.

At October 31, 2013 and July 31, 2013, total unrecognized tax benefits, all of which were recorded as non-current income taxes payable in our Condensed Consolidated Balance Sheets, were \$3,068,000 and \$2,963,000, respectively, including interest of \$102,000 and \$90,000, respectively. Of these amounts, \$2,413,000 and \$2,348,000, respectively, net of the reversal of the federal benefit recognized as deferred tax assets relating to state reserves, excluding interest, would positively impact our effective tax rate, if recognized. Unrecognized tax benefits result from income tax positions taken or expected to be taken on our income tax returns for which a tax benefit has not been recorded in our financial statements.

Our policy is to recognize interest and penalties relating to uncertain tax positions in income tax expense.

Our federal income tax returns for fiscal 2010 through 2013 are subject to potential future IRS audit. Future tax assessments or settlements could have a material adverse effect on our consolidated results of operations and financial condition.

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

(13) Stock Based Compensation

Overview

We issue stock-based awards to certain of our employees and our Board of Directors pursuant to our 2000 Stock Incentive Plan, as amended, (the “Plan”) and our 2001 Employee Stock Purchase Plan (the “ESPP”) and recognize related stock-based compensation for both equity and liability-classified stock-based awards in our consolidated financial statements. The Plan provides for the granting to employees and consultants of Comtech (including prospective employees and consultants): (i) incentive and non-qualified stock options, (ii) restricted stock units (“RSUs”), (iii) RSUs with performance measures (which we refer to as “performance shares”), (iv) restricted stock, (v) stock units (reserved for issuance to non-employee directors) and share units (reserved for issuance to employees) (collectively, “share units”) and (vi) stock appreciation rights (“SARs”), among other types of awards. Our non-employee directors are eligible to receive non-discretionary grants of stock-based awards, subject to certain limitations. The aggregate number of shares of common stock which may be issued, pursuant to the Plan, may not exceed 8,962,500. Stock options granted may not have a term exceeding ten years or, in the case of an incentive stock award granted to a stockholder who owns stock representing more than 10.0% of the voting power, no more than five years. We expect to settle all outstanding awards under the Plan and ESPP with new shares, except for SARs which may only be settled with cash.

As of October 31, 2013, we had granted stock-based awards pursuant to the Plan representing the right to purchase and/or acquire an aggregate of 6,874,264 shares (net of 2,695,240 expired and canceled awards), of which an aggregate of 3,830,652 have been exercised or converted into common stock, substantially all of which related to stock options.

As of October 31, 2013, the following stock-based awards, by award type, were outstanding:

	October 31, 2013
Stock options	2,870,620
Performance shares	121,986
RSUs and restricted stock	37,326
Share units	6,680
SARs	7,000
Total	3,043,612

Our ESPP, approved by our shareholders on December 12, 2000, provides for the issuance of 675,000 shares of our common stock. Our ESPP is intended to provide our eligible employees the opportunity to acquire our common stock at 85% of fair market value at the date of issuance. Through October 31, 2013, we have cumulatively issued 526,517 shares of our common stock to participating employees in connection with our ESPP.

Stock-based compensation for awards issued is reflected in the following line items in our Condensed Consolidated Statements of Operations:

	Three months ended October 31,	
	2013	2012
Cost of sales	\$53,000	\$45,000
Selling, general and administrative expenses	771,000	601,000
Research and development expenses	123,000	99,000

Edgar Filing: COMTECH TELECOMMUNICATIONS CORP /DE/ - Form 10-Q

Stock-based compensation expense before income tax benefit	947,000	745,000	
Estimated income tax benefit	(346,000	) (264,000)
Net stock-based compensation expense	\$601,000	\$481,000	

14

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

Stock-based compensation for equity-classified awards is measured at the date of grant, based on an estimate of the fair value of the award and is generally expensed over the vesting period of the award. Stock-based compensation for liability-classified awards is determined the same way, except that the fair value of liability-classified awards is re-measured at the end of each reporting period until the award is settled, with changes in fair value recognized pro-rata for the portion of the requisite service period rendered. At October 31, 2013, unrecognized stock-based compensation of \$10,374,000, net of estimated forfeitures of \$853,000, is expected to be recognized over a weighted average period of 3.3 years. Total stock-based compensation capitalized and included in ending inventory at both October 31, 2013 and July 31, 2013 was \$72,000. Included in accrued expenses at October 31, 2013 and July 31, 2013 is \$4,000 and \$1,000, respectively, relating to the potential cash settlement of liability-classified SARs.

