

FREQUENCY ELECTRONICS INC  
Form 10-Q  
December 15, 2014

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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, 2014

OR

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

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

Commission File No. 1-8061

FREQUENCY ELECTRONICS, INC.  
(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

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

11553  
(Zip Code)

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

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

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

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. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller Reporting  
(do not check if a smaller reporting Company   
company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of Registrant's Common Stock, par value \$1.00 as of December 8, 2014 – 8,605,666

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

## ITEM 1 - FINANCIAL STATEMENTS

## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

## Condensed Consolidated Balance Sheets

|                                                                                                                      | October 31,<br>2014<br>(UNAUDITED) | April 30,<br>2014 |
|----------------------------------------------------------------------------------------------------------------------|------------------------------------|-------------------|
|                                                                                                                      | (In thousands except par value)    |                   |
| <b>ASSETS:</b>                                                                                                       |                                    |                   |
| Current assets:                                                                                                      |                                    |                   |
| Cash and cash equivalents                                                                                            | \$ 6,415                           | \$ 7,698          |
| Marketable securities                                                                                                | 13,830                             | 16,030            |
| Accounts receivable, net of allowance for doubtful accounts of \$216 at October 31, 2014 and \$234 at April 30, 2014 | 12,861                             | 7,741             |
| Costs and estimated earnings in excess of billings, net                                                              | 11,305                             | 10,439            |
| Inventories                                                                                                          | 41,265                             | 41,227            |
| Deferred income taxes                                                                                                | 3,163                              | 3,220             |
| Prepaid expenses and other                                                                                           | 1,312                              | 1,507             |
| Total current assets                                                                                                 | 90,151                             | 87,862            |
| Property, plant and equipment, at cost, less accumulated depreciation and amortization                               | 13,232                             | 11,240            |
| Deferred income taxes                                                                                                | 6,650                              | 6,650             |
| Goodwill and other intangible assets                                                                                 | 644                                | 689               |
| Cash surrender value of life insurance and cash held in trust                                                        | 11,603                             | 11,321            |
| Other assets                                                                                                         | 1,761                              | 1,699             |
| Total assets                                                                                                         | \$ 124,041                         | \$ 119,461        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>                                                                         |                                    |                   |
| Current liabilities:                                                                                                 |                                    |                   |
| Accounts payable - trade                                                                                             | \$ 3,774                           | \$ 2,336          |
| Accrued liabilities                                                                                                  | 6,540                              | 7,361             |
| Total current liabilities                                                                                            | 10,314                             | 9,697             |
| Long term debt- noncurrent                                                                                           | 11,400                             | 10,100            |
| Deferred compensation                                                                                                | 10,914                             | 10,724            |
| Deferred rent and other liabilities                                                                                  | 512                                | 594               |
| Total liabilities                                                                                                    | 33,140                             | 31,115            |
| Commitments and contingencies                                                                                        |                                    |                   |
| Stockholders' equity:                                                                                                |                                    |                   |
| Preferred stock - \$1.00 par value                                                                                   | -                                  | -                 |
| Common stock - \$1.00 par value, issued 9,164 shares                                                                 | 9,164                              | 9,164             |
| Additional paid-in capital                                                                                           | 53,865                             | 53,181            |
| Retained earnings                                                                                                    | 26,710                             | 24,702            |
|                                                                                                                      | 89,739                             | 87,047            |

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|                                                                                                                          |            |            |
|--------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Common stock reacquired and held in treasury - at cost (561 shares at October 31, 2014 and 593 shares at April 30, 2014) | (2,571 )   | (2,715 )   |
| Accumulated other comprehensive income                                                                                   | 3,733      | 4,014      |
| Total stockholders' equity                                                                                               | 90,901     | 88,346     |
| Total liabilities and stockholders' equity                                                                               | \$ 124,041 | \$ 119,461 |

See accompanying notes to condensed consolidated financial statements.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

## Condensed Consolidated Statements of Income and Comprehensive Income

Six Months Ended October 31,  
(Unaudited)

|                                                                                                          | 2014                                 | 2013     |
|----------------------------------------------------------------------------------------------------------|--------------------------------------|----------|
|                                                                                                          | (In thousands except per share data) |          |
| <b>Condensed Consolidated Statements of Income</b>                                                       |                                      |          |
| Revenues                                                                                                 | \$38,983                             | \$33,834 |
| Cost of revenues                                                                                         | 26,644                               | 21,336   |
| Gross margin                                                                                             | 12,339                               | 12,498   |
| Selling and administrative expenses                                                                      | 6,970                                | 7,045    |
| Research and development expense                                                                         | 2,645                                | 3,226    |
| Operating profit                                                                                         | 2,724                                | 2,227    |
| Other income (expense):                                                                                  |                                      |          |
| Investment income                                                                                        | 625                                  | 351      |
| Interest expense                                                                                         | (81                                  | ) (95    |
| Other income (expense), net                                                                              | (10                                  | ) 734    |
| Income before provision for income taxes                                                                 | 3,258                                | 3,217    |
| Provision for income taxes                                                                               | 1,250                                | 1,150    |
| Net income                                                                                               | \$2,008                              | \$2,067  |
| Net income per common share                                                                              |                                      |          |
| Basic                                                                                                    | \$0.23                               | \$0.24   |
| Diluted                                                                                                  | \$0.23                               | \$0.24   |
| Weighted average shares outstanding                                                                      |                                      |          |
| Basic                                                                                                    | 8,589                                | 8,505    |
| Diluted                                                                                                  | 8,860                                | 8,780    |
| <b>Condensed Consolidated Statements of Comprehensive Income</b>                                         |                                      |          |
| Net income                                                                                               | \$2,008                              | \$2,067  |
| Other comprehensive income (loss):                                                                       |                                      |          |
| Foreign currency translation adjustment                                                                  | (392                                 | ) 818    |
| Unrealized gain (loss) on marketable securities:                                                         |                                      |          |
| Change in market value of marketable securities before reclassification, net of tax of (\$186) and \$255 | 360                                  | (401     |
| Reclassification adjustment for realized gains included in net income, net of tax of \$128 and \$25      | (249                                 | ) (49    |
| Total unrealized gain (loss) on marketable securities, net of tax                                        | 111                                  | (450     |
| Total other comprehensive (loss) income                                                                  | (281                                 | ) 368    |
| Comprehensive income                                                                                     | \$1,727                              | \$2,435  |

See accompanying notes to consolidated condensed financial statements.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

## Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended October 31,  
(Unaudited)

|                                                                                                        | 2014                                 | 2013     |
|--------------------------------------------------------------------------------------------------------|--------------------------------------|----------|
|                                                                                                        | (In thousands except per share data) |          |
| <b>Condensed Consolidated Statements of Income</b>                                                     |                                      |          |
| Revenues                                                                                               | \$19,243                             | \$17,007 |
| Cost of revenues                                                                                       | 12,569                               | 10,775   |
| Gross margin                                                                                           | 6,674                                | 6,232    |
| Selling and administrative expenses                                                                    | 3,472                                | 3,485    |
| Research and development expense                                                                       | 1,406                                | 1,483    |
| Operating profit                                                                                       | 1,796                                | 1,264    |
| Other income (expense):                                                                                |                                      |          |
| Investment income                                                                                      | 211                                  | 208      |
| Interest expense                                                                                       | (47                                  | ) (36    |
| Other income (expense), net                                                                            | (11                                  | ) 725    |
| Income before provision for income taxes                                                               | 1,949                                | 2,161    |
| Provision for income taxes                                                                             | 660                                  | 770      |
| Net income                                                                                             | \$1,289                              | \$1,391  |
| <b>Net income per common share</b>                                                                     |                                      |          |
| Basic                                                                                                  | \$0.15                               | \$0.16   |
| Diluted                                                                                                | \$0.15                               | \$0.16   |
| <b>Weighted average shares outstanding</b>                                                             |                                      |          |
| Basic                                                                                                  | 8,598                                | 8,520    |
| Diluted                                                                                                | 8,877                                | 8,822    |
| <b>Condensed Consolidated Statements of Comprehensive Income</b>                                       |                                      |          |
| Net income                                                                                             | \$1,289                              | \$1,391  |
| Other comprehensive income (loss):                                                                     |                                      |          |
| Foreign currency translation adjustment                                                                | (597                                 | ) 976    |
| Unrealized gain (loss) on marketable securities:                                                       |                                      |          |
| Change in market value of marketable securities before reclassification, net of tax of (\$47) and \$66 | 89                                   | (126     |
| Reclassification adjustment for realized gains included in net income, net of tax of \$33 and \$25     | (64                                  | ) (49    |
| Total unrealized gain (loss) on marketable securities, net of tax                                      | 25                                   | (175     |



|                                         |       |   |         |
|-----------------------------------------|-------|---|---------|
| Total other comprehensive (loss) income | (572  | ) | 801     |
| Comprehensive income                    | \$717 |   | \$2,192 |

See accompanying notes to consolidated condensed financial statements.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

Six Months Ended October 31,  
(Unaudited)

|                                                                                                | 2014           | 2013     |
|------------------------------------------------------------------------------------------------|----------------|----------|
|                                                                                                | (In thousands) |          |
| Cash flows from operating activities:                                                          |                |          |
| Net income                                                                                     | \$2,008        | \$2,067  |
| Non-cash charges to earnings                                                                   | 2,333          | 2,800    |
| Gain on sale of equipment                                                                      | -              | (736 )   |
| Net changes in operating assets and liabilities                                                | (6,847 )       | (6,634 ) |
| Net cash used in operating activities                                                          | (2,506 )       | (2,503 ) |
| Cash flows from investing activities:                                                          |                |          |
| Proceeds on redemption of marketable securities                                                | 4,130          | 1,767    |
| Purchase of marketable securities                                                              | (1,418 )       | (67 )    |
| Purchase of fixed assets and other assets                                                      | (3,120 )       | (2,786 ) |
| Net cash used in investing activities                                                          | (408 )         | (1,086 ) |
| Cash flows from financing activities:                                                          |                |          |
| Proceeds from credit line borrowings                                                           | 2,300          | 4,100    |
| Payment of credit line borrowings                                                              | (1,000 )       | -        |
| Tax benefit from exercise of stock-based compensation                                          | 29             | 157      |
| Payment of lease obligations                                                                   | -              | (15 )    |
| Net cash provided by financing activities                                                      | 1,329          | 4,242    |
| Net (decrease) increase in cash and cash equivalents<br>before effect of exchange rate changes |                |          |
|                                                                                                | (1,585 )       | 653      |
| Effect of exchange rate changes on cash and cash equivalents                                   | 302            | 949      |
| Net (decrease) increase in cash and cash equivalents                                           | (1,283 )       | 1,602    |
| Cash and cash equivalents at beginning of period                                               | 7,698          | 3,460    |
| Cash and cash equivalents at end of period                                                     | \$6,415        | \$5,062  |
| Supplemental disclosures of cash flow information:                                             |                |          |
| Cash paid during the period for:                                                               |                |          |
| Interest                                                                                       | \$82           | \$87     |
| Income Taxes                                                                                   | \$490          | \$1,260  |

See accompanying notes to condensed consolidated financial statements.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

## NOTE A – CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management of Frequency Electronics, Inc. (“the Company”), the accompanying unaudited condensed consolidated interim financial statements reflect all adjustments (which include only normal recurring adjustments) necessary to present fairly, in all material respects, the consolidated financial position of the Company as of October 31, 2014 and the results of its operations and cash flows for the six and three months ended October 31, 2014 and 2013. The April 30, 2014 condensed consolidated balance sheet was derived from audited financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended April 30, 2014, filed on July 29, 2014. The results of operations for such interim periods are not necessarily indicative of the operating results for the full fiscal year.

## NOTE B – EARNINGS PER SHARE

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

|                                         | Six months<br>Periods ended October 31, |           | Three months |           |
|-----------------------------------------|-----------------------------------------|-----------|--------------|-----------|
|                                         | 2014                                    | 2013      | 2014         | 2013      |
| Weighted average shares<br>outstanding: |                                         |           |              |           |
| Basic                                   | 8,588,594                               | 8,504,810 | 8,598,456    | 8,519,718 |
| Effect of dilutive securities           | 271,230                                 | 275,578   | 278,516      | 302,061   |
| Diluted                                 | 8,859,824                               | 8,780,388 | 8,876,972    | 8,821,779 |

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

|                                       | Six months<br>Periods ended October 31, |         | Three months |         |
|---------------------------------------|-----------------------------------------|---------|--------------|---------|
|                                       | 2014                                    | 2013    | 2014         | 2013    |
| Outstanding options and SARS excluded | 274,000                                 | 290,375 | 240,000      | 272,375 |

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

At October 31, 2014 and April 30, 2014, costs and estimated earnings in excess of billings, net, consist of the following:

|  | October 31,<br>2014 | April 30, 2014 |
|--|---------------------|----------------|
|  |                     |                |

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|                                                    | (In thousands) |           |
|----------------------------------------------------|----------------|-----------|
| Costs and estimated earnings in excess of billings | \$ 12,351      | \$ 11,965 |
| Billings in excess of costs and estimated earnings | (1,046 )       | (1,526 )  |
| Net asset                                          | \$ 11,305      | \$ 10,439 |

