FREQUENCY ELECTRONICS INC
Form 10-K
July 31, 2017

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

FORM 10-K

(Mark one)

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

For the Fiscal Year ended April 30, 2017

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

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

Title of each class	Name of each exchange on which registered
Common Stock (par value $1.00 per share)	NASDAQ Global Market

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

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 (Do not check if a smaller reporting company)	Smaller Reporting Company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of voting stock held by non-affiliates of the Registrant as of October 31, 2016 - $45,300,000

The number of shares outstanding of Registrant's Common Stock, par value $1.00 as of July 25, 2017 – 8,729,682

DOCUMENTS INCORPORATED BY REFERENCE: PART III incorporates information by reference from the definitive proxy statement to be filed for the Annual Meeting of Stockholders to be held on or about November 8, 2017.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

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PART I

Item 1. Business

GENERAL DISCUSSION

Frequency Electronics, Inc. (sometimes referred to as “Registrant”, “Frequency Electronics” or the “Company”) is a world leader in precision time and frequency generation technology, which is employed in commercial and Government Satellite Payload systems, Secure Communications, Command, Control, Communication, Computer, Intelligence, Security and Reconnaissance (“C4ISR”), and EW (Electronic Warfare) systems. Its technology is used for a wide range of terrestrial and space applications.

Unless the context indicates otherwise, references to the Registrant or the Company are to Frequency Electronics, Inc. and its subsidiaries. References to “FEI” are to the parent company alone and do not refer to any of the subsidiaries. Frequency Electronics, a Delaware corporation, has its principal executive office at 55 Charles Lindbergh Boulevard, Mitchel Field, New York 11553. Its telephone number is 516-794-4500 and its website is www.frequencyelectronics.com.

Frequency Electronics was founded in 1961 as a research and development firm generating proprietary precision time and frequency technology primarily under contracts for end-use by the United States (“U.S.”) Government. In the mid-1990’s, the Company evolved into a designer, developer and manufacturer of state-of-the-art products for both commercial and government end-use. The Company’s present mission is to be the world leader in providing precision time and low phase noise frequency generation systems, from 1 Hz to 46 GHz for space and other challenging environments. The Company’s technology is the key element in enhancing the functionality and performance of many electronic systems.

MARKETS

The Company’s dominant end markets are satellite payloads and precision time for terrestrial secure communications and command and control.

For the satellite market, the Company has a unique legacy of providing master timing systems, power converters, and frequency generation, synthesis and distribution systems. It is currently addressing new opportunities in frequency converters and receivers, representing a potential for a significant increase in the revenue for FEI products on any one satellite. These products support primary and hosted payloads for both commercial and U.S. Government end-use. Currently, approximately one thousand satellites with varying remaining years of useful life are operating in High/Geostationary, Medium and Low Earth Orbits. This number of operational satellites with emphasis on high-throughput is expected to continue to grow over the next ten years as many new satellites are added and older ones are replaced. Furthermore, the U.S. Government is expected to issue a competitive request for proposals for twenty-two additional satellites for the GPS III constellation, and the Company is well positioned to participate via prime contractors with its high-precision digital atomic frequency standard.

For the terrestrial secure communications and command and control market, the Company’s products support multiple C4ISR counter measures and EW applications for the U.S. Government on land, sea and air-borne platforms. Recently identified threats to the communication capabilities of U.S. Government facilities through jamming, multi-path or “spoofing” GPS signals may be mitigated by the Company’s technologies. In addition, similar types of threats to the public and enterprise networks have been identified by the Department of Homeland Security. The Company’s high precision, ruggedized clocks combined with specialized software are essential for communication and operational security.

To address these markets, the Company has several corporate entities which operate under two reportable segments primarily based on the geographic locations of its subsidiaries.

Frequency Electronics has made a strategic decision to concentrate its focus on two of its major business areas, satellite payloads and secure communications, because these two business areas represent unprecedented opportunities for growth in comparison to both domestic and foreign opportunities looking ahead in the Company's wire line network infrastructure business. The Company believes it should allocate the full measure of its resources on its FEI-NY and FEI-Zyfer segments in which the satellite payload and secure communications revenues are generated. Accordingly, the Company has determined to divest Gillam-FEI s.a. ("Gillam"), FEI's heretofore third reportable segment. Gillam is a wholly owned foreign (Belgium) subsidiary of FEI, which develops and manufactures network infrastructure products.

In December 2016, the Company entered into a contingent share purchase agreement with certain foreign parties with respect to a potential sale of Gillam. However, these parties have not yet performed their obligations under that agreement, and the Company continues to negotiate with these parties with respect to a potential sale. Subsequently, in April 2017, the Company decided to sell its Gillam business in any event as soon as practicable. The Company is currently in discussions with a number of potential buyers and believes that the divestment of Gillam is on a path to completion by the end of fiscal year 2018. Accordingly, the Company determined that the assets and liabilities of this reportable segment met the discontinued operations criteria set forth in Accounting Standards Codification 205-20-45 in the quarter ended April 30, 2017. As such Gillam's results have been classified as discontinued operations in the accompanying Consolidated Statements of Operations and Comprehensive (Loss) Income.

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1. FEI-NY The Company’s satellite payload products for U.S. Government and commercial satellite programs are designed, developed and manufactured at its Long Island, New York facility. At this location, the Company also applies its technology and legacy to products for the U.S. military and other U.S. Government agencies, as well as products for certain terrestrial commercial communications and other industrial applications.

Frequency Electronics, Inc. Asia (“FEI-Asia”) was established in fiscal year 2002 as a wholly-owned subsidiary, to be the Company’s Asia-based low-cost manufacturer of certain commercial communications products used primarily in the wireless and wireline markets as well as power grids. FEI-Asia is located in the Free-Trade Zone in Tianjin, China.