Stock-based compensation expense, by award type, is summarized as follows:

	Three months ended October 31,	
	2013	2012
Stock options	\$648,000	573,000
Performance shares	177,000	86,000
ESPP	45,000	53,000
RSUs and restricted stock	68,000	32,000
Share units	6,000	6,000
Equity-classified stock-based compensation expense	944,000	750,000
Liability-classified stock-based compensation expense (SARs)	3,000	(5,000)
Stock-based compensation expense before income tax benefit	947,000	745,000
Estimated income tax benefit	(346,000)	(264,000)
Net stock-based compensation expense	\$601,000	481,000

ESPP stock-based compensation expense primarily relates to the 15% discount offered to employees participating in the ESPP.

The estimated income tax benefit, as shown in the above table, was computed using income tax rates expected to apply when the awards are settled and results in a deferred tax asset which is netted in our long-term deferred tax liability in our Condensed Consolidated Balance Sheet. The actual income tax benefit recognized for tax reporting is based on the fair market value of our common stock at the time of settlement and can significantly differ from the estimated income tax benefit recorded for financial reporting.

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

The following table provides the components of the actual income tax benefit recognized for tax deductions relating to the settlement of stock-based awards:

	Three months ended October 31,	
	2013	2012
Actual income tax benefit recorded for the tax deductions relating to the settlement of stock-based awards	\$54,000	1,000
Less: Tax benefit initially recognized on settled stock-based awards vesting subsequent to the adoption of accounting standards that require us to expense stock-based awards, excluding income tax shortfalls	41,000	1,000
Excess income tax benefit recorded as an increase to additional paid-in capital	13,000	—
Less: Tax benefit initially disclosed but not previously recognized on settled equity-classified stock-based awards vesting prior to the adoption of accounting standards that require us to expense stock-based awards, excluding income tax shortfalls	13,000	—
Excess income tax benefit from settled equity-classified stock-based awards reported as a cash flow from financing activities in our Condensed Consolidated Statements of Cash Flows	\$—	—

As of October 31, 2013 and July 31, 2013, the amount of hypothetical tax benefits related to stock-based awards, recorded as a component of additional paid-in capital, was \$18,072,000 and \$19,981,000, respectively. These amounts represent the initial hypothetical tax benefit of \$8,593,000 determined upon adoption of ASC 718 (which reflects our estimate of cumulative actual tax deductions for awards issued and settled prior to the August 1, 2005), adjusted for actual excess income tax benefits or shortfalls since that date. During the three months ended October 31, 2013 and 2012, we recorded \$1,911,000 and \$2,897,000, respectively, as a net reduction to additional paid-in capital and accumulated hypothetical tax benefits, which primarily represents the reversal of unrealized deferred tax assets associated with certain vested equity-classified stock-based awards that expired during the respective periods.

Stock Options

The following table summarizes the Plan's activity (including SARs) during the three months ended October 31, 2013:

	Awards (in Shares)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at July 31, 2013	3,047,910	\$29.94		
Granted	247,000	27.23		
Expired/canceled	(413,240)	) 45.66		
Exercised	(4,050)	) 19.54		
Outstanding at October 31, 2013	2,877,620	\$27.46	5.66	\$7,426,000
Exercisable at October 31, 2013	1,499,240	\$27.18	3.22	\$4,313,000

Vested and expected to vest at October 31, 2013	2,776,031	\$27.44	5.57	\$7,207,000
---	-----------	---------	------	-------------

16

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

Stock options (including SARs) outstanding as of October 31, 2013 have exercise prices ranging between \$13.19-\$35.79. The total intrinsic value relating to stock options exercised during the three months ended October 31, 2013 and 2012 was \$41,000 and \$350,000, respectively. Stock options granted during the three months ended October 31, 2013 had exercise prices equal to the fair market value of our common stock on the date of grant, a contractual term of ten years and a vesting period of five years. There were no stock options granted during the three months ended October 31, 2012. There were no SARs granted or exercised during the three months ended October 31, 2013 and 2012. The estimated per-share weighted average grant-date fair value of stock options granted during the three months ended October 31, 2013 was \$5.47 which was determined using the Black-Scholes option pricing model, and included the following weighted average assumptions:

Expected dividend yield	4.04	%
Expected volatility	32.89	%
Risk-free interest rate	1.38	%
Expected life (years)	5.44	

Expected dividend yield is the expected annual dividend as a percentage of the fair market value of our common stock on the date of grant, based on our Board's annual dividend target at the time of grant, which, as of October 31, 2013, was \$1.10 per share. We estimate expected volatility by considering the historical volatility of our stock, the implied volatility of publicly-traded call options on our stock, the implied volatility of call options embedded in our 3.0% convertible senior notes and our expectations of volatility for the expected life of stock options. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for an instrument which closely approximates the expected term. The expected term is the number of years we estimate that awards will be outstanding prior to exercise and is determined by employee groups with sufficiently distinct behavior patterns. Assumptions used in computing the fair value of stock-based awards reflect our best estimates, but involve uncertainties relating to market and other conditions, many of which are outside of our control. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by recipients of stock-based awards.

Performance Shares, RSUs, Restricted Stock and Share Unit Awards

The following table summarizes the Plan's activity relating to performance shares, RSUs, restricted stock and share units:

	Awards (in Shares)	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at July 31, 2013	102,334	\$25.80	
Granted	68,167	24.58	
Converted to common stock	(4,509)	26.25	
Outstanding at October 31, 2013	165,992	\$25.28	\$4,983,000
Vested at October 31, 2013	12,335	\$26.84	\$370,000
Vested and expected to vest at October 31, 2013	158,953	\$25.29	\$4,772,000

Performance shares granted to employees prior to fiscal 2014 vest over a 5.3 year period, beginning on the date of grant if pre-established performance goals are attained, and are convertible into shares of our common stock generally

at the time of vesting, on a one-for-one basis for no cash consideration. The performance shares granted to employees during the three months ended October 31, 2013 vest over a three-year performance period that ends on July 31, 2016, if pre-established performance goals are attained or as specified pursuant to the Plan and related agreement. As of October 31, 2013, the number of outstanding performance shares included in the above table, and the related compensation expense, assume achievement of the pre-established goals at a target level. During the three months ended October 31, 2013, our Board of Directors determined that the pre-established performance goals for 35,003 performance shares granted in fiscal 2012 had been attained and, as a result, the first tranche of 6,996 performance shares vested and converted into 3,496 net shares of our common stock, after reduction for 1,013 shares retained to satisfy minimum tax withholding and 2,487 shares for deferral requirements.

Index

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

RSUs and restricted stock granted to non-employee directors have a vesting period of three years and are convertible into shares of our common stock generally at the time of termination, on a one-for-one basis for no cash consideration, or earlier under certain circumstances. RSUs granted to employees have a vesting period of five years and are convertible into shares of our common stock generally at the time of vesting, on a one-for-one basis for no cash consideration.

Share units are vested when issued and are convertible into shares of our common stock generally at the time of termination, on a one-for-one basis for no cash consideration, or earlier under certain circumstances.

No RSUs, restricted stock or share units granted to date have been converted into common stock.

The fair value of performance shares, RSUs, restricted stock and share units is determined using the closing market price of our common stock on the date of grant, less the present value of any estimated future dividend equivalents such awards are not entitled to receive. RSUs and performance shares granted in fiscal 2012 are not entitled to dividend equivalents. RSUs, performance shares and restricted stock granted in fiscal 2013 and 2014 are entitled to dividend equivalents unless forfeited before vesting occurs; however, performance shares granted in fiscal 2013 and 2014 are not entitled to such dividend equivalents until our Board of Directors has determined that the pre-established performance goals have been met. Share units granted prior to fiscal 2014 are not entitled to dividend equivalents. Share units granted in fiscal 2014 are entitled to dividend equivalents while the underlying shares are unissued.

Dividend equivalents are subject to forfeiture, similar to the terms of the underlying stock-based awards, and are payable in cash generally at the time of conversion of the underlying shares into our common stock. As of October 31, 2013 and July 31, 2013, accrued dividend equivalents were \$32,000 and \$7,000, respectively. Such amounts were recorded as a reduction to retained earnings.

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

(14) Customer and Geographic Information

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

	Three months ended October 31,		
	2013	2012	
United States			
U.S. government	25.6	% 43.4	%
Commercial	17.4	% 13.5	%
Total United States	43.0	% 56.9	%
International			
North African country	12.4	% 2.3	%
Other international	44.6	% 40.8	%
Total International	57.0	% 43.1	%

Sales to U.S. government end customers include the Department of Defense ("DoD") and intelligence and civilian agencies, as well as sales directly to or through prime contractors.