Such amounts represent revenue recognized on long-term contracts that had not been billed at the balance sheet dates or represent a liability for amounts billed in excess of the revenue recognized. Amounts are billed to customers pursuant to contract terms, whereas the related revenue is recognized on the percentage of completion basis at the measurement date. In general, the recorded amounts will be billed and collected or revenue recognized within twelve months of the balance sheet date. Revenue on these long-term contracts is accounted for on the percentage of completion basis. During the six and three months ended October 31, 2014, revenue recognized under percentage of completion contracts was approximately \$24.4 million and \$11.5 million, respectively. During the six and three months ended October 31, 2013, such revenue was approximately \$19.5 million and \$9.8 million, respectively.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

## NOTE D – TREASURY STOCK TRANSACTIONS

During the six and three month periods ended October 31, 2014, the Company made contributions of 22,432 shares and 10,569 shares, respectively, of its common stock held in treasury to the Company's profit sharing plan and trust under section 401(k) of the Internal Revenue Code. Such contributions are in accordance with the Company's discretionary match of employee voluntary contributions to this plan. During the same periods, the Company issued 9,653 shares and 8,294 shares, respectively, from treasury upon the exercise of SARs by certain officers and employees of the Company.

## NOTE E – INVENTORIES

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

|                                   | October 31,<br>2014 | April 30, 2014 |
|-----------------------------------|---------------------|----------------|
|                                   | (In thousands)      |                |
| Raw Materials and Component Parts | \$ 25,287           | \$ 24,986      |
| Work in Progress                  | 10,776              | 12,385         |
| Finished Goods                    | 5,202               | 3,856          |
|                                   | \$ 41,265           | \$ 41,227      |

As of October 31, 2014 and April 30, 2014, approximately \$32.6 million and \$33.4 million, respectively, of total inventory is located in the United States, approximately \$7.2 million and \$7.1 million, respectively, is located in Belgium and \$1.5 million and \$0.7 million, respectively, is located in China.

## NOTE F – SEGMENT INFORMATION

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

- (1) FEI-NY – operates out of New York and its operations consist principally of precision time and frequency control products used in three principal markets- communication satellites (both commercial and U.S. Government-funded); terrestrial cellular telephone or other ground-based telecommunication stations and other components and systems for the U.S. military.
- (2) Gillam-FEI - operates out of Belgium and France and primarily sells wireline synchronization and network management systems in non-U.S. markets. All sales from Gillam-FEI to the United States are to other segments of the Company.
- (3) FEI-Zyfer – operates out of California and its products incorporate Global Positioning System (GPS) technologies into systems and subsystems for secure communications, both government and commercial, and other locator applications. This segment also provides sales and support for the Company's wireline telecommunications family of products, including US5G, which are sold in the United States market.

The FEI-NY segment also includes the operations of the Company's wholly-owned subsidiaries, FEI-Elcom Tech ("FEI-Elcom") and FEI-Asia. FEI-Asia functions primarily as a manufacturing facility for the Company's commercial

product subsidiaries with historically minimal sales to outside customers. Beginning in late fiscal year 2014, FEI-Asia began shipping higher volumes of product to third parties as a contract manufacturer. FEI-Elcom, in addition to its own product line, provides design and technical support for the FEI-NY segment's satellite business.

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

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

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

|                            | Six months<br>Periods ended October 31, |           | Three months |           |
|----------------------------|-----------------------------------------|-----------|--------------|-----------|
|                            | 2014                                    | 2013      | 2014         | 2013      |
| Revenues:                  |                                         |           |              |           |
| FEI-NY                     | \$ 31,937                               | \$ 26,039 | \$ 14,680    | \$ 12,865 |
| Gillam-FEI                 | 4,547                                   | 4,568     | 3,056        | 1,873     |
| FEI-Zyfer                  | 4,180                                   | 4,352     | 3,060        | 2,363     |
| less intersegment revenues | (1,681 )                                | (1,125 )  | (1,553 )     | (94 )     |
| Consolidated revenues      | \$ 38,983                               | \$ 33,834 | \$ 19,243    | \$ 17,007 |

|                               | Six months<br>Periods ended October 31, |          | Three months |          |
|-------------------------------|-----------------------------------------|----------|--------------|----------|
|                               | 2014                                    | 2013     | 2014         | 2013     |
| Operating profit (loss):      |                                         |          |              |          |
| FEI-NY                        | \$ 3,279                                | \$ 2,740 | \$ 1,199     | \$ 1,564 |
| Gillam-FEI                    | (513 )                                  | (36 )    | 65           | (92 )    |
| FEI-Zyfer                     | 159                                     | (275 )   | 665          | (76 )    |
| Corporate                     | (201 )                                  | (202 )   | (133 )       | (132 )   |
| Consolidated operating profit | \$ 2,724                                | \$ 2,227 | \$ 1,796     | \$ 1,264 |

|                                               | October 31,<br>2014 | April 30, 2014 |
|-----------------------------------------------|---------------------|----------------|
| Identifiable assets:                          |                     |                |
| FEI-NY (approximately \$3.4 million in China) | \$ 70,987           | \$ 62,969      |
| Gillam-FEI (all in Belgium or France)         | 17,443              | 19,595         |
| FEI-Zyfer                                     | 11,957              | 11,220         |
| less intersegment balances                    | (19,364 )           | (19,819 )      |
| Corporate                                     | 43,018              | 45,496         |
| Consolidated identifiable assets              | \$ 124,041          | \$ 119,461     |

## NOTE G – INVESTMENT IN MORION, INC.

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

During the six months ended October 31, 2014 and 2013, the Company acquired product from Morion in the aggregate amount of approximately \$96,000 and \$98,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately \$289,000 and \$652,000, respectively. (See discussion of



revenues recognized under the license agreement in the paragraph below.) During the three months ended October 31, 2014 and 2013, the Company acquired product from Morion in the aggregate amount of approximately \$20,000 and \$68,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately \$106,000 and \$510,000, respectively. At October 31, 2014, approximately \$1,400 was payable to Morion and accounts receivable from Morion was approximately \$69,000.

On October 22, 2012, the Company entered into an agreement with respect to its licensing of rubidium oscillator production technology to Morion. The agreement requires the Company to supply production equipment and parts and to provide training to Morion employees to enable Morion to achieve certain levels of volume production of rubidium oscillators. Morion will pay the Company approximately \$2.7 million for the license, the equipment, parts and training, plus 5% royalties on third party sales. For a 5-year period following an initial production run, the Company commits to purchase from Morion a minimum of approximately \$400,000 worth of rubidium oscillators per year although Morion is not obligated to sell that amount to the Company. In November 2012, Morion paid the Company a \$925,000 deposit under the agreement which amount had been recorded on the Company's balance sheet as deferred revenue. In October 2013, after amending the original document to clarify certain billing events, the Company invoiced Morion for the equipment, certain component parts for the production of rubidium oscillators, training of certain Morion employees and transfer of the production technology and license to Morion. Accordingly, during the six and three-month periods ended October 31, 2013, the Company recorded revenues of \$400,000 for the technology transfer, training and sale of parts and recognized a gain of approximately \$736,000 upon the sale of fully-depreciated equipment. The \$925,000 deposit previously recorded as deferred revenue was included in these revenues and gain. Additional revenues under the agreement will be recorded after the Company provides further on-site training for Morion personnel, delivers more component parts and obtains relief from certain U.S. Government limitations relating to the sales of items to be manufactured under the license. The United States Department of State has approved the technology transfer called for under the agreement.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

## NOTE H – FAIR VALUE OF FINANCIAL INSTRUMENTS

The cost, gross unrealized gains, gross unrealized losses and fair market value of available-for-sale securities at October 31, 2014 and April 30, 2014 are as follows (in thousands):

|                         | October 31, 2014 |                              |                               |                         |
|-------------------------|------------------|------------------------------|-------------------------------|-------------------------|
|                         | Cost             | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Market<br>Value |
| Fixed income securities | \$ 5,893         | \$ 100                       | \$ (28 )                      | \$ 5,965                |
| Equity securities       | 6,932            | 1,029                        | (96 )                         | 7,865                   |
|                         | \$ 12,825        | \$ 1,129                     | \$ (124 )                     | \$ 13,830               |

|                         | April 30, 2014 |                              |                               |                         |
|-------------------------|----------------|------------------------------|-------------------------------|-------------------------|
|                         | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Market<br>Value |
| Fixed income securities | \$ 8,927       | \$ 116                       | \$ (36 )                      | \$ 9,007                |
| Equity securities       | 6,267          | 909                          | (153 )                        | 7,023                   |
|                         | \$ 15,194      | \$ 1,025                     | \$ (189 )                     | \$ 16,030               |

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

|                            | Less than 12 months |                      | 12 Months or more |                      | Total         | Unrealized |
|----------------------------|---------------------|----------------------|-------------------|----------------------|---------------|------------|
|                            | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value     | Unrealized<br>Losses | Fair<br>Value | Losses     |
| October 31, 2014           |                     |                      |                   |                      |               |            |
| Fixed Income<br>Securities | \$200               | \$(3 )               | \$454             | \$(25 )              | \$654         | \$(28 )    |
| Equity Securities          | 2,160               | (91 )                | 622               | (5 )                 | 2,782         | (96 )      |
|                            | \$2,360             | \$(94 )              | \$1,076           | \$(30 )              | \$3,436       | \$(124 )   |
| April 30, 2014             |                     |                      |                   |                      |               |            |
| Fixed Income<br>Securities | \$501               | \$(3 )               | \$448             | \$(33 )              | \$949         | \$(36 )    |
| Equity Securities          | 366                 | (1 )                 | 925               | (152 )               | 1,291         | (153 )     |
|                            | \$867               | \$(4 )               | \$1,373           | \$(185 )             | \$2,240       | \$(189 )   |

The Company regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. The Company does not believe that its investments in marketable securities with unrealized losses at October 31, 2014 are other-than-temporary due to market volatility of the security's fair value, analysts' expectations and the Company's ability to hold the securities for a period of time sufficient to allow for any anticipated recoveries in market value.



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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

During the six months ended October 31, 2014 and 2013, the Company sold or redeemed available-for-sale securities in the amounts of \$4.1 million and \$1.8 million, respectively, realizing gains of approximately \$377,000 and \$74,000, respectively.

Maturities of fixed income securities classified as available-for-sale at October 31, 2014 are as follows, at cost (in thousands):

|                                        |         |
|----------------------------------------|---------|
| Current                                | \$2,657 |
| Due after one year through five years  | 1,413   |
| Due after five years through ten years | 1,823   |
|                                        | \$5,893 |

The fair value accounting framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. All of the Company's investments in marketable securities are valued on a Level 1 basis.

## NOTE I – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued Accounting Standard Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 eliminates most of the existing industry-specific revenue recognition guidance and significantly expands related disclosures. The required disclosures will include both quantitative and qualitative information about the amount, timing and uncertainty of revenue from contracts with customers and the significant judgments used. Entities can retrospectively apply ASU 2014-09 or use an alternative transition method. This ASU is effective for public companies for annual reporting periods beginning on or after December 15, 2016 and for the Company, must be adopted for its fiscal year 2018 beginning on May 1, 2017. The Company is in the process of determining the effect that ASU 2014-09 may have on its financial statements.

NOTE J – CREDIT FACILITY

The Company has a credit facility (the “Facility”) with JPMorgan Chase Bank, N.A. (“JPMorgan”) pursuant to a credit agreement (the “Credit Agreement”) between the Company and JPMorgan. Under the Facility the Company may make borrowings from either Tranche A or Tranche B or a combination of both, not to exceed \$25.0 million. Pursuant to the Credit Agreement, the amount of Tranche A borrowings may not exceed the value of the Pledged Investments (as defined in the Credit Agreement). The amount of Tranche B borrowings may not exceed the lesser of (i) \$15.0 million and (ii) the Borrowing Base (as defined in the Credit Agreement). Current outstanding borrowings of \$11.4 million under the Facility are all under Tranche A. The Facility is fully guaranteed by certain of the Company’s subsidiaries and is secured by, among other things, a pledge of substantially all personal property of the Company and certain of the Company’s subsidiaries.

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Borrowings under the Facility are evidenced by a line of credit note (the “Note”) and bear interest, payable monthly, at a rate equal to the LIBOR Rate, as determined from time to time by JPMorgan pursuant to the terms of the Note, plus a margin of 0.75% for Tranche A borrowings and 1.75% for Tranche B borrowings. The principal balance on the Note, along with any accrued and unpaid interest, is due and payable no later than June 5, 2018, which is the maturity date of the Facility. In addition, the Company is required to pay JPMorgan fees equal to 0.1% per annum on any unused portion of the Facility.

The Credit Agreement contains a number of affirmative and negative covenants, including limitations on the incurrence of additional debt, liens on property, acquisitions, loans and guarantees, mergers, consolidations, liquidations and dissolutions, asset sales, and distributions and other payments in respect of the Company’s capital stock. The Credit Agreement also contains certain events of default customary for credit facilities of this type, including nonpayment of principal or interest when due, material incorrectness of representations and warranties when made, breach of covenants, bankruptcy and insolvency, unstayed material judgment beyond specified periods, and acceleration or payment default of other material indebtedness. The Credit Agreement requires the Company to maintain, as of the end of each fiscal quarter, a funded debt to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) ratio and an interest charge coverage ratio. The calculation of both ratios is defined in the Credit Agreement. For the period ended October 31, 2014, the Company met the required covenants for its borrowings under Tranche A.

NOTE K – VALUATION ALLOWANCE ON DEFERRED TAX ASSETS

In prior fiscal years, the Company reduced the valuation allowance on the deferred tax assets of its U.S. subsidiaries. Consequently, for the six and three months ended October 31, 2014 and 2013, the Company recorded provisions for income taxes based on both current taxes due in the United States as well as the tax provision or benefit to be realized from temporary tax differences. As of October 31, 2014 and April 30, 2014, the remaining deferred tax asset valuation allowance is approximately \$2.1 million and is primarily related to deferred tax assets of the Company’s non-U.S.-based subsidiaries.

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
(Continued)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

The statements in this quarterly report on Form 10-Q regarding future earnings and operations and other statements relating to the future constitute "forward-looking" statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "believe," "may," "will," "could," "should," "would," "anticipate," "estimate," "expect," "project," "intend," "objective," "seek," "strive," "might," "likely result," "build," "grow," "plan," "goal," "expand," "position," or similar words, or the negatives of these words, or similar terminology, identify forward-looking statements. These statements are based on assumptions that the Company believes are reasonable, but are subject to a wide range of risks and uncertainties, and a number of factors could cause the Company's actual results to differ materially from those expressed in the forward-looking statements referred to above. Factors that would cause or contribute to such differences include, but are not limited to, continued acceptance of the Company's products in the marketplace, competitive factors, new products and technological changes, product prices and raw material costs, dependence upon third-party vendors, competitive developments, changes in manufacturing and transportation costs, changes in contractual terms, the availability of capital, and other risks detailed in the Company's periodic report filings with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which relate only to events as of the date on which the statements are made and which reflect management's analysis, judgments, belief, or expectation only as of such date. By making these forward-looking statements, the Company undertakes no obligation to update these statements for revisions or changes after the date of this report.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 30, 2014. The Company believes its most critical accounting policies to be the recognition of revenue and costs on production contracts and the valuation of inventory. Each of these areas requires the Company to make use of reasoned estimates including estimating the cost to complete a contract, the realizable value of its inventory or the market value of its products. Changes in estimates can have a material impact on the Company's financial position and results of operations.

Revenue Recognition

Revenues under larger, long-term contracts which generally require billings based on achievement of milestones rather than delivery of product, are reported in operating results using the percentage of completion method. On fixed-price contracts, which are typical for commercial and U.S. Government satellite programs and other long-term U.S. Government projects, and which require initial design and development of the product, revenue is recognized on the cost-to-cost method. Under this method, revenue is recorded based upon the ratio that incurred costs bear to total estimated contract costs with related cost of sales recorded as the costs are incurred. Each month management reviews estimated contract costs through a process of aggregating actual costs incurred and estimating additional costs to completion based upon the current available information and status of the contract. The effect of any change in the estimated gross margin percentage for a contract is reflected in revenues in the period in which the change is known. Provisions for anticipated losses on contracts are made in the period in which they become determinable.

On production-type orders, revenue is recorded as units are delivered with the related cost of sales recognized on each shipment based upon a percentage of estimated final program costs.

Changes in job performance on long-term contracts and production-type orders may result in revisions to costs and income and are recognized in the period in which revisions are determined to be required. Provisions for anticipated losses on customer orders are made in the period in which they become determinable.

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

#### Costs and Expenses

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



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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
(Continued)

## Inventory

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

## Marketable Securities

All of the Company's investments in marketable securities are Level 1 securities which trade on public markets and have current prices that are readily available. In general, investments in fixed price securities are only in the commercial paper of financially sound corporations or the bonds of U.S. Government agencies. Although the value of such investments may fluctuate significantly based on economic factors, the Company's own financial strength enables it to wait for the securities to either recover their value or to mature such that any interim unrealized gains or losses are deemed to be temporary.

## Foreign Operations and Foreign Currency Adjustments

The Company maintains manufacturing operations in Belgium and the People's Republic of China. The Company is vulnerable to currency risks in these countries. The local currency is the functional currency of each of the Company's non-U.S. subsidiaries. No foreign currency gains or losses are recorded on intercompany transactions since they are effected at current rates of exchange. The results of operations of foreign subsidiaries, when translated into U.S. dollars, reflect the average rates of exchange for the periods presented. The balance sheets of foreign subsidiaries, except for equity accounts which are translated at historical rates, are translated into U.S. dollars at the rates of exchange in effect on the date of the balance sheet. As a result, similar results in local currency can vary upon translation into U.S. dollars if exchange rates fluctuate significantly from one period to the next.

## RESULTS OF OPERATIONS

The table below sets forth for the respective periods of fiscal years 2015 and 2014 (which end on April 30, 2015 and 2014, respectively) the percentage of consolidated revenues represented by certain items in the Company's consolidated statements of operations:

|                                     | Six months                |        | Three months |        |
|-------------------------------------|---------------------------|--------|--------------|--------|
|                                     | Periods ended October 31, |        | 2014         | 2013   |
|                                     | 2014                      | 2013   |              |        |
| Revenues                            |                           |        |              |        |
| FEI-NY                              | 81.9 %                    | 76.9 % | 76.3 %       | 75.6 % |
| Gillam-FEI                          | 11.7                      | 13.5   | 15.9         | 11.0   |
| FEI-Zyfer                           | 10.7                      | 12.9   | 15.9         | 13.9   |
| Less intersegment revenues          | (4.3 )                    | (3.3 ) | (8.1 )       | (0.5 ) |
|                                     | 100.0                     | 100.0  | 100.0        | 100.0  |
| Cost of revenues                    | 68.3                      | 63.1   | 65.3         | 63.4   |
| Gross margin                        | 31.7                      | 36.9   | 34.7         | 36.6   |
| Selling and administrative expenses | 17.9                      | 20.8   | 18.0         | 20.5   |

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|                                   |     |   |     |   |      |   |      |   |
|-----------------------------------|-----|---|-----|---|------|---|------|---|
| Research and development expenses | 6.8 |   | 9.5 |   | 7.3  |   | 8.7  |   |
| Operating profit                  | 7.0 |   | 6.6 |   | 9.4  |   | 7.4  |   |
| Other income, net                 | 1.4 |   | 2.9 |   | 0.8  |   | 5.3  |   |
| Pretax income                     | 8.4 |   | 9.5 |   | 10.2 |   | 12.7 |   |
| Provision for income taxes        | 3.2 |   | 3.4 |   | 3.4  |   | 4.5  |   |
| Net income                        | 5.2 | % | 6.1 | % | 6.8  | % | 8.2  | % |

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
(Continued)