The Company’s subsidiary, FEI-Elcom Tech, Inc. (“FEI-Elcom”) designs and manufactures Radio Frequency (“RF”) microwave modules, devices and subsystems up to 46 GHz including fast switching, ultra-low phase noise synthesizers, up-down converters, receivers, tuners, ceramic resonant oscillators and dielectric resonant oscillators. These instruments and components are mission critical for multiple applications in the EW market, including SATCOM communication, surveillance, signal intelligence (COMINT, MASINT and ELINT), threat simulation, electronic attack (EA) and electronic prevention (EP) systems. FEI-Elcom’s RF microwave technology has also been utilized to develop new products for application in the Company’s satellite payload end market. We continue to right-size the FEI-NY subsidiary in response to the end market weakness while at the same time best positioning FEI to capture the eventual recovery in business. These actions have had to include headcount reductions, however, we are ensuring that these reductions will have no effect on the Company’s ability to provide on time delivery for present contractual obligations and to fully achieve its internal research and development objectives. We are also implementing a variety of improved operating disciplines that should prove to optimize the organization allowing the company to generate larger margins and enhanced inventory turns when our satellite end markets recover. We are working to consolidate certain of FEI-Elcom’s capabilities with other FEI-NY operations in an effort to reduce costs and improve working capital management. This should have the collateral benefit of providing engineering efficiencies and better customer coverage.

2. FEI-Zyfer - Precision time for terrestrial secure communications and command and control, and frequency products that incorporate global positioning systems (“GPS”) technology are manufactured by the Company’s subsidiary FEI-Zyfer, Inc. (“FEI-Zyfer”). FEI-Zyfer’s GPS capability complements the Company’s existing technologies and permits the combined entities to provide a broader range of embedded systems for a variety of timing functions and anti-spoofing (“SAASM”) applications.

For additional information about these reportable segments, see “Item 1. Business – Reportable Segments and Products.”

In addition to its subsidiaries, the Company made a strategic investment in and licensed certain technology to Morion, Inc. (“Morion”), a Russian crystal oscillator manufacturer located in St. Petersburg, Russia. The Company’s relationship with Morion, which includes ownership of 4.6% of the outstanding shares of Morion’s common stock, permits the Company to secure a cost-effective source for high precision quartz resonators and crystal oscillators. The Morion investment is accounted for under the cost method. For more information regarding the Company’s investment in Morion, see Note 10 to Consolidated Financial Statements.

REPORTABLE SEGMENTS AND PRODUCTS

The Company operates under two reportable segments, primarily aligned with the geographical locations of its subsidiaries: (1) FEI-NY and (2) FEI-Zyfer. Within each segment the Company designs, develops, manufactures and markets precision time and frequency control products for different markets as described below. The Company’s Chief Executive Officer measures segment performance based on total revenues and profits generated by each geographic center rather than on the specific types of customers or end-users. Consequently, the Company determined that the segments indicated above appropriately reflect the way the Company's management views the business. The FEI-NY segment, which operates out of the Company's Long Island, New York headquarters facility, also includes the operations of the Company's wholly-owned subsidiaries, FEI-Asia and FEI-Elcom. FEI-Asia functions as a manufacturing facility for FEI-NY and FEI-Zyfer with historically minimal sales to outside customers. Beginning in late fiscal year 2014 thru fiscal 2016, FEI-Asia increased shipments of product to third parties as a contract manufacturer. Subsequently such third party sales declined to prior nominal levels. FEI-Elcom, in addition to its own product line, provides design and technical support for the FEI-NY segment's satellite business. The products manufactured by the FEI-NY segment are principally marketed to the commercial and U.S. Government satellite markets, to other U.S. Department of Defense ("DOD") programs and to wireless communications networks. The primary business of the FEI-Zyfer segment, which operates out of California, is the design and manufacture of products which incorporate GPS technologies and rugged high-precision-clocks that are designed and manufactured at FEI-NY. FEI-Zyfer sells its products to both commercial and U.S. Government customers and collaborates with FEI-NY on joint product development activities.

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During fiscal years 2017 and 2016, approximately 78% and 80%, respectively, of the Company's consolidated revenues were from products sold by the FEI-NY segment. In fiscal years 2017 and 2016, sales for the FEI-Zyfer segment were 30% and 22% of consolidated revenues, respectively. (The sum of annual sales percentages exceeds 100% due to intersegment sales.)

Consolidated revenues include sales to end-users in countries located outside of the U.S, primarily in Europe and China. During fiscal years 2017 and 2016, foreign sales comprised 9% and 12%, respectively, of consolidated revenues. For segment information, see Note 14 to the Consolidated Financial Statements.

FEI-NY segment:

The Company provides precision time, frequency generation and synchronization products and subsystems that are found on-board satellites, in ground-based communication stations, and imbedded in moving platforms operated by the U.S. military. The Company has made a substantial investment in research and development to apply its core technologies to satellite payloads, non-space DOD programs and commercial and industrial markets. Revenues from satellite payloads, both for commercial and U.S. Government applications have increased in recent years while the portion of network infrastructure sales was reduced. The Company expects to continue to generate substantial revenues from deployment of new and replacement satellites and other U.S. Government/DOD applications including sales of ruggedized subsystems for moving platforms of the U.S. military.

Satellite Payloads

The use of satellites launched for communications, navigation, weather forecasting, video and data transmissions and Internet access has expanded the need to transmit increasing amounts of voice, video, and data to earth-based receivers. This requires more precise timing and frequency control at the satellite. The Company manufactures the master timing systems (quartz, rubidium and cesium) and other significant timing and frequency generation products for communication satellites, and many of the Company's other space assemblies are used onboard spacecraft for command, control and power distribution. Efficient and reliable DC-DC power converters are also manufactured for the Company's own assemblies and as stand-alone products for space applications. The Company's oven-controlled quartz crystal oscillators are cost-effective precision clocks suited for high-end performance required in satellite transmissions, airborne telephony and geophysical survey positioning systems. Newly developed and upgraded frequency generators, synthesizers, and up/down converters and receivers have augmented the Company's product offerings and positioned the Company to provide a greater share of a typical satellite's payload. Commercial satellite programs which utilize the Company's space-qualified products include Iridium NEXT Constellation, Intelsat EPIC, O3B, WAAS, MexSat, MSV, ICO, TerreStar, EchoStar, Inmarsat and numerous others. The Company is also positioned to participate in certain large constellations being planned for the very near future that will operate in low or mid earth orbits such as the O3B Next Generation Constellation and the LeoSat constellation that consists of up to 108 satellites.