Excluding sales in our mobile data communications segment, aggregate sales to U.S. government end customers for our telecommunications transmission and RF microwave amplifiers segments were 20.6% and 36.3% of the combined net sales of these two segments for the three months ended October 31, 2013 and 2012, respectively.

International sales for the three months ended October 31, 2013 and 2012 (which include sales to U.S. domestic companies for inclusion in products that will be sold to international customers) were \$47,540,000 and \$39,217,000, respectively.

For the three months ended October 31, 2013, sales to a prime contractor represented approximately 12.5% of consolidated net sales (almost all of which related to our North African country end-customer). For the three months ended October 31, 2013 and 2012, no other customer or individual country (including sales to U.S. domestic companies for inclusion in products that will be sold to a foreign country) represented more than 10% of consolidated net sales.

(15) Segment Information

Reportable operating segments are determined based on Comtech's management approach. The management approach, as defined by FASB ASC 280, "Segment Reporting," is based on the way that the chief operating decision-maker organizes the segments within an enterprise for making decisions about resources to be allocated and assessing their performance. Our chief operating decision-maker is our President and Chief Executive Officer.

While our results of operations are primarily reviewed on a consolidated basis, the chief operating decision-maker also manages the enterprise in three operating segments: (i) telecommunications transmission, (ii) RF microwave amplifiers, and (iii) mobile data communications.

Telecommunications transmission products include satellite earth station products (such as analog and digital modems, frequency converters, power amplifiers, transceivers and voice gateways) and over-the-horizon microwave communications products and systems (such as digital troposcatter modems).

RF microwave amplifier products include traveling wave tube amplifiers and solid-state, high-power narrow and broadband amplifier products that use the microwave and radio frequency spectrums.

Mobile data communications products and services substantially relate to our support of the U.S. Army's Blue Force Tracking ("BFT-1") and the U.S. Army's Movement Tracking System ("MTS") programs, which are currently in a sustainment mode. We license certain of our intellectual property to the U.S. Army and provide satellite network and related engineering services (including program management) on a cost-plus-fixed-fee basis.

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

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

	Three months ended October 31, 2013				
	Telecommunications Transmission	RF Microwave Amplifiers	Mobile Data Communications	Unallocated	Total
Net sales	\$54,365,000	20,197,000	8,806,000	—	\$83,368,000
Operating income (loss)	8,929,000	591,000	4,106,000	(3,527,000)	10,099,000
Interest income and other (expense)	6,000	(5,000)	3,000	269,000	273,000
Interest expense (income)	59,000	—	—	1,959,000	2,018,000
Depreciation and amortization	2,259,000	943,000	74,000	963,000	4,239,000
Expenditure for long-lived assets, including intangibles	933,000	94,000	—	—	1,027,000
Total assets at October 31, 2013	243,851,000	92,774,000	7,236,000	338,714,000	682,575,000

	Three months ended October 31, 2012				
	Telecommunications Transmission	RF Microwave Amplifiers	Mobile Data Communications	Unallocated	Total
Net sales	\$53,327,000	25,289,000	12,337,000	—	\$90,953,000
Operating income (loss)	12,259,000	1,718,000	3,471,000	(4,086,000)	13,362,000
Interest income and other (expense)	(9,000)	(22,000)	9,000	298,000	276,000
Interest expense	159,000	—	—	1,952,000	2,111,000
Depreciation and amortization	2,436,000	980,000	152,000	784,000	4,352,000
Expenditure for long-lived assets, including intangibles	841,000	207,000	15,000	—	1,063,000
Total assets at October 31, 2012	233,446,000	95,785,000	8,511,000	367,852,000	705,594,000

Operating income in our telecommunications transmission segment for the three months ended October 31, 2013 and 2012 includes \$239,000 and \$2,378,000, respectively, of a benefit related to a change in fair value of the earn-out liability associated with our acquisition of Stampede. See Note (8) - "Accrued Expenses and Other Current Liabilities."

Operating income in our mobile data communications segment, for the three months ended October 31, 2012, includes a pre-tax restructuring charge of \$822,000 related to the wind-down of our microsatellite product line. See Note (9) - "Cost Reduction Actions."