## Revenues

| Segment                  | Six months<br>Periods ended October 31, |           |               | Three months |           |               |
|--------------------------|-----------------------------------------|-----------|---------------|--------------|-----------|---------------|
|                          | 2014                                    | 2013      | Change        | 2014         | 2013      | Change        |
| FEI-NY                   | \$ 31,937                               | \$ 26,039 | \$ 5,898 23 % | \$ 14,680    | \$ 12,865 | \$ 1,815 14 % |
| Gillam-FEI               | 4,547                                   | 4,568     | (21 ) 0 %     | 3,056        | 1,873     | 1,183 63 %    |
| FEI-Zyfer                | 4,180                                   | 4,352     | (172 ) (4 %)  | 3,060        | 2,363     | 697 29 %      |
| Intersegment<br>revenues | (1,681 )                                | (1,125 )  | (556 )        | (1,553 )     | (94 )     | (1,459)       |
|                          | \$ 38,983                               | \$ 33,834 | \$ 5,149 15 % | \$ 19,243    | \$ 17,007 | \$ 2,236 13 % |

For the six and three months ended October 31, 2014, revenues from commercial and U.S. Government satellite programs accounted for approximately 60% of consolidated revenues and increased by 27% and 18%, respectively, over the same periods of fiscal year 2014. Revenues on these contracts are recognized primarily under the percentage of completion method. Revenues from the satellite market are recorded in the FEI-NY segment. Revenues from non-space U.S. Government/DOD customers, which are recorded in both the FEI-NY and FEI-Zyfer segments, accounted for approximately 15% of consolidated revenues for the six months of fiscal year 2015 as compared to approximately 20% of revenues during the same period of fiscal year 2014. For the three-month period ended October 31, 2014, such revenues were approximately 20% of consolidated revenues and increased by 30% over non-space government revenues for the second quarter of fiscal year 2014. The primary reason for this growth during the second quarter of fiscal year 2015 was due to additional funding received by the FEI-Zyfer segment on an U.S. Government initiative to protect secure communications from jamming and multi-path in GPS systems. Total revenues from U.S. Government satellite contracts and non-space programs were approximately 40% of consolidated revenues for the six months ended October 31, 2014 and were approximately 50% of revenues for the three-month period then ended. Network infrastructure and other industrial revenues in the fiscal year 2015 periods accounted for approximately 20% of consolidated revenues which is similar to their share of consolidated revenues in the prior year. These fiscal year 2015 commercial revenues increased by approximately 20% for the six month period and declined by approximately 10% for the three-month period ended October 31, 2014, as compared to the same periods of fiscal year 2014. The primary reason for growth in this commercial, non-space market area is due to increased third party revenues in the Company's FEI-Asia subsidiary which is part of the FEI-NY segment. In prior periods, third party revenues for the FEI-Asia subsidiary were insignificant as most of its manufacturing capacity was applied to intersegment production. For the three-month period ended October 31, 2014, Gillam-FEI revenues increased over the prior year primarily due to higher intersegment sales which are eliminated in consolidation.

For the six and three months ended October 31, 2013, revenues from commercial and U.S. Government satellite programs accounted for more than 55% of consolidated revenues and increased by approximately 20% over the same periods of fiscal year 2013. Revenues on these contracts are recognized primarily under the percentage of completion method. Revenues from the satellite market are recorded in the FEI-NY segment. Revenues from non-space U.S. Government/DOD customers, which are recorded in both the FEI-NY and FEI-Zyfer segments, accounted for approximately 20% of fiscal year 2014 consolidated revenues. Such revenues decreased by 10% and 36%, respectively, from the same periods of fiscal year 2013. Total revenues from U.S. Government satellite contracts and non-space programs approached 60% of consolidated revenues for the six months ended October 31, 2013 and were approximately 55% of revenues for the three-month period then ended. Network infrastructure and other industrial revenues in the fiscal year 2014 periods accounted for approximately 20% of consolidated revenues and declined by approximately 25% and 10%, respectively, from the same periods of fiscal year 2013. These commercial, non-space

revenues are recorded in all three segments although the largest network infrastructure sales volume is recorded in the Gillam-FEI and FEI-Zyfer segments and accounted for most of the year-over-year decline in FEI-Zyfer's revenues. For the three-month period ended October 31, 2013, Gillam-FEI revenues decreased over the prior year primarily due to lower intersegment sales which are eliminated in consolidation.

Based on the Company's current backlog, over three-fourths of which represent satellite payload business, and the potential for additional new orders, revenues for fiscal year 2015 are expected to grow. Satellite payload revenues will continue to be the dominant portion of the Company's business and represents the Company's best growth opportunity. Revenues for non-space U.S. Government/DOD customers are also expected to increase, particularly for the FEI-Zyfer segment, as it receives additional orders on systems to protect secure communications from jamming and multi-path in GPS systems.

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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

(Continued)

## Gross margin

|         | Six months                |           |                | Three months |          |            |
|---------|---------------------------|-----------|----------------|--------------|----------|------------|
|         | Periods ended October 31, |           |                |              |          |            |
|         | 2014                      | 2013      | Change         | 2014         | 2013     | Change     |
|         | \$ 12,339                 | \$ 12,498 | \$ (159) (1 %) | \$ 6,674     | \$ 6,232 | \$ 442 7 % |
| GM Rate | 31.7 %                    | 36.9 %    |                | 34.7 %       | 36.6 %   |            |

Gross margin for the six months ended October 31, 2014, decreased over the prior fiscal year due primarily to lower revenues in the first quarter on non-space U.S. Government business and at the Gillam-FEI segment. During the three month period ended October 31, 2014, gross margin increased as a result of higher revenues in all segments as compared to fiscal year 2014. The fiscal year 2015 gross margin rates were lower than fiscal year 2014 rates due to the effect of low sales volume in the first quarter and product mix.

Gross margin for the six and three month periods ended October 31, 2013, decreased due to lower revenues and lower gross margin rates. The gross margin rate was impacted by product mix as well as by unabsorbed overhead costs during fiscal year 2014.

The gross margin rates recorded in the fiscal year 2015 and 2014 periods were less than the Company's targeted rate of 40%. As satellite payload sales volume increases and as the product mix changes, the Company anticipates that it will realize improved gross margin rates for the remainder of fiscal year 2015.

## Selling and administrative expenses

|  | Six months                |          |               | Three months |          |             |
|--|---------------------------|----------|---------------|--------------|----------|-------------|
|  | Periods ended October 31, |          |               |              |          |             |
|  | 2014                      | 2013     | Change        | 2014         | 2013     | Change      |
|  | \$ 6,970                  | \$ 7,045 | \$ (75) (1 %) | \$ 3,472     | \$ 3,485 | \$ (13) 0 % |

For the six and three-month periods ended October 31, 2014 and 2013, selling and administrative expenses ("SG&A") were approximately 18% and 21%, respectively, of consolidated revenues. The fluctuation in expenses in the fiscal year 2015 periods compared to the same periods of fiscal year 2014 is due to lower selling expenses partially offset by increased incentive compensation expenses. For the remainder of fiscal year 2015, the Company expects SG&A expenses to be incurred at approximately the same rate and to be less than 20% of consolidated revenues.

## Research and development expense

|  | Six months                |          |               | Three months |          |              |
|--|---------------------------|----------|---------------|--------------|----------|--------------|
|  | Periods ended October 31, |          |               |              |          |              |
|  | 2014                      | 2013     | Change        | 2014         | 2013     | Change       |
|  | \$ 2,645                  | \$ 3,226 | \$ (581)(18%) | \$ 1,406     | \$ 1,483 | \$ (77)(5 %) |

Research and development ("R&D") expenditures represent investments intended to keep the Company's products at the leading edge of time and frequency technology and enhance competitiveness for future revenues. R&D spending for the six and three-month periods ended October 31, 2014, was approximately 7% of consolidated revenues compared to 9% for the same periods of the prior fiscal year. In the fiscal year 2015 periods, the Company continued the

development of new satellite payload microwave receivers/converters from DC to Ka band. The rate of R&D spending on such satellite payload products decreased in fiscal year 2015 as development is nearly complete and the products are ready for customer evaluation and new contract awards during fiscal year 2015. Internal R&D spending also includes development and improvement of quartz-based and rubidium atomic clocks, development of new GPS-based synchronization products and further enhancement of the capabilities of the Company's line of low g-sensitivity and ruggedized rubidium oscillators. Included in these efforts are product design and process improvements to enhance product manufacturability and reduce production costs.

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
(Continued)

In addition to internal R&D efforts, the Company continues to conduct development activities on customer-funded programs the cost of which appears in cost of revenues. The Company will continue to devote significant resources to develop new products, enhance existing products and implement efficient manufacturing processes. For fiscal year 2015, the Company is targeting to spend less than 10% of revenues on internal R&D projects. Internally generated cash and cash reserves are adequate to fund these development efforts.

## Operating profit

| Six months                |          |             | Three months |          |             |
|---------------------------|----------|-------------|--------------|----------|-------------|
| Periods ended October 31, |          |             |              |          |             |
| 2014                      | 2013     | Change      | 2014         | 2013     | Change      |
| \$ 2,724                  | \$ 2,227 | \$ 497 22 % | \$ 1,796     | \$ 1,264 | \$ 532 42 % |

Higher consolidated revenues and lower operating costs during the fiscal year 2015 periods resulted in increased operating profits. Fiscal year 2015's six- and three-month operating profit was 7.0% and 9.4%, respectively, of consolidated revenues compared to 6.6% and 7.4%, respectively, of consolidated revenues in the same periods of the prior year.

The Company anticipates that for the full fiscal year 2015, increased revenues will enable it to generate an operating profit that exceeds that of fiscal year 2014.

## Other income (expense)

|                             | Six months                |        |                 | Three months |        |                 |
|-----------------------------|---------------------------|--------|-----------------|--------------|--------|-----------------|
|                             | Periods ended October 31, |        |                 |              |        |                 |
|                             | 2014                      | 2013   | Change          | 2014         | 2013   | Change          |
| Investment income           | \$ 625                    | \$ 351 | \$ 274 78 %     | \$ 211       | \$ 208 | \$ 3 1 %        |
| Interest expense            | (81 )                     | (95 )  | 14 15 %         | (47 )        | (36 )  | (11 ) (30 %)    |
| Other income (expense), net | (10 )                     | 734    | (744) NM        | (11 )        | 725    | (736) NM        |
|                             | \$ 534                    | \$ 990 | \$ (456) (46 %) | \$ 153       | \$ 897 | \$ (744) (83 %) |

Investment income is derived primarily from the Company's holdings of marketable securities. Earnings on these securities may vary based on fluctuating interest rates and dividend payout levels and the timing of purchases or sales of securities. During the six months ended October 31, 2014 and 2013, the Company recorded gains of approximately \$377,000 and \$74,000, respectively, on the sale of certain marketable securities. Gains recorded during the three months ended October 31, 2014 and 2013, were approximately \$97,000 and \$74,000, respectively.

The decrease in interest expense for the six months ended October 31, 2014 compared to the same period of fiscal year 2014 is due to the lower interest rate under the Company's new credit facility from a bank. For the three month period ended October 31, 2014, the interest rate was higher than the same period of fiscal year 2014 due to a higher level of borrowing under the credit facility.

During the fiscal year 2015 periods, other income consisted of insignificant non-operating expenses. Other income in the fiscal year 2014 periods consists primarily of a \$736,000 gain recognized upon the sale of certain manufacturing

equipment to Morion, Inc. under the terms of a license agreement related to the Company's rubidium oscillator production technology. (See Note G to the accompanying condensed financial statements.)

Income tax provision

| Six months                |          |            | Three months |        |                |
|---------------------------|----------|------------|--------------|--------|----------------|
| Periods ended October 31, |          |            |              |        |                |
| 2014                      | 2013     | Change     | 2014         | 2013   | Change         |
| \$ 1,250                  | \$ 1,150 | \$ 100 9 % | \$ 660       | \$ 770 | \$ (110) (14%) |

Effective tax rate on pre-tax book income:

|      |   |      |   |      |   |      |   |
|------|---|------|---|------|---|------|---|
| 38.4 | % | 35.7 | % | 33.9 | % | 35.6 | % |
|------|---|------|---|------|---|------|---|

The provision for income taxes for the six and three months ended October 31, 2014 differed from the provision recorded in the same periods of fiscal year 2014 due primarily to varying effective tax rates. The effective tax rate is impacted by pre-tax income or loss recorded at the Company's foreign subsidiaries for which no net tax provision or benefit is recognized. During the quarter ended October 31, 2014, such subsidiaries recorded a combined pretax profit but for the six-month period then ended, recorded a combined pretax loss. For the full fiscal year 2015, the effective tax rate is expected to be in the range of 30% to 36% depending on the level of pretax income or loss recorded at the Company's foreign subsidiaries.



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## FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

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As of October 31, 2014 and April 30, 2014, the remaining deferred tax asset valuation allowance is approximately \$2.1 million.

The Company is subject to taxation in several countries as well as the states of New York, New Jersey and California. The statutory federal rates are 34% in the United States and Belgium. The effective rate is impacted by the income or loss of certain of the Company's European and Asian subsidiaries for which no tax benefit is currently available. In addition, the Company utilizes the availability of research and development tax credits ("R&D Credit") and the Domestic Production Activity credit in the United States to lower its tax rate. The R&D Credit expired on December 31, 2013 and the U.S. Congress has yet to reinstate it. As of April 30, 2014, the Company's European subsidiaries had available net operating loss carryforwards of approximately \$3.6 million, which will offset future taxable income. As a result of the FEI-Elcom acquisition, the Company has a federal net operating loss carryforward of \$5.6 million that may be applied in annually limited amounts to offset future U.S.-sourced taxable income over the next 18 years.

## Net income

| Six months                |          |               | Three months |          |                |
|---------------------------|----------|---------------|--------------|----------|----------------|
| Periods ended October 31, |          |               |              |          |                |
| 2014                      | 2013     | Change        | 2014         | 2013     | Change         |
| \$ 2,008                  | \$ 2,067 | \$ (59) (3 %) | \$ 1,289     | \$ 1,391 | \$ (102) (7 %) |

As detailed above, operating profit was higher in the fiscal year 2015 periods while other income was higher in the fiscal year 2014 periods. This resulted in similar pretax income and provisions for income taxes for both fiscal years resulting in nominal differences in net income between the comparable fiscal periods. Based on recent bookings and its backlog, the Company expects to record higher consolidated revenues and to realize improved gross margins and operating profits over the remainder of fiscal year 2015.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's balance sheet continues to reflect a strong working capital position of \$79.8 million at October 31, 2014, compared to working capital of \$78.2 million at April 30, 2014. Included in working capital at October 31, 2014 is \$20.2 million consisting of cash, cash equivalents and marketable securities. The Company's current ratio at October 31, 2014 is 8.7 to 1.

For the six months ended October 31, 2014 and 2013, the Company used cash from operations in the amount of \$2.5 million each fiscal period. In both fiscal years the reduced cash resulted primarily from increased accounts receivables and increased inventory. For the six-month periods ended October 31, 2014 and 2013, the Company incurred approximately \$2.3 million and \$2.8 million, respectively, of non-cash operating expenses, such as depreciation and amortization and accruals for employee benefit programs. Net income in fiscal year 2014 also included a \$736,000 gain on the sale of equipment and such gain is excluded from operating cash flow. For the balance of fiscal year 2015, as receivables are billed and collected, the Company expects to generate positive cash flow from operating activities.

Net cash used in investing activities for the six months ended October 31, 2014, was \$408,000 compared to \$1.1 million used in the same period of fiscal year 2014. During the fiscal year 2015 period, marketable securities were sold or redeemed in the amount of \$4.1 million compared to \$1.8 million of such redemptions during the fiscal year

2014 period. Some of these proceeds and other cash were reinvested in additional marketable securities for the periods ended October 31, 2014 and 2013 in the amount of \$1.4 million and \$67,000, respectively. In the fiscal periods ended October 31, 2014 and 2013, the Company acquired property, plant and equipment in the amount of approximately \$3.1 million and \$2.8 million, respectively. The Company may continue to invest cash equivalents in longer-term securities or to convert short-term investments to cash equivalents as dictated by its investment and acquisition strategies. The Company will continue to acquire more efficient equipment to automate its production process. The Company intends to spend between \$4.0 million and \$4.5 million on capital equipment during fiscal year 2015. Internally generated cash or additional borrowings under the Company's credit facility will be used to acquire this level of capital equipment.

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
(Continued)

Net cash provided by financing activities for the six months ended October 31, 2014 and 2013 was \$1.3 million and \$4.2 million, respectively. In the fiscal year 2015 period, the Company borrowed \$2.3 million under its credit facility with a bank and also repaid \$1.0 million of such borrowings. During the fiscal year 2014 period, the Company borrowed \$4.1 million under the credit facility. In both fiscal years, such funds were used for working capital and to finance the acquisition of certain fixed assets. For the six months ended October 31, 2014 and 2013, the Company realized \$29,000 and \$157,000, respectively, from the tax benefits arising from the exercise of stock-based awards. During fiscal year 2014, the Company made payments of \$15,000 against capital lease obligations.

The Company has been authorized by its Board of Directors to repurchase up to \$5 million worth of shares of its common stock for treasury whenever appropriate opportunities arise but it has neither a formal repurchase plan nor commitments to purchase additional shares in the future. As of October 31, 2014, the Company has repurchased approximately \$4 million of its common stock out of the \$5 million authorization.

The Company will continue to expend resources to develop, improve and acquire products for space applications, guidance and targeting systems, and communication systems which management believes will result in future growth and continued profitability. During fiscal year 2015, the Company intends to make a substantial investment of capital and technical resources to develop and acquire new products to meet the needs of the U.S. Government, commercial space and network infrastructure marketplaces and to invest in more efficient product designs and manufacturing procedures. Where possible, the Company will secure partial customer funding for such development efforts but is targeting to spend its own funds at a rate of less than 10% of revenues to achieve its development goals. Internally generated cash will be adequate to fund these development efforts. The Company may also pursue acquisitions to expand its range of products and may use internally generated cash and external funding in connection with such acquisitions.

As of October 31, 2014, the Company's consolidated funded backlog is approximately \$52 million compared to \$48 million at April 30, 2014, the end of fiscal year 2014. Approximately 70% of this backlog is expected to be realized in the next twelve months. Included in the backlog at October 31, 2014 is approximately \$2 million under cost-plus-fee contracts which the Company believes represent firm commitments from its customers for which the Company has not received full funding to-date. The Company excludes from backlog any contracts or awards for which it has not received authorization to proceed and on fixed price contracts excludes any unfunded portion. The Company expects these contracts to become fully funded over time and will add to its backlog at that time.

The Company believes that its liquidity is adequate to meet its operating and investment needs through at least October 31, 2015.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements, other than operating leases, that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES  
(Continued)

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

**Disclosure Controls and Procedures.** The Company's management, with the participation of the Company's chief executive officer and chief financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based on their evaluation, the Company's chief executive officer and chief financial officer have concluded that, as of October 31, 2014, the Company's disclosure controls and procedures were effective to ensure that information relating to the Company, including its consolidated subsidiaries, required to be included in its reports that it filed or submitted under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

**Changes in Internal Control Over Financial Reporting.** There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the six months ended October 31, 2014 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 6. Exhibits

31.1 - Certification by the Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 - Certification by the Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 - Certifications by the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 - The following materials from the Frequency Electronics, Inc. Quarterly Report on Form 10-Q for the quarter ended October 31, 2014 formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Income and Comprehensive Income, (iii) Condensed Consolidated Statements of Cash Flows and (iv) Notes to Condensed Consolidated Financial Statements

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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.

FREQUENCY ELECTRONICS, INC.  
(Registrant)

Date: December 15, 2014

BY /s/ Alan

Miller

Alan Miller

Chief Financial Officer and Treasurer

Signing on behalf of the registrant and as principal financial officer

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