In the years ahead, the Company expects that the U.S. DOD will require more secure communication capabilities, more assets in space and greater bandwidth. The Global Positioning Satellite System (GPS), the MILSTAR Satellite System and the AEHF Satellite System are examples of the programs in which the Company participates - programs which management believes are important to the success of the U.S. Government's security, communication and intelligence needs. The Company has manufactured the master clock for the Trident missile, the basic timing system for the Voyager I and Voyager II deep space exploratory missions and the quartz timing system for the Space Shuttle. The Company's product offerings for U.S. Government satellite programs are similar in design and function to those used on commercial satellites, as described above.

U.S. Government- Non-space:

In addition to space-based programs, the Company's proprietary products have been used in airborne and ground-based guidance, navigation, communications, radar, sonar surveillance and electronic countermeasure and timing systems. The Company has developed and patented a low g-sensitivity (gravity) technology which offers a 100-fold improvement in performance under shock, vibration and other environmental effects. Products are built in accordance with DOD standards and are in use on many of the U.S. Government's important military applications. The Company anticipates that adequate funds will be provided by the U.S. Government to ensure that these programs are sustained.

FEI-Elcom designs and manufactures Radio Frequency (RF) microwave modules and subsystems up to 46 GHz including fast switching, ultra-low phase noise synthesizers, up-down converters, receivers, tuners, ceramic resonant oscillators and dielectric resonant oscillators. These instruments and components are mission critical for multiple applications in the EW market, including SATCOM communication, surveillance, signal intelligence (COMINT, MASINT, and ELINT), threat simulation, electronic attack (EA) and electronic prevention (EP) systems.

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

As indicated above, many of the programs and platforms for which the Company supplies products and systems, are used by the U.S. Government for maintaining secure communications world-wide, for obtaining vital intelligence and for enabling precision targeting capabilities. It is the belief of management that the future success of the mission of the U.S. military and intelligence gathering community is dependent on successful and timely deployment of these systems. Thus, the Company anticipates that adequate funds will be provided by the U.S. Government to ensure that the programs are completed. The Company's experience indicates that some programs or product sales have been slowed or delayed due to U.S. Government spending constraints.

Recently the Company has also received several cost-plus-fee contracts under U.S. Government programs. Under these contracts, the Company may be able to recover all of its direct and indirect costs related to the programs plus a pre-determined fee. In the event of substantial cost overruns, the fee may be reduced.

Negotiations on U.S. Government contracts are sometimes based in part on Certificates of Current Costs. An inaccuracy in such certificates may entitle the government to an appropriate recovery. The Company's accounts with respect to these contracts are subject to audit by the Defense Contracts Audit Agency ("DCAA"). Frequency's last full incurred cost audit was performed in 2008. The Company is required to submit for subsequent review an incurred cost report by October 31, for each year then ended. All such required reports have been filed with no adverse comment to date.

In connection with a large anticipated Cost Plus fixed fee contract, the DCAA has initiated an Accounting System Audit which upon successful completion would for the first time enable Frequency to enter into cost plus contracts with certain Government agencies directly without intermediary contractors, which would further enable the Company to take advantage of future opportunities. The Company knows of no reason to expect other than a quick and favorable Audit result.

All U.S. Government end-use contracts are subject to termination by the purchaser for the convenience of the U.S. Government and are subject to various other provisions for the protection of the U.S. Government. In the event of such termination, the Company is entitled to receive compensation as provided under such contracts and in the applicable U.S. Government regulations. There were no end-use contracts terminated for the year ended April 30, 2017.

FEI-Zyfer segment:

FEI-Zyfer designs, develops and manufactures products for precision time and frequency generation and synchronization, primarily incorporating GPS technology. FEI-Zyfer's products make use of both "in-the-clear" civil and "crypto-secured" military signals from GPS. In most cases, FEI-Zyfer's products are integrated into communications systems, computer networks, test equipment, and military command and control terminals for ground and satellite link applications. More than 85% of revenues are derived from sales where the end user is the U.S. Government. FEI-Zyfer's products are an important extension of FEI's core product line, specifically in the area of GPS capabilities and precision time for terrestrial secure communications and command and control. Recently identified threats to the communication capabilities of U.S. Government facilities and to the public and enterprise networks through jamming, multi-path or "spoofing" GPS signals may be mitigated by FEI-Zyfer's technologies and products. High precision, ruggedized clocks combined with specialized software are essential for communication and operational security.

BACKLOG

As of April 30, 2017, the Company's consolidated backlog amounted to approximately $28 million compared to approximately $30 million at the end of the prior fiscal year. Approximately 80% of the current backlog is expected to be filled during the Company's fiscal year ending April 30, 2018. As of April 30, 2017, there are no amounts included in backlog under cost-plus fee contracts that have not been funded. The Company excludes from backlog those contracts or awards for which it has not received authorization to proceed. On fixed price contracts, the Company excludes unfunded portion. The Company expects any partially funded contracts to become fully funded over time and will add the additional funding to its backlog at that time. The backlog is subject to change by reason of several factors including possible cancellation of orders, change orders, terms of the contracts and other factors beyond the Company's control. Accordingly, the backlog is not necessarily indicative of the revenues or profits (losses) which may be realized when the results of such contracts are reported.

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CUSTOMERS AND SUPPLIERS

The Company markets its products both directly and through independent sales representative organizations located in the U.S., Europe and Asia. Sales to non-U.S. end-users, totaled approximately 9% and 12%, respectively, of net revenues in fiscal years 2017 and 2016.

The Company's products are sold to both commercial and governmental customers. For the years ended April 30, 2017 and 2016, approximately 59% and 65%, respectively, of the Company's sales were made under contracts to the U.S. Government or subcontracts for U.S. Government end-use.

During fiscal year 2017, Lockheed Martin Corporation ("Lockheed"), Northrop Grumman Corporation ("Northrop"), and Thales Alenia Space ("Thales"), each accounted for more than 10% of FEI-NY segment revenues; additionally, Lockheed and Northrop also each accounted for more than 10% of consolidated revenues. During fiscal year 2016, Boeing Corporation ("Boeing"), Lockheed, Northrop and Space and Intelligence Systems/Harris Corporation ("Harris"), each accounted for more than 10% of FEI-NY segment revenues; additionally, Boeing and Lockheed also each accounted for more than 10% of consolidated revenues.

During fiscal year 2017, Raytheon Company ("Raytheon") was a major customer of the FEI-Zyfer segment, accounting for more than 10% of the segment's revenues; additionally, Raytheon also accounted for more than 10% of consolidated revenues. During fiscal year 2016, Copper River Information Technology and Raytheon were major customers of the FEI-Zyfer segment, each accounting for more than 10% of the segment's revenues.

The loss by the Company of any one of these customers could have a material adverse effect on the Company's business. The Company believes its relationship with these companies to be mutually satisfactory and is not aware of any prospect for the cancellation or significant reduction of any of its commercial or existing U.S. Government contracts.

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

RESEARCH AND DEVELOPMENT

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

The Company continues to focus a significant portion of its own resources and efforts on developing hardware for satellite (commercial and U.S. Government) and terrestrial commercial communications systems, including wireless and GPS-related systems. During fiscal years 2017 and 2016, the Company expended $6.9 million and $5.4 million of its own funds, respectively, on such research and development activity. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." Additionally, the Company receives customer funding for specific R&D projects, and anticipates additional funding from customers for future R&D initiatives. During fiscal years 2017 and 2016, some of the Company's development resources were applied to certain cost-plus-fee contracts and the design-stage of fixed-price satellite payload programs. For fiscal year 2018 the resources to be allocated to research and development will depend on market conditions and identification of new opportunities, as was the case in fiscal 2017.

PATENTS AND LICENSES

The Company believes that its business is generally not dependent on patent or license protection. Rather, it is primarily dependent upon the Company's technical competence, the quality of its products and its prompt and responsible contract performance. However, employees working for the Company assign all rights to inventions to the Company and the Company presently holds such patents and licenses. In certain limited circumstances, the U.S. Government may use or permit the use by the Company's competitors of certain patents or licenses the government has funded. During fiscal year 2003, the Company received a broad and significant patent for, proprietary quartz oscillator technology which the Company intends to exploit in both legacy and new applications. In 2006, the Company obtained a basic patent for its low g-sensitivity technology which management believes will permit greatly enhanced performance of devices on moving platforms and under externally imposed shock or vibration.

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COMPETITION

The Company experiences competition in all areas of its business. Many of the Company's competitors are larger, have greater financial resources and have larger research and development and marketing staffs. The Company has a strong history of competing successfully in this environment due to the quality, reliability and outstanding record of performance its products have achieved. The Company competes primarily on the basis of the accuracy, performance and reliability of its products, the ability of its products to function under severe conditions, such as in space or in other extremely hostile environments, and the Company's track record of prompt and responsive contract performance and technical competence. The Company has unique and broad capabilities which includes quartz, rubidium, and cesium-based timing references and specialized RF microwave technology. With respect to very high precision products, the Company encounters fewer competitors than it does for lower precision products for which there are a significant number of suppliers.

The Company's principal competition for space products is the in-house capability of its major customers such as Boeing, Northrop, Lockheed Martin and Space Systems Loral as well as a number of other firms capable of providing high-reliability microwave frequency generators. With respect to non-space products, such as systems for precision time for terrestrial secure communication and command and control, and products for multiple applications in the EW market, the Company competes with large domestic companies such as Microsemi Corporation, Vectron, Inc., a division of Dover Corp., and Mercury Systems.

The Company has successfully outsourced certain manufacturing processes to third parties and to its wholly-owned subsidiary, FEI-Asia in Tianjin, China and to Russia-based Morion, in which the Company is a minority shareholder. The Company conducts this outsourcing to maintain a competitive position on cost while adhering to its high quality standards. The Company believes its ability to obtain raw materials, manufacture finished products, integrate them into systems and sub-systems and interface these systems with highly sophisticated end-user applications provides a strong competitive edge.

EMPLOYEES

The Company employs approximately 320 full-time persons worldwide. None of the U.S. or Chinese employees are represented by labor unions.

OTHER ASPECTS

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

EXECUTIVE OFFICERS OF THE COMPANY

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

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

Martin B. Bloch	-	President, Chief Executive Officer and Director
Markus Hechler	-	Executive Vice President, President of FEI Government Systems, Inc. and Secretary and Treasurer

Oleandro Mancini	-	Senior Vice President, Business Development
Steven Strang	-	President, FEI-Zyfer
James Davis	-	President, FEI-Elcom Tech
Thomas McClelland	-	Vice President, Advanced Development
Adrian Lalicata	-	Vice President, RF & Microwave Systems
Steven L. Bernstein	-	Chief Financial Officer

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Martin B. Bloch, age 81, has been a Director of the Company and of its predecessor since 1961. Mr. Bloch is the Company's President and Chief Executive Officer and has held such positions since inception of the Company, except for the period from December 1993 through October 1998 when General Franklin held the CEO position. Previous to forming the Company, Mr. Bloch served as chief electronics engineer of the Electronics Division of Bulova Watch Company.

Markus Hechler, age 71, joined the Company in 1967. He was elected to the position of Executive Vice President in February 1999, prior to which he served as Vice President, Manufacturing since 1982. In October 2001, he was named President of the Company's subsidiary, FEI Government Systems, Inc. He has served as Assistant Secretary since 1978, and in April 2016 was appointed Secretary and Treasurer.

Oleandro Mancini, age 68, joined the Company in August 2000 as Vice President, Business Development and was promoted to Senior Vice President in 2010. Prior to joining the Company, Mr. Mancini served from 1998 as Vice President, Sales and Marketing at Satellite Transmission Systems, Inc. and from 1995 to 1998 as Vice President, Business Development at Cardion, Inc., a Siemens A.G. company. From 1987 to 1995, he held the position of Vice President, Engineering at Cardion, Inc.

Steven Strang, age 53, was named President of FEI-Zyfer, Inc., effective May 1, 2005. Previously, Mr. Strang was Executive Vice President of this subsidiary and its predecessor companies where he has served for 20 years in various technical and management positions.

James Davis, age 64, is the President of FEI-Elcom Tech, Inc. which the Company acquired in February 2012. Mr. Davis was named an officer of the Company in October 2013. Mr. Davis became the president of Elcom Technologies, Inc., the pre-acquisition company, on September 20, 2007. Prior to joining FEI-Elcom, Mr. Davis held leadership positions at other technology companies including General Manager of Hewlett Packard's (Agilent) Semiconductor Systems Center, Vice President and General Manager of Schlumberger Technologies N.A. and Vice President and General Manager of Gretag Macbeth LLC. Mr. Davis also held the rank of Captain as a U.S. Army Special Forces Team Commander.

Thomas McClelland, age 62, joined the Company as an engineer in 1984 and was elected Vice President, Commercial Products in March 1999. In fiscal year 2011, Mr. McClelland's title was modified to Vice President Advanced Development to describe his expanded role in the Company.

Adrian Lalicata, age 70, joined the Company in 2006 as Vice President, RF & Microwave Systems. Prior to joining the Company, Mr. Lalicata served as Vice President of Engineering at Herley-CTI and Communication Techniques, a Dover Company. Mr. Lalicata has served as Director of Engineering at Microphase Corp. and Adcomm, Inc. He also held leading engineering positions at Loral Electronic Systems, Cardion Electronics, and Airborne Instruments Laboratories.

Steven L. Bernstein, age 52, joined the Company in April 2010 as its Controller and was appointed to the position of Chief Financial Officer in April 2016. Prior to joining the Company, Mr. Bernstein worked in the North America accounting group of a Fortune 500 electronics distributor.

Item 1A. Risk Factors

This item is not required for smaller reporting companies.

Item 1B. Unresolved Staff Comments

This item is not required for smaller reporting companies.

Item 2. Properties

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

Location	Size (sq. ft.)	Own or Lease
Long Island, NY	93,000	Lease
Garden Grove, CA	27,850	Lease
Tianjin, China	28,000	Lease
Rockleigh, NJ	32,000	Lease

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

The Company leased its manufacturing and office space from Reckson under an initial 11-year lease followed by two five-year renewal periods. The Company is currently in the second 5-year renewal period paying annual rent of $800,000 per year plus it's pro rata share of real estate taxes and the costs of utilities and insurance. The lease will end in January 2019. The leased space is adequate to meet the Company's domestic operational needs which encompass the principal operations of the FEI-NY segment and also serves as the Company's world-wide corporate headquarters.

The Garden Grove, California facility is leased by the Company's subsidiary, FEI-Zyfer, Inc. The facility consists of a combination office and manufacturing space. The lease, which expires in August 2017, currently requires monthly payments of approximately $31,200 and will remain constant over the remaining 4 months of the lease term. The Company has signed a second amendment to the lease, which extends the lease an additional 88 months, beginning October 1, 2017 and expiring January 31, 2025. The average annual rent over the period of the amendment is approximately $332,000.

The Tianjin, China facility is the location of the Company's wholly-owned subsidiary, FEI-Asia. The subsidiary's office and manufacturing facility is located in the Tianjin Free-Trade Zone. The lease is renewable annually with monthly rent of $1,000 through May 2018. The facility is adequate for the near-term manufacturing expectations for the Company.

FEI-Elcom operates out of a leased facility located in Rockleigh, New Jersey. The facility consists of a combination office and manufacturing space. The lease, which expires in March 2018, requires monthly payments of $39,900.

Item 3. Legal Proceedings

From time to time, the Company is a defendant in litigation arising out of the ordinary course of business. As of July 31, 2017, the Company is not a party to any material, pending legal proceeding other than routine litigation incidental to its business.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Common Stock of the Company is listed on The Nasdaq Global Market ("NASDAQ") under the ticker symbol "FEIM." The following table shows the high and low sale price for the Company's Common Stock for the quarters indicated, as reported on the NASDAQ.

FISCAL QUARTER	HIGH SALE	LOW SALE
2017–		
FIRST QUARTER	$11.99	$8.60
SECOND QUARTER	11.99	9.05
THIRD QUARTER	11.24	9.00
FOURTH QUARTER	11.50	10.29
2016 –		
FIRST QUARTER	$13.42	$10.33
SECOND QUARTER	11.46	9.95
THIRD QUARTER	11.28	8.51
FOURTH QUARTER	11.00	8.83

As of July 25, 2017, the approximate number of holders of record of common stock was 655. The closing share price of the Company's stock on April 30, 2017 was $10.50. The closing share price of the Company's stock on July 25, 2017 was $8.70.

DIVIDEND POLICY

The Board of Directors reviews the Company's dividend policy at each regular meeting. No dividends were declared or paid during fiscal years 2017 and 2016.

STOCK BUYBACK PROGRAM

In March 2005, the Company's Board of Directors authorized a stock repurchase program for up to $5 million of the Company's outstanding common stock. This program does not have an expiration date. Shares may be purchased in open market purchases, private transactions or otherwise at such times and from time to time, and at such prices and in such amounts as the Company believes appropriate and in the best interests of its shareholders. The timing and volume of repurchases will vary depending on market conditions and other factors. Purchases may be commenced or suspended at any time without notice. During fiscal year 2009, the Company repurchased 724,632 shares under the buyback program, including a block purchase of 615,000 shares from its former largest institutional shareholder. The average purchase price was $4.29 per share or an aggregate amount of approximately $3.1 million. With these purchases, the Company has acquired approximately $4 million of its common stock out of the total authorization of $5 million. The Company did not make any purchases of stock for the treasury during fiscal years 2017 or 2016.

EQUITY COMPENSATION PLAN INFORMATION

Number of securities to	Weighted-average exercise price of	Number of securities

Plan Category	be issued upon exercise of outstanding options warrants and rights	outstanding options warrants and rights	remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity Compensation Plans Approved by Security Holders (1)	1,642,625	$ 8.97	18,563

(1) The Company's equity compensation plans are described in Note 12 to the Consolidated Financial Statements.

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Item 6. Selected Financial Data

This item is not required for smaller reporting companies.

Item 7. 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 Annual Report on Form 10-K regarding future earnings and operations and other statements relating to the future constitute "forward-looking" statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to, inability to integrate operations and personnel, actions by significant customers or competitors, general domestic and international economic conditions, consumer spending trends, reliance on key customers, 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, the availability of capital, and the outcome of any litigation and arbitration proceedings. The factors listed above are not exhaustive. Other sections of this Form 10-K include additional factors that could materially and adversely impact the Company's business, financial condition and results of operations. Moreover, the Company operates in a very competitive and rapidly changing environment. New factors emerge from time to time and it is not possible for management to predict the impact of all these factors on the Company's business, financial condition or results of operations or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not rely on forward-looking statements as a prediction of actual results. Any or all of the forward-looking statements contained in this Form 10-K and any other public statement made by the Company or its management may turn out to be incorrect. The Company expressly disclaims any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 1 to the Consolidated Financial Statements. The Company believes its most critical accounting policies to be the recognition of revenue and costs on production contracts and the valuation of inventory. Each of these areas requires the Company to make use of reasonable 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 the full amount of 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 FEI-Zyfer segment 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.

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Costs and Expenses

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

Inventory

In accordance with industry practice, inventoried costs contain amounts relating to contracts and programs with long production cycles, a portion of which will not be realized within one year. Inventory write downs are established for slow-moving materials, 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.

Income taxes

Our income tax expense, deferred tax asset and liabilities, and liabilities for unrecognized tax benefits reflect management's best estimate of current and future taxes to be paid. We are subject to tax in the United States and foreign jurisdictions. Significant judgments and estimates are required in the determination of the consolidated income tax expense.

Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, which will result in taxable or deductible amounts in the future. In evaluating our ability to recover deferred tax assets in the jurisdiction from which they arise, we consider all positive and negative evidence, including the reversal of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. The carrying value of the Company's net deferred tax assets, assumes that the Company will be able to generate sufficient future taxable income in certain jurisdictions, based on estimates and assumptions. If these estimates and assumptions change in the future, the Company may be required to record an additional valuation allowances against its deferred tax assets resulting in additional income tax expense in the consolidated statement of operations, or conversely to further reduce its existing valuation allowance resulting in less income tax expense. The Company evaluates the realizability of deferred tax assets quarterly and assesses the need for additional valuation allowance quarterly. Tax benefits are recognized for an uncertain tax position when, in the Company's judgment, it is more likely than not that the position will be sustained upon examination by a taxing authority. For a tax position that meets the more-likely-than-not recognition threshold, the tax benefit is measured as the largest amount that is judged to have a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority. The liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances and when new information becomes available. Such adjustments are recognized entirely in the period in which they are identified. The effective tax rate includes the net impact of changes in the liability for unrecognized tax benefits and subsequent adjustments as considered appropriate by the Company. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, the Company believes its liability for unrecognized tax benefits is adequate. Interest and penalties recognized on the liability for unrecognized tax benefits are recorded as income tax expense.

RESULTS OF OPERATIONS

Discontinued Operations Presentation

The results of Gillam for fiscal years ended April 30, 2017 and 2016, are presented as discontinued operations in our Consolidated Statements of Operations and Comprehensive (Loss) Income. Unless otherwise stated, financial results discussed herein refer to continuing operations.

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Consolidated Results

The table below sets forth for the fiscal years ended April 30, 2017 and 2016, the percentage of consolidated net sales represented by certain items in the Company's consolidated statements of operations:

	2017	2016
Revenues		
FEI-NY	78.4 %	79.8 %
FEI-Zyfer	29.5	22.2
Less intersegment revenues	(7.9)	(2.0)
	100.0	100.0
Cost of Revenues	77.7	65.2
Gross Margin	22.3	34.8
Selling and Administrative expenses	23.6	20.5
Research and Development expenses	13.7	9.8
Operating (Loss) Profit	(15.0)	4.5
Other Income (Expenses), net	1.0	1.5
(Benefit) Provision for Income Taxes	(4.2)	1.9
(Loss) Income from continuing operations	(9.8)	4.1
Income (Loss) from discontinued operations, net of tax	0.2	(2.2)
Net (Loss) Income	(9.6)%	1.9 %

Revenues

Fiscal years ended April 30, (in thousands)				
			Change	
	2017	2016	$	%
FEI-NY	$39,486	$44,238	$(4,752)	(11%)
FEI-Zyfer	14,853	12,285	2,568	21 %
Intersegment sales	(3,988)	(1,107)	(2,881)	
	$50,351	$55,416	$(5,065)	(9 %)

Fiscal year 2017 compared to fiscal year 2016:

Fiscal 2017 revenues from satellite programs, the Company's largest business area, decreased by $10.5 million, or 32%, compared to the prior fiscal year. This decrease is in line with the protracted industry wide slowdown in commercial communications satellite procurement, and reflects reductions in orders received from satellite service providers by the Company's major customers. Revenues on satellite program contracts are recorded in the FEI-NY segment and are recognized primarily under the percentage of completion method. Sales revenues from non-space U.S. Government/DOD customers increased by approximately $3.8 million or 24% compared to prior fiscal year. These revenues are recorded in both the FEI-NY and FEI-Zyfer segments, accounted for approximately 38% and 28% of consolidated revenues for fiscal years 2017, and 2016, respectively. For the year ended April 30, 2017, other commercial and industrial sales accounted for approximately 17% of consolidated revenues compared to approximately 12% for fiscal year 2016. Sales in this business area were $8.6 million for the year ended April 30, 2017 compared to $6.9 million for the preceding year.

Gross Margin

	Fiscal years ended April 30, (in thousands)			
			Change	
	2017	2016	$	%
	$11,249	$19,275	$(8,026)	(42%)
GM Rate	22.3 %	34.8 %		

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For the year ended April 30, 2017, gross margin and gross margin rate both decreased compared to the prior year. The two major contributing factors affecting gross margin dollars, include the $5.1 million revenue decrease and the $7 million of inventory adjustments. The gross margin percentage rate additionally reflects one-time non-cash inventory adjustments. Consistent with the Company's phase-out of its wire-line network infrastructure business area and the anticipated sale of Gillam-FEI, its foreign (Belgium) subsidiary, the Company took a one-time non-cash write down of approximately $5 million of inventory relating to wire-line copper based synchronization products in the FEI-Zyfer segment. Additionally, the Company recorded $2 million of inventory adjustments in the FEI-NY segment.

Selling and Administrative Expenses

Fiscal years ended April 30, (in thousands)			
		Change	
2017	2016	$	%
$11,898	$11,379	$519	5%

In the fiscal years ended April 30, 2017 and 2016, selling and administrative costs ("SG&A") were 24% and 21%, respectively, of consolidated revenues, the percentage increase of ("SG&A") was impacted by the year over year decline in revenues. A reduction in other selling and administrative costs was more than offset by a year over year increase in deferred compensation expense. Stock compensation expenses which are included in total ("SG&A") were $424,000 and $548,000, in 2017 and 2016 respectively.

Research and Development Expenses

Fiscal years ended April 30, (in thousands)			
		Change	
2017	2016	$	%
$6,876	$5,428	$1,448	27%

During fiscal 2017, the Company accelerated its research and development ("R&D") activity. As a percentage of consolidated revenue, R&D spending for the years ended April 30, 2017 and 2016 was approximately 14% and 10%, respectively. These R&D efforts address large business opportunities in secure communications command and control, and satellite systems that require advanced technologies and capabilities going forward. The Company believes it enjoys a competitive edge and has a head start in the development of these requirements.

The Company also engages in customer-funded development activity. The funds received in connection therewith appear in revenues and are not included in the table above. Although funding is obtained from customers, the Company retains the rights to any products developed. The Company believes that internally generated cash and cash reserves are adequate to fund its research and development activity.

Operating (Loss) Profit

Fiscal years ended April 30, (in thousands)			
		Change	
2017	2016	$	%
$(7,525)	$2,468	$(9,993)	(405%)

For fiscal year ended April 30, 2017, the Company recorded an operating loss of 15% of revenues compared to an operating profit of 4.5% of revenues for fiscal 2016. Approximately $7 million of the $7.5 million operating loss was due to non-cash inventory adjustments.

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Other Income (Expense)

Fiscal years ended April 30, (in thousands)				
			Change	
	2017	2016	$	%
Investment income	$549	$490	$59	12 %
Interest expense	(150)	(131)	(19)	15 %
Other income (expense), net	87	447	(360)	NM
	$486	$806	$(320)	(40%)

Investment income is derived primarily from the Company's holdings of marketable securities. Earnings on these securities vary based on changes in dividend payments and interest rates. During fiscal year 2017, investment income included losses upon the sale or redemption of marketable securities of approximately $28,000 compared to a gain of approximately $131,000 during fiscal year 2016. In fiscal year 2017, the Company received a $249,000 dividend from its investment in Morion compared to $30,000 in the prior year, yielding higher investment income than in prior year.

In fiscal year 2017, interest expense was incurred on borrowings under the Company's credit facility with a bank and on deferred compensation payments. During fiscal year 2017, deferred compensation interest payments increased and interest expense relating to the line of credit was reduced. As all borrowings under the credit facility were paid in full.

Other income (expense), net decreased because during fiscal year 2016, other income included approximately $380,000 from the proceeds of a life insurance policy of a former officer of the Company.

Income Tax (Benefit) Provision

Fiscal years ended April 30, (in thousands)			
		Change	
2017	2016	$	%
$(2,115)	$1,070	$(3,185)	298%

Effective tax rate on pre-tax book income:

30.0%	32.7%

The Company is subject to taxation in several countries. The statutory federal rates are 34% in the U.S., 33% in Europe and 25% in China. For the year ended April 30, 2017, the Company recognized a tax benefit related to a current year domestic pretax loss compared to a provision for taxes in in the prior year related to domestic pretax income. The Company intends to carry back the fiscal 2017 domestic loss for a refund of taxes paid in prior years. The effective tax rate was impacted favorably by a U.S. tax deduction relating to the realization of the excess tax basis in common shares of FEI-Asia as the Company made an election to treat FEI-Asia as a disregarded entity. The effective tax rate was also impacted unfavorably by unrecognized tax benefits, a state tax rate change, and losses incurred at the Company's foreign subsidiaries for which it receives no tax benefit. (See Note 13 to the Consolidated Financial Statements for a reconciliation of the actual tax benefit to the expected tax provision at the federal statutory rate and a tabular rollforward of unrecognized tax benefits.)

The Company's Asia subsidiary has available net operating loss ("NOL") carryforwards of approximately $0.9 million to offset future taxable income. The associated deferred tax asset for the foreign subsidiary NOL is fully reserved by a valuation allowance. These loss carryforwards have no expiration date. As a result of the acquisition of FEI-Elcom, the Company has a federal NOL carryforward of $4.4 million which may be applied in annually limited amounts to offset future U.S.-sourced taxable income over the next 14 years.

Discontinued Operations

	Fiscal years ended April 30, (in thousands)			
			Change	
	2017	2016	$	%
Net Income (Loss)	$103	$(1,199)	$1,302	NM

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The above table represents the net income (loss) for the Gillam segment accounted for as discontinued operations as presented in Note 2 to the financial statements. Revenues for 2017 and 2016 were relatively flat at approximately $5.9 million for each fiscal year. The gross margin and gross margin percentage increased in fiscal 2017 due to increased engineering costs incurred in fiscal 2016. Combined SG&A and R&D expenses for fiscal 2017 decreased approximately 9% compared to fiscal 2016, resulting in an operating loss of $544,000 compared $1.2 million in fiscal 2016. The Company recognized a deferred tax asset, net of valuation allowance, of $650,000 for its excess outside tax basis in the common shares of Gillam. The corresponding tax benefit has been allocated to discontinued operations.

LIQUIDITY AND CAPITAL RESOURCES

Net positive cash flow from operations increased to $3.5 million in fiscal 2017 compared to $2.8 million in the prior year. The Company generated positive cash flow from operations despite the reported operating loss for fiscal 2017. The Company's balance sheet continues to reflect a highly liquid position with working capital of $61.7 million at April 30, 2017. Included in working capital at April 30, 2017 is approximately $10.0 million consisting of cash, cash equivalents and short-term investments. The Company's current ratio at April 30, 2017 is 8.6 to 1 compared to 8.3 to 1 at the end of the prior fiscal year.

During fiscal years 2017 and 2016, the Company incurred $11.3 million and $2.8 million, respectively, in non-cash charges to earnings, including depreciation and amortization expense, inventory adjustments, warranty and accounts receivable reserves, certain employee benefit plan expenses, including accounting for stock-based compensation. During fiscal year 2017, operating cash was increased by decreases in inventory, accounts payable, and accrued liabilities. During fiscal year 2016, operating cash was reduced by increases to inventory offset by a decrease to accounts receivables.

Net cash used in investing activities for the fiscal year ended April 30, 2017 was $1.4 million compared $3.4 million in fiscal year 2016. In fiscal year 2017, investing activities included net proceeds from the redemption, sale or purchase of marketable securities for $3.8 million and uses of acquisitions of capital equipment and other long-term assets for $5.2 million. In fiscal year 2016, investing activities included net uses from the redemption, sale or purchase of marketable securities for $89,000 and acquisitions of capital equipment and other long-term assets for $3.3 million. The Company may continue to invest cash equivalents as dictated by its investment and acquisition strategies.

During the year ended April 30, 2017, cash used in financing activities was $6.7 million consisting of the net principal balance repayment of $6 million to JPMorgan Chase Bank, N.A ("JP Morgan") and the tax effect arising from the exercise of stock-based awards. On January 30, 2017, the Company repaid the principal balance due on its credit facility, dated June 6, 2013, with JPMorgan. Subsequently, the Company voluntarily terminated this credit facility with JPMorgan to reduce the fees and expenses associated with maintaining that facility. The Company did not incur any early termination fees associated with its voluntary termination of this credit facility.

During the year ended April 30, 2016, cash provided by financing activities was $141,000 consisting of the tax benefit arising from the exercise of stock-based awards. There were no additional borrowings or payments made under the bank credit facility in 2016. 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 fixed repurchase plan nor commitments to purchase additional shares in the future. As of the end of fiscal year 2017, the Company has repurchased approximately $4 million of its common stock out of the $5 million authorization. There were no repurchases in fiscal 2017 or 2016.

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 profitability. During fiscal year 2017, the Company secured partial customer funding for a portion of its R&D efforts. The customer funds received in connection therewith appear in revenues and are not included in R&D expenses. For fiscal year 2018, the Company anticipates securing additional customer funding for a portion of its research and development activities, and will allocate internal funds depending on market conditions and identification of new opportunities as in fiscal 2017. The Company expects 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.

Based upon the Company’s decision to sell its Gillam business and the associated presentation as Discontinued Operations, the Company believes that the effect on cash flow will be neutral, however it is expected to have a positive cash effect when the intended sale is concluded.

The Company’s international business is subject to changes in demand or pricing resulting from fluctuations in currency exchange rates, primarily in the Euro to U.S. Dollar exchange rate and in the Chinese Renminbi to U.S. Dollar exchange rate.

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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.

As of April 30, 2017, the Company's consolidated backlog amounted to approximately $28 million as compared to approximately $30 million at the beginning of the fiscal year. (See Item 1). Approximately 80% of this backlog is expected to be filled during the Company's fiscal year ending April 30, 2017. The Company excludes from backlog any contracts or awards for which it has not received authorization to proceed. On fixed price contracts, the Company excludes any unfunded portion. The Company expects any partially funded contracts to become fully funded over time and will add the additional funding to its backlog at that time. The backlog is subject to change by reason of several factors including possible cancellation of orders, change orders, terms of the contracts and other factors beyond the Company's control. Accordingly, the backlog is not necessarily indicative of the revenues or profits (losses) which may be realized when the results of such contracts are reported.

The Company's liquidity is adequate to meet its operating and investment needs through at least July 31, 2018.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment ("ASU 2017-04"), which simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Under ASU 2017-04 goodwill impairment will be tested by comparing the fair value of a reporting unit with its carrying amount, and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The new guidance must be applied on a prospective basis and is effective for periods beginning after December 15, 2019, with early adoption permitted. The Company will not be early adopting and is in the process of determining the effect that ASU 2017-04 may have, however, the Company expects the new standard to have an immaterial effect on its financial statements.

In March 2016, the FASB amended the existing accounting standards for stock-based compensation, ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments impact several aspects of accounting for share-based payment transactions, including the income tax consequences, forfeitures, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This guidance requires a mix of prospective, modified retrospective, and retrospective transