

COMTECH TELECOMMUNICATIONS CORP /DE/

Form 10-Q

March 11, 2015

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 January 31, 2015

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

(State or other jurisdiction of incorporation

/organization)

11-2139466

(I.R.S. Employer Identification Number)

68 South Service Road, Suite 230,

Melville, NY

(Address of principal executive offices)

11747

(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 March 6, 2015, the number of outstanding shares of Common Stock, par value \$.10 per share, of the registrant was 16,254,613 shares.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	January 31, 2015 (Unaudited)	July 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 135,139,000	154,500,000
Accounts receivable, net	68,896,000	54,887,000
Inventories, net	67,472,000	61,332,000
Prepaid expenses and other current assets	11,153,000	9,947,000
Deferred tax asset, net	10,056,000	10,178,000
Total current assets	292,716,000	290,844,000
Property, plant and equipment, net	17,448,000	18,536,000
Goodwill	137,354,000	137,354,000
Intangibles with finite lives, net	23,099,000	26,220,000
Deferred financing costs, net	—	65,000
Other assets, net	870,000	833,000
Total assets	\$471,487,000	473,852,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 17,896,000	18,902,000
Accrued expenses and other current liabilities	27,559,000	29,803,000
Dividends payable	4,869,000	4,844,000
Customer advances and deposits	8,597,000	12,610,000
Interest payable	—	29,000
Total current liabilities	58,921,000	66,188,000
Other liabilities	4,181,000	4,364,000
Income taxes payable	1,980,000	2,743,000
Deferred tax liability, net	4,069,000	3,632,000
Total liabilities	69,151,000	76,927,000
Commitments and contingencies (See Note 18)		
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 31,095,737 shares and 31,016,469 shares at January 31, 2015 and July 31, 2014, respectively	3,110,000	3,102,000
Additional paid-in capital	423,678,000	421,240,000
Retained earnings	412,408,000	409,443,000
	839,196,000	833,785,000
Less:		
Treasury stock, at cost (14,857,582 shares at January 31, 2015 and July 31, 2014)	(436,860,000)	(436,860,000)
Total stockholders' equity	402,336,000	396,925,000
Total liabilities and stockholders' equity	\$471,487,000	473,852,000

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended January 31,		Six months ended January 31,	
	2015	2014	2015	2014
Net sales	\$81,802,000	85,499,000	158,193,000	168,867,000
Cost of sales	43,927,000	48,130,000	84,993,000	95,120,000
Gross profit	37,875,000	37,369,000	73,200,000	73,747,000
Expenses:				
Selling, general and administrative	16,026,000	16,349,000	31,552,000	32,547,000
Research and development	9,666,000	8,266,000	19,685,000	16,765,000
Amortization of intangibles	1,560,000	1,582,000	3,121,000	3,164,000
	27,252,000	26,197,000	54,358,000	52,476,000
Operating income	10,623,000	11,172,000	18,842,000	21,271,000
Other expenses (income):				
Interest expense	69,000	1,998,000	334,000	4,016,000
Interest income and other	(90,000)	(228,000)	(174,000)	(501,000)
Income before provision for income taxes	10,644,000	9,402,000	18,682,000	17,756,000
Provision for income taxes	3,059,000	3,419,000	5,872,000	6,468,000
Net income	\$7,585,000	5,983,000	12,810,000	11,288,000
Net income per share (See Note 5):				
Basic	\$0.47	0.37	0.79	0.70
Diluted	\$0.46	0.32	0.78	0.60
Weighted average number of common shares outstanding – basic	16,241,000	15,970,000	16,229,000	16,212,000
Weighted average number of common and common equivalent shares outstanding – diluted	16,505,000	22,487,000	16,510,000	22,552,000
Dividends declared per issued and outstanding common share as of the applicable dividend record date	\$0.30	0.30	0.60	0.575

See accompanying notes to condensed consolidated financial statements.

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
SIX MONTHS ENDED JANUARY 31, 2015 AND 2014
(Unaudited)

	Common Stock		Additional	Retained	Treasury Stock		Stockholders'
	Shares	Amount	Paid-in Capital	Earnings	Shares	Amount	Equity
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	—	—	1,990,000	—	—	—	1,990,000
Equity-classified stock awards issued	—	—	139,000	—	—	—	139,000
Proceeds from exercise of options	95,425	10,000	2,549,000	—	—	—	2,559,000
Proceeds from issuance of employee stock purchase plan shares	20,727	2,000	428,000	—	—	—	430,000
Common stock issued for net settlement of stock-based awards	3,496	—	(25,000)	—	—	—	(25,000)
Cash dividends declared	—	—	—	(9,260,000)	—	—	(9,260,000)
Accrual of dividend equivalents	—	—	—	(51,000)	—	—	(51,000)
Net income tax shortfall from settlement of stock-based awards	—	—	(155,000)	—	—	—	(155,000)
Reversal of deferred tax assets associated with expired and unexercised stock-based awards	—	—	(1,925,000)	—	—	—	(1,925,000)
Repurchases of common stock	—	—	—	—	935,992	(29,107,000)	(29,107,000)
Net income	—	—	—	11,288,000	—	—	11,288,000

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Balance as of January 31, 2014	29,186,440	\$2,919,000	\$366,889,000	\$405,375,000	13,544,493	\$(395,238,000)	\$379,945,000
Balance as of July 31, 2014	31,016,469	\$3,102,000	\$421,240,000	\$409,443,000	14,857,582	\$(436,860,000)	\$396,925,000
Equity-classified stock award compensation	—	—	2,398,000	—	—	—	2,398,000
Proceeds from exercise of options	4,200	—	119,000	—	—	—	119,000
Proceeds from issuance of employee stock purchase plan shares	16,491	2,000	477,000	—	—	—	479,000
Common stock issued for net settlement of stock-based awards	58,577	6,000	(395,000)	) —	—	—	(389,000)
Cash dividends declared	—	—	—	(9,732,000)	—	—	(9,732,000)
Accrual of dividend equivalents	—	—	—	(113,000)	—	—	(113,000)
Net income tax shortfall from settlement of stock-based awards	—	—	(149,000)	) —	—	—	(149,000)
Reversal of deferred tax assets associated with expired and unexercised stock-based awards	—	—	(12,000)	) —	—	—	(12,000)
Net income	—	—	—	12,810,000	—	—	12,810,000
Balance as of January 31, 2015	31,095,737	\$3,110,000	\$423,678,000	\$412,408,000	14,857,582	\$(436,860,000)	\$402,336,000

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended January 31,	
	2015	2014
Cash flows from operating activities:		
Net income	\$12,810,000	11,288,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization of property, plant and equipment	3,230,000	3,383,000
Amortization of intangible assets with finite lives	3,121,000	3,164,000
Amortization of stock-based compensation	2,398,000	2,016,000
Deferred financing costs	65,000	697,000
Change in fair value of contingent earn-out liability	—	(239,000)
Loss on disposal of property, plant and equipment	3,000	42,000
Provision for allowance for doubtful accounts	74,000	92,000
Provision for excess and obsolete inventory	1,324,000	1,485,000
Excess income tax benefit from stock-based award exercises	(138,000)	(16,000)
Deferred income tax benefit	(548,000)	(1,689,000)
Changes in assets and liabilities:		
Accounts receivable	(14,083,000)	(7,056,000)
Inventories	(7,391,000)	(5,939,000)
Prepaid expenses and other current assets	475,000	(4,308,000)
Other assets	(37,000)	6,000
Accounts payable	(1,006,000)	210,000
Accrued expenses and other current liabilities	(2,634,000)	(3,574,000)
Customer advances and deposits	(4,086,000)	409,000
Other liabilities	(290,000)	149,000
Interest payable	(29,000)	—
Income taxes payable	(1,498,000)	(66,000)
Net cash (used in) provided by operating activities	(8,240,000)	54,000
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2,145,000)	(3,424,000)
Net cash used in investing activities	(2,145,000)	(3,424,000)
Cash flows from financing activities:		
Cash dividends paid	(9,712,000)	(9,053,000)
Proceeds from issuance of employee stock purchase plan shares	479,000	430,000
Excess income tax benefit from stock-based award exercises	138,000	16,000
Proceeds from exercises of stock options	119,000	2,559,000
Repurchases of common stock	—	(29,107,000)
Fees related to line of credit	—	(75,000)
Payment of contingent consideration related to business acquisition	—	(49,000)
Net cash used in financing activities	(8,976,000)	(35,279,000)
Net decrease in cash and cash equivalents	(19,361,000)	(38,649,000)
Cash and cash equivalents at beginning of period	154,500,000	356,642,000
Cash and cash equivalents at end of period	\$135,139,000	317,993,000

See accompanying notes to condensed consolidated financial statements.
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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
 (Unaudited)

	Six months ended January 31,	
	2015	2014
Supplemental cash flow disclosures:		
Cash paid during the period for:		
Interest	\$ 117,000	3,178,000
Income taxes	\$ 7,919,000	8,224,000
Non-cash investing and financing activities:		
Cash dividends declared but unpaid (including accrual of dividend equivalents)	\$ 5,093,000	4,789,000
Equity-classified stock awards issued	\$ —	139,000

See accompanying notes to condensed consolidated financial statements.

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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 and six months ended January 31, 2015 and 2014 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, 2014 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"). During the six months ended January 31, 2015, we adopted FASB:

ASU No. 2013-04, which provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements, for which the total amount of the obligation is fixed at the reporting date. Our adoption of this ASU did not have any impact on our consolidated financial statements and or disclosures.

ASU No. 2013-05, which requires a parent company that ceases to have a controlling interest in a subsidiary or group of assets that is a non profit entity or business within a foreign entity, to release any cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. Our adoption of this ASU did not have any impact on our consolidated financial statements.

ASU No. 2013-07, which clarifies that an entity should apply the liquidation basis of accounting when liquidation is imminent, as defined. This ASU also provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. Our adoption of this ASU did not have any impact on our consolidated financial statements.

ASU No. 2013-11, which amends the presentation requirements of ASC 740, "Income Taxes," and requires that unrecognized tax benefits, or portions of unrecognized tax benefits, relating to a net operating loss carryforward, a similar tax loss, or a tax credit carryforward be presented in the financial statements as a reduction to the associated deferred tax asset. See Note (11) "Income Taxes" for further information about the impact of adopting this ASU.

ASU No. 2014-17, which provides an acquired entity with an option to apply pushdown accounting in its separate financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity. Our adoption of this ASU 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.

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

(4) Fair Value Measurements and Financial Instruments

As of January 31, 2015 and July 31, 2014, we had approximately \$3,129,000 and \$4,628,000, respectively, consisting principally 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 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.

As of January 31, 2015 and July 31, 2014, other than our cash and cash equivalents, we have no other significant assets or liabilities included in our Condensed Consolidated Balance Sheets recorded at 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 outstanding and dilutive, during each respective period. During the six months ended January 31, 2014, we had \$200,000,000 of our 3.0% convertible senior notes outstanding, all of which were redeemed or repurchased in May 2014. 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 settlement 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 recognized for financial reporting purposes.

Weighted average basic and diluted shares outstanding for the three and six months ended January 31, 2014 reflects a reduction of approximately 439,000 and 289,000 shares as a result of the repurchase of our common shares during the respective periods. There were no repurchases of our common stock during the three and six months ended January 31, 2015. See Note (17) – "Stockholders' Equity" for more information on our stock repurchase program.

Weighted average stock options outstanding to purchase 447,000 and 573,000 shares for the three months ended January 31, 2015 and 2014, respectively, were not included in our diluted EPS calculation because their effect would have been anti-dilutive. Weighted average stock options outstanding to purchase 287,000 and 2,308,000 shares for the six months ended January 31, 2015 and 2014, respectively, were not included in our diluted EPS calculation because their effect would have been anti-dilutive.

Our EPS calculations exclude 120,000 and 92,000 weighted average RSUs with performance measures (which we refer to as performance shares) outstanding for the three months ended January 31, 2015 and 2014, respectively, and 119,000 and 70,000 weighted average performance shares outstanding for the six months ended January 31, 2015 and

2014, 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.

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

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

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

	Three months ended January 31,		Six months ended January 31,	
	2015	2014	2015	2014
Numerator:				
Net income for basic calculation	\$7,585,000	5,983,000	12,810,000	11,288,000
Effect of dilutive securities:				
Interest expense (net of tax) on 3.0% convertible senior notes	—	1,117,000	—	2,234,000
Numerator for diluted calculation	\$7,585,000	7,100,000	12,810,000	13,522,000
Denominator:				
Denominator for basic calculation	16,241,000	15,970,000	16,229,000	16,212,000
Effect of dilutive securities:				
Stock-based awards	264,000	287,000	281,000	141,000
Conversion of 3.0% convertible senior notes	—	6,230,000	—	6,199,000
Denominator for diluted calculation	16,505,000	22,487,000	16,510,000	22,552,000

(6) Accounts Receivable

Accounts receivable consist of the following at:

	January 31, 2015	July 31, 2014
Billed receivables from commercial customers	\$36,759,000	31,681,000
Billed receivables from the U.S. government and its agencies	10,285,000	10,316,000
Unbilled receivables on contracts-in-progress	22,552,000	13,517,000
Total accounts receivable	69,596,000	55,514,000
Less allowance for doubtful accounts	700,000	627,000
Accounts receivable, net	\$68,896,000	54,887,000

Of the unbilled receivables at January 31, 2015 and July 31, 2014, \$21,164,000 and \$9,990,000, respectively, relates to our two large over-the-horizon microwave system contracts with our large U.S. prime contractor customer (the majority of which related to our North African country end-customer). The remaining unbilled receivables include \$490,000 and \$770,000 at January 31, 2015 and July 31, 2014, respectively, due from the U.S. government and its agencies. We had virtually no retainage included in unbilled receivables at January 31, 2015 and \$120,000 of retainage at July 31, 2014. In the opinion of management, substantially all of the unbilled receivables at January 31, 2015 will be billed and collected within one year.

As of January 31, 2015 and July 31, 2014, 37.1% and 18.0%, respectively of total accounts receivable was due from one large U.S. prime contractor customer (the majority of which related to our North African country end-customer).

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

(7) Inventories

Inventories consist of the following at:

	January 31, 2015	July 31, 2014
Raw materials and components	\$53,236,000	50,423,000
Work-in-process and finished goods	30,360,000	27,218,000
Total inventories	83,596,000	77,641,000
Less reserve for excess and obsolete inventories	16,124,000	16,309,000
Inventories, net	\$67,472,000	61,332,000

At January 31, 2015 and July 31, 2014, the amount of inventory directly related to long-term contracts (including contracts-in-progress) was \$4,139,000 and \$1,000,000, respectively. As of January 31, 2015, \$1,728,000 of our long-term contract inventory relates to our contract to develop and manufacture the Advanced Time Division Multiple Access Interface Processor ("ATIP") for the U.S. Navy's Space and Naval Warfare Systems Command.

At January 31, 2015 and July 31, 2014, \$517,000 and \$654,000, 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:

	January 31, 2015	July 31, 2014
Accrued wages and benefits	\$10,278,000	12,410,000
Accrued warranty obligations	8,295,000	8,618,000
Accrued commissions and royalties	3,322,000	3,215,000
Other	5,664,000	5,560,000
Accrued expenses and other current liabilities	\$27,559,000	29,803,000

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:

	Six months ended January 31, 2015	2014
Balance at beginning of period	\$8,618,000	7,797,000
Provision for warranty obligations	1,992,000	3,548,000
Charges incurred	(2,315,000)	(3,054,000)
Balance at end of period	\$8,295,000	8,291,000

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

(9) 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 January 31, 2015, the amount of the acquisition-related restructuring reserve is as follows:

	Cumulative Activity Through January 31, 2015
Present value of estimated facility exit costs at August 1, 2008	\$2,100,000
Cash payments made	(6,946,000)
Cash payments received	7,629,000
Accreted interest recorded	1,218,000
Net liability as of January 31, 2015	4,001,000
Amount recorded as accrued expenses and other current liabilities in the Condensed Consolidated Balance Sheet	34,000
Amount recorded as other liabilities in the Condensed Consolidated Balance Sheet	\$3,967,000

As of July 31, 2014, the present value of the estimated facility exit costs was \$3,773,000. During the six months ended January 31, 2015, we made cash payments of \$550,000 and we received cash payments of \$643,000. Interest accreted for the three and six months ended January 31, 2015 and 2014 was \$69,000 and \$135,000, respectively and \$61,000 and \$120,000, respectively, and is included in interest expense for each respective fiscal period.

Future cash payments associated with our restructuring plan are summarized below:

	As of January 31, 2015
Future lease payments to be made in excess of anticipated sublease payments	\$4,001,000
Interest expense to be accreted in future periods	822,000

Total remaining net cash payments	\$4,823,000
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In addition to our Radyne acquisition-related restructuring accrual, we have \$229,000 in accrued expenses and other current liabilities in our Condensed Consolidated Balance Sheet as of January 31, 2015 related to our fiscal 2012 plan to wind-down our mobile data communications segment's microsatellite product line.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(Unaudited)

(10) Credit Facility

In November 2014, we entered into an uncommitted \$15,000,000 secured credit facility (the "Credit Facility") with one bank that provides for the extension of credit to us in the form of revolving loans, including letters of credit and standby 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 \$15,000,000. Subject to covenant limitations, the Credit Facility may be used for working capital, capital expenditures and other general corporate purposes. The Credit Facility, which expires October 31, 2015, can be terminated by us or the bank at any time without penalty. At January 31, 2015, we had \$2,268,000 of standby letters of credit outstanding related to our guarantees of future performance on certain customer contracts and no outstanding commercial letters of credit.

Interest expense, including amortization of deferred financing costs, recorded during the three months ended January 31, 2014 was \$167,000. There was no interest expense recorded during the three months ended January 31, 2015. During the six months ended January 31, 2015 and 2014 interest expense was \$198,000 and \$353,000 respectively, all of which related to a committed \$100,000,000 secured revolving credit facility that expired on October 31, 2014.

(11) Income Taxes

Excluding the impact of any discrete tax items, our fiscal 2015 effective tax rate is expected to approximate 34.75%. This rate reflects the extension of the federal research and experimentation credit through December 31, 2014.

At January 31, 2015 and July 31, 2014, total unrecognized tax benefits were \$3,075,000 and \$2,743,000, respectively. As of January 31, 2015, \$1,980,000 of our unrecognized tax benefits was recorded as non-current income taxes payable in our Condensed Consolidated Balance Sheet. The remaining unrecognized tax benefits of \$1,095,000 were presented as an offset to the associated non-current deferred tax asset in our Condensed Consolidated Balance Sheet, as required by ASU No. 2013-11, which we adopted prospectively during the six months ended January 31, 2015. As of July 31, 2014, all of our unrecognized tax benefits were recorded as non-current income taxes payable in our Consolidated Balance Sheet. Interest recorded on unrecognized tax benefits was \$57,000 and \$40,000 at January 31, 2015 and July 31, 2014, respectively. Of the total unrecognized tax benefits at January 31, 2015 and July 31, 2014, \$2,373,000 and \$2,152,000, 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 2011 through 2014 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.

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(Unaudited)

(12) 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 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.

As of January 31, 2015, we had granted stock-based awards pursuant to the Plan representing the right to purchase and/or acquire an aggregate of 7,476,130 shares (net of 2,804,962 expired and canceled awards), of which an aggregate of 5,008,878 have been exercised or converted into common stock, substantially all of which related to stock options.

As of January 31, 2015, the following stock-based awards, by award type, were outstanding:

	January 31, 2015
Stock options	2,234,733
Performance shares	173,341
RSUs and restricted stock	50,675
Share units	8,503
Total	2,467,252

Our ESPP, approved by our stockholders 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 January 31, 2015, we have cumulatively issued 571,234 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 January 31,		Six months ended January 31,	
	2015	2014	2015	2014
Cost of sales	\$66,000	84,000	133,000	137,000
Selling, general and administrative expenses	856,000	832,000	1,958,000	1,603,000
Research and development expenses	139,000	153,000	307,000	276,000
Stock-based compensation expense before income tax benefit	1,061,000	1,069,000	2,398,000	2,016,000

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Estimated income tax benefit	(383,000) (403,000) (851,000) (749,000)
Net stock-based compensation expense	\$678,000	666,000	1,547,000	1,267,000	

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(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 January 31, 2015, unrecognized stock-based compensation of \$9,923,000, net of estimated forfeitures of \$821,000, is expected to be recognized over a weighted average period of 3.1 years. Total stock-based compensation capitalized and included in ending inventory at both January 31, 2015 and July 31, 2014 was \$68,000. There are no liability-classified stock-based awards outstanding as of January 31, 2015 and July 31, 2014.

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

	Three months ended January 31,		Six months ended January 31,	
	2015	2014	2015	2014
Stock options	\$731,000	719,000	1,489,000	1,367,000
Performance shares	167,000	230,000	575,000	407,000
ESPP	53,000	43,000	106,000	88,000
RSUs and restricted stock	96,000	68,000	200,000	136,000
Share units	14,000	6,000	28,000	12,000
Equity-classified stock-based compensation expense	1,061,000	1,066,000	2,398,000	2,010,000
Liability-classified stock-based compensation expense (SARs)	—	3,000	—	6,000
Stock-based compensation expense before income tax benefit	1,061,000	1,069,000	2,398,000	2,016,000
Estimated income tax benefit	(383,000)	(403,000)	(851,000)	(749,000)
Net stock-based compensation expense	\$678,000	666,000	1,547,000	1,267,000

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.

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(Unaudited)

The following table reconciles the actual income tax benefit recognized for tax deductions relating to the settlement of stock-based awards to the excess income tax benefit reported as a cash flow from financing activities in our Condensed Consolidated Statements of Cash Flows:

	Six months ended January 31,	
	2015	2014
Actual income tax benefit recorded for the tax deductions relating to the settlement of stock-based awards	\$ 941,000	174,000
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	803,000	145,000
Excess income tax benefit recorded as an increase to additional paid-in capital	138,000	29,000
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	—	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	\$ 138,000	16,000

As of January 31, 2015 and July 31, 2014, the amount of hypothetical tax benefits related to stock-based awards, recorded as a component of additional paid-in capital, was \$17,413,000 and \$17,574,000, 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 six months ended January 31, 2015, we recorded a \$161,000 reduction to additional paid-in capital and accumulated hypothetical tax benefits, which primarily represents net income tax shortfalls recognized from the settlement of stock-based awards during the respective period. During the six months ended January 31, 2014, we recorded a \$2,080,000 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 period.

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(Unaudited)

Stock Options

The following table summarizes the Plan's activity during the six months ended January 31, 2015:

	Awards (in Shares)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at July 31, 2014	2,132,896	\$28.17		
Granted	253,000	33.94		
Expired/canceled	(9,900)	) 29.10		
Exercised	(146,963)	) 26.43		
Outstanding at October 31, 2014	2,229,033	28.94		
Granted	154,025	33.76		
Expired/canceled	(10,800)	) 29.20		
Exercised	(137,525)	) 28.06		
Outstanding at January 31, 2015	2,234,733	\$29.32	7.23	\$8,645,000
Exercisable at January 31, 2015	722,743	\$28.24	5.19	\$3,469,000
Vested and expected to vest at January 31, 2015	2,063,199	\$29.29	7.16	\$7,745,000

Stock options outstanding as of January 31, 2015 have exercise prices ranging between \$24.35 - \$33.94. The total intrinsic value relating to stock options exercised during the three months ended January 31, 2015 and 2014 was \$806,000 and \$391,000, respectively. The total intrinsic value relating to stock options exercised during the six months ended January 31, 2015 and 2014 was \$1,959,000 and \$432,000, respectively. Stock options granted during the six months ended January 31, 2015 and 2014 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 SARs granted or exercised during the three and six months ended January 31, 2015 and 2014.

During the six months ended January 31, 2015, at the election of certain holders of vested stock options, 280,288 stock options were net settled upon exercise. As a result, 45,989 net shares of our common stock were issued after reduction of shares retained to satisfy the exercise price and minimum statutory tax withholding requirements. There were no net settlements of stock options during the six months ended January 31, 2014.

The estimated per-share weighted average grant-date fair value of stock options granted during the three and six months ended January 31, 2015 was \$6.46 and \$6.14, respectively, and \$6.26 and \$5.50, respectively, during the three and six months ended January 31, 2014, which was determined using the Black-Scholes option pricing model, and included the following weighted average assumptions:

	Three months ended January 31,		Six months ended January 31,		
	2015	2014	2015	2014	
Expected dividend yield	3.55	% 3.84	% 3.54	% 4.03	%
Expected volatility	29.98	% 32.00	% 28.13	% 32.85	%
Risk-free interest rate	1.36	% 1.50	% 1.61	% 1.39	%

Expected life (years)	5.48	5.31	5.45	5.44
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(Unaudited)

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 was \$1.20 per share for grants in the three and six months ended January 31, 2015. We estimate expected volatility by considering the historical volatility of our stock, the implied volatility of publicly-traded call options on our stock 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, 2014	180,097	\$26.20	
Granted	60,378	33.97	
Converted to common stock	(13,376)	) 27.75	
Forfeited	(248)	) 31.44	
Outstanding at October 31, 2014	226,851	28.17	
Granted	5,916	33.94	
Converted to common stock	—	—	
Forfeited	(248)	) 31.44	
Outstanding at January 31, 2015	232,519	\$28.31	\$7,682,000
Vested at January 31, 2015	23,308	\$27.09	\$770,000
Vested and expected to vest at January 31, 2015	203,485	\$28.31	\$6,723,000

The total intrinsic value relating to fully-vested awards converted into our common stock during the six months ended January 31, 2015 and 2014 was \$504,000 and \$110,000, respectively. 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 since fiscal 2014 principally vest over a three year performance period, if pre-established performance goals are attained or as specified pursuant to the Plan and related agreement. As of January 31, 2015, the number of outstanding performance shares included in the above table, and the related compensation expense prior to consideration of estimated pre-vesting forfeitures, assume achievement of the pre-established goals at a target level. During the six months ended January 31, 2015, our Board of Directors determined that the pre-established performance goals for performance shares granted in fiscal 2013 had been attained, and as a result, the first tranche of 5,568 performance shares vested and converted into 4,149 shares of our

common stock, after reduction of shares retained to satisfy deferral requirements.

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 share units granted to date have been converted into common stock.

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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, 2014 and 2015 are entitled to dividend equivalents unless forfeited before vesting occurs; however, performance shares granted in fiscal 2013 were not entitled to such dividend equivalents until our Board of Directors determined that the pre-established performance goals were met. Share units granted prior to fiscal 2014 are not entitled to dividend equivalents. Share units granted beginning 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. During the six months ended January 31, 2015, we accrued \$113,000 of dividend equivalents and paid out \$5,000. As of January 31, 2015 and July 31, 2014, accrued dividend equivalents were \$224,000 and \$116,000, respectively. Such amounts were recorded as a reduction to retained earnings.

(13) Customer and Geographic Information

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

	Three months ended January 31,		Six months ended January 31,			
	2015	2014	2015	2014		
United States						
U.S. government	27.5	% 31.2	% 26.2	% 28.4	%	
Commercial	11.7	% 11.3	% 12.8	% 14.3	%	
Total United States	39.2	% 42.5	% 39.0	% 42.7	%	
International						
North African country	15.0	% 13.7	% 14.8	% 13.1	%	
Other international	45.8	% 43.8	% 46.2	% 44.2	%	
Total International	60.8	% 57.5	% 61.0	% 57.3	%	

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.

International sales for the three months ended January 31, 2015 and 2014 (which include sales to U.S. domestic companies for inclusion in products that will be sold to international customers) were \$49,768,000 and \$49,144,000, respectively. International sales for the six months ended January 31, 2015 and 2014 (which include sales to U.S. domestic companies for inclusion in products that will be sold to international customers) were \$96,524,000 and \$96,684,000, respectively.

Sales to a U.S. prime contractor customer represented approximately 14.4% of consolidated net sales for both the three and six months ended January 31, 2015 and 13.5% and 13.0% for the three and six months ended January 31, 2014, respectively. Almost all of these sales related to our North African country end-customer.

For the three and six months ended January 31, 2015 and 2014, 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.

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(Unaudited)

(14) 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-makers are our President and Chief Executive Officer and our Executive Chairman.

While our results of operations are primarily reviewed on a consolidated basis, the chief operating decision-makers also manage 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 BFT-1 and MTS programs, which are currently in a sustainment mode. We currently perform engineering services and satellite network operations on a cost-plus-fixed fee basis and program management services on a firm-fixed-price basis and we license certain of our intellectual property to the U.S. Army.

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

	Three months ended January 31, 2015				
	Telecommunications Transmission	RF Microwave Amplifiers	Mobile Data Communications	Unallocated	Total
Net sales	\$53,867,000	21,646,000	6,289,000	—	\$81,802,000
Operating income (loss)	11,049,000	969,000	2,709,000	(4,104,000)	10,623,000
Interest income and other (expense)	(26,000	) (7,000	) 3,000	120,000	90,000
Interest expense	69,000	—	—	—	69,000
Depreciation and amortization	2,196,000	906,000	72,000	1,069,000	4,243,000
Expenditure for long-lived assets, including intangibles	742,000	582,000	60,000	14,000	1,398,000
Total assets at January 31, 2015	240,413,000	92,918,000	6,002,000	132,154,000	471,487,000

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(Unaudited)

	Three months ended January 31, 2014				
	Telecommunications Transmission	RF Microwave Amplifiers	Mobile Data Communications	Unallocated	Total
Net sales	\$56,521,000	22,041,000	6,937,000	—	\$85,499,000
Operating income (loss)	10,268,000	1,077,000	3,273,000	(3,446,000)	11,172,000
Interest income and other (expense)	(18,000	) (13,000	) 3,000	256,000	228,000
Interest expense (income)	61,000	—	(3,000	) 1,940,000	1,998,000
Depreciation and amortization	2,231,000	945,000	63,000	1,085,000	4,324,000
Expenditure for long-lived assets, including intangibles	1,981,000	163,000	246,000	7,000	2,397,000
Total assets at January 31, 2014	244,478,000	90,733,000	7,114,000	312,889,000	655,214,000

	Six months ended January 31, 2015				
	Telecommunications Transmission	RF Microwave Amplifiers	Mobile Data Communications	Unallocated	Total
Net sales	\$105,223,000	40,410,000	12,560,000	—	\$158,193,000
Operating income (loss)	19,215,000	2,032,000	5,576,000	(7,981,000)	18,842,000
Interest income and other (expense)	(55,000	) (25,000	) 6,000	248,000	174,000
Interest expense	136,000	—	—	198,000	334,000
Depreciation and amortization	4,409,000	1,785,000	142,000	2,413,000	8,749,000
Expenditure for long-lived assets, including intangibles	1,280,000	674,000	144,000	47,000	2,145,000
Total assets at January 31, 2015	240,413,000	92,918,000	6,002,000	132,154,000	471,487,000