Unallocated expenses include corporate expenses such as executive compensation, accounting, legal and other regulatory compliance related costs. In addition, for the three months ended October 31, 2013 and 2012, unallocated expenses include \$947,000 and \$745,000, respectively, of stock-based compensation expense. Interest expense (which

includes amortization of deferred financing costs) associated with our convertible senior notes and our Credit Facility is not allocated to the operating segments. Depreciation and amortization includes amortization of stock-based compensation. Unallocated assets consist principally of cash, deferred financing costs and deferred tax assets. Substantially all of our long-lived assets are located in the U.S.

Index

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

Intersegment sales for the three months ended October 31, 2013 and 2012 by the telecommunications transmission segment to the RF microwave amplifiers segment were

2018

2017

2018 vs. 2017

Revenue

\$
1,448.1

\$
1,175.5

100.0
%

100.0
%

23.2
%
Operating income

47.5

32.9

3.3
%

2.8
%

44.4
%

(1) Certain immaterial organizational changes were made in the first quarter of 2018 related to the Company's Managed Transport business. Previously, it had been included in the Logistics segment and in 2018 it has been reflected in the Transportation segment. Prior period information was recast to conform to current year presentation.

Note: Total depreciation and amortization for the Logistics segment included in Cost of transportation and services, Direct operating expense and SG&A was \$55.3 million and \$46.7 million for the three months ended March 31, 2018 and 2017, respectively.

Logistics

Revenue in our Logistics segment increased by 23.2% to \$1.4 billion for the first quarter of 2018, compared with \$1.2 billion for the first quarter of 2017. The increase was driven by strong demand for contract logistics in both Europe and North America. European logistics revenue growth reflected a significant benefit from new contract starts with retail, e-commerce and fashion customers in the United Kingdom, the Netherlands, Spain, Italy and France and favorable foreign exchange rates. In North America, the largest gains came from the omnichannel retail, consumer packaged goods, technology, and automotive sectors.

Operating income for the first quarter of 2018 increased to \$47.5 million, or 3.3% of revenue, compared with \$32.9 million, or 2.8% of revenue, for the same quarter in 2017. The operating income increase was driven by strong

Table of Contents

revenue growth and site productivity improvements, partially offset by higher direct operating costs related to new contract startups that resulted in higher temporary labor costs, payroll expenses, and higher use of purchased services.

Liquidity and Capital Resources

Our principal existing sources of cash are cash generated from operations and borrowings available under the Second Amended and Restated Revolving Loan Credit Agreement (the “ABL Facility”). As of March 31, 2018, we had cash and cash equivalents of \$380.0 million and availability under the ABL Facility of \$514.8 million. Availability under the ABL Facility is based on a borrowing base of \$912.1 million, as well as outstanding letters of credit of \$237.3 million, respectively.

We continually evaluate our liquidity requirements, capital needs and the availability of capital resources based on our operating needs and our planned growth initiatives. We believe that our existing sources of cash will be sufficient to support our existing operations over the next 12 months.

Refinancing of Existing Term Loans

In February 2018, the Company entered into a Refinancing Amendment (Amendment No. 3 to Credit Agreement) (the “Third Amendment”), by and among XPO, its subsidiaries signatory thereto, as guarantors, the lenders party thereto and Morgan Stanley Senior Funding, Inc., in its capacity as administrative agent, amending that certain Senior Secured Term Loan Credit Agreement, dated as of October 30, 2015 (as amended, amended and restated, supplemented or otherwise modified, including by that certain Incremental and Refinancing Amendment (Amendment No. 1 to Credit Agreement), dated as of August 25, 2016, and by that certain Refinancing Amendment (Amendment No. 2 to Credit Agreement), dated March 10, 2017, the “Term Loan Credit Agreement”).

Pursuant to the Third Amendment, the outstanding \$1,494.0 million principal amount of term loans under the Term Loan Credit Agreement (the “Existing Term Loans”) were replaced with \$1,503.0 million in aggregate principal amount of new term loans (the “New Term Loans”) having substantially similar terms as the Existing Term Loans, except with respect to the interest rate and maturity date applicable to the New Term Loans, prepayment premiums in connection with certain voluntary prepayments and certain other amendments to the restrictive covenants. Proceeds from the New Term Loans were used to refinance the Existing Term Loans and to pay interest, fees and expenses in connection therewith.

The interest rate margin applicable to the New Term Loans was reduced from 1.25% to 1.00%, in the case of base rate loans, and from 2.25% to 2.00%, in the case of London Interbank Offered Rate (“LIBOR”) loans (with the LIBOR floor remaining at 0.0%). The interest rate on the New Term Loans was 3.92% at March 31, 2018. The New Term Loans will mature on February 23, 2025. The refinancing resulted in a debt extinguishment charge of \$10.3 million during the first quarter ended March 31, 2018.

In the first quarter of 2017, the Company recorded a debt extinguishment charge of \$9.0 million in connection with the refinancing of the Term Loan facility (Amendment No. 2 to Credit Agreement).

European Trade Securitization Program

In October 2017, XPO Logistics Europe SA, in which the Company holds an 86.25% controlling interest, entered into a European trade receivables securitization program for a term of three years co-arranged by Crédit Agricole and HSBC. In the first quarter of 2018, the aggregate maximum amount available under the program was increased to €350 million (approximately \$431.0 million as of March 31, 2018). At March 31, 2018, the remaining borrowing capacity was €28.0 million (approximately \$34.5 million) and the weighted-average interest rate was 0.99%.

Loan Covenants and Compliance

As of March 31, 2018, we were in compliance with the covenants and other provisions of our debt agreements. Any failure to be in compliance with any material provision or covenant of these agreements could have a material adverse effect on our liquidity and operations.

Sources and Uses of Cash

During the three months ended March 31, 2018, we: (i) received proceeds, net of repurchases, of \$92.2 million on

Table of Contents

our long-term debt, (ii) received advances, net of repayments, of \$60.0 million on our ABL Facility, (iii) generated proceeds from bank overdrafts for \$55.7 million, and (iv) generated proceeds from sales of assets of \$10.4 million. We used cash during this period principally to (i) fund operations for \$19.4 million, (ii) purchase property and equipment of \$142.1 million, (iii) make payments for tax withholdings on restricted shares of \$40.1 million, and (iv) make payments on long-term debt and capital leases of \$37.3 million.

During the three months ended March 31, 2017, we: (i) generated cash from operating activities of \$15.5 million, (ii) generated proceeds from sales of assets of \$20.5 million, (iii) received advances, net of repayments, of \$70.0 million on our ABL Facility, and (iv) received proceeds, net of repayments, on our Term Loan Facility of \$12.1 million. We used cash during this period principally to (i) purchase property and equipment of \$122.4 million, and (ii) make payments on long-term debt and capital leases of \$29.2 million.

Cash flows from operating activities for the three months ended March 31, 2018 decreased by \$34.9 million compared to the prior year quarter due to net movements in operating assets and liabilities of \$78.8 million, partially offset by higher cash-related net income of \$43.9 million. The changes in the balances of operating assets and liabilities in the three months ended March 31, 2018 compared to 2017 primarily resulted from higher revenues, which led to a higher growth in accounts receivable on a year-over-year basis. The increase in cash-related net income was primarily due to higher revenues in both our transportation and logistics segments. Cash-related net income represents total cash flows from operating activities less changes in assets and liabilities on the Condensed Consolidated Statements of Cash Flows. The largest components of cash-related net income are Net income plus Depreciation and amortization. Investing activities used \$131.7 million and \$101.9 million of cash in the three months ended March 31, 2018 and 2017, respectively. During the three months ended March 31, 2018, the Company used \$142.1 million of cash to purchase fixed assets and received \$10.4 million from the sale of assets. During the three months ended March 31, 2017, the Company used \$122.4 million of cash to purchase fixed assets and received \$20.5 million from the sale of assets.

Financing activities generated \$126.0 million in the three months ended March 31, 2018 compared to \$53.6 million generated in the three months ended March 31, 2017. The main source of cash from financing activities during the three months ended March 31, 2018 was \$898.2 million of net proceeds from the issuance of long-term debt, consisting of the refinancing of the New Term Loans and amounts received under the senior variable funding notes in connection with our European trade securitization program, \$60.0 million of net advances from the ABL Facility and \$55.7 million in bank overdrafts. The primary use of cash during the three months ended March 31, 2018 was \$812.4 million repurchase of debt, consisting of the refinancing of the Existing Term Loans, \$40.1 million of payments for tax withholding related to restricted shares and \$37.3 million repayment of debt and capital leases. During the three months ended March 31, 2017, the main source of cash was the \$514.6 million of net proceeds from the issuance of long-term debt and \$70.0 million of net advances from the ABL Facility. Our primary use of cash from financing activities during the three months ended March 31, 2017 was \$511.4 million repurchase of debt and the \$29.2 million repayment of debt and capital leases.

Contractual Obligations

Following the refinancing of the New Term Loans in February 2018, the principal balance of approximately \$1.5 billion became due in 2025. The Existing Term Loans were previously scheduled to mature in 2021. Additional annual interest payments of approximately \$60 million are due in 2022 through 2024. There were no other material changes to our contractual obligations since December 31, 2017.

New Accounting Standards

Information related to new accounting standards is included in Note 1—Organization, Description of Business and Basis of Presentation and Note 3—Revenue Recognition to our Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We have a significant proportion of our net assets and income in non-U.S. dollar currencies, primarily the Euro (“EUR”) and British Pound Sterling (“GBP”). We are exposed to currency risk from the potential changes in

Table of Contents

functional currency values of our foreign currency denominated assets, liabilities and cash flows. Consequently, a depreciation of the EUR and GBP relative to the U.S. dollar could have an adverse impact on our financial results. In order to mitigate against the risk of a reduction in the value of foreign currency from the Company's international operations, the Company uses foreign currency option and forward contracts and gains or losses on these contracts are recorded in Foreign currency loss in the Condensed Consolidated Statements of Operations. See Note 5—Derivative Instruments for further information.

There have been no material changes to our quantitative and qualitative disclosures about market risk during the three months ended March 31, 2018 as compared to the quantitative and qualitative disclosures about market risk described in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures as of March 31, 2018 were effective as of such time such that the information required to be included in our SEC reports is: (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to the Company, including our consolidated subsidiaries, and (ii) accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting during the quarter ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

Table of Contents

Part II—Other Information

Item 1. Legal Proceedings.

For information related to our legal proceedings, please refer to “Legal Proceedings” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 and Note 10—Legal and Regulatory Matters of Item 1, “Financial Statements” of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors.

There are no material changes to the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the quarter ended March 31, 2018, pursuant to the Investment Agreement dated as of June 13, 2011 by and among Jacobs Private Equity, LLC (“JPE”) and the other investors party thereto (collectively with JPE, the “Investors”) the Company issued 7,143 unregistered shares of its common stock as a result of the exercise of warrants by certain shareholders for cash resulting in the receipt of \$50,001 of total proceeds by the Company. The proceeds received by the Company will be used for general corporate purposes. The issuance of these shares was exempt from the registration requirements of the Securities Act of 1933, as amended, in accordance with Section 4(a)(2) thereof, as a transaction by an issuer not involving any public offering.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Table of Contents

Item 6. Exhibits.

Exhibit Number	Description
10.1	<u>Refinancing Amendment (Amendment No. 3 to Credit Agreement), dated as of February 23, 2018, by and among XPO Logistics, Inc. and certain subsidiaries signatory thereto, the lenders party thereto and Morgan Stanley Senior Funding, Inc., as administrative agent (incorporated herein by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on February 26, 2018).</u>
10.2 *	<u>Amendment No. 2 to Second Amended and Restated Revolving Loan Credit Agreement, dated as of March 22, 2018, by and among XPO Logistics, Inc. and certain subsidiaries signatory thereto, the lenders party thereto and Morgan Stanley Senior Funding, Inc., as administrative agent.</u>
31.1 *	<u>Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2018.</u>
31.2 *	<u>Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2018.</u>
32.1 **	<u>Certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, with respect to the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2018.</u>
32.2 **	<u>Certification of the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, with respect to the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2018.</u>
101.INS *	XBRL Instance Document.
101.SCH *	XBRL Taxonomy Extension Schema.
101.CAL *	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF *	XBRL Taxonomy Extension Definition Linkbase.
101.LAB *	XBRL Taxonomy Extension Label Linkbase.
101.PRE *	XBRL Taxonomy Extension Presentation Linkbase.

* Filed herewith.

**Furnished herewith.

Table of Contents

SIGNATURES

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

XPO Logistics, Inc.

By: /s/ Bradley S. Jacobs

Bradley S. Jacobs

Chief Executive Officer

(Principal Executive Officer)

By: /s/ John J. Hardig

John J. Hardig

Chief Financial Officer

(Principal Financial Officer)

Date: May 7, 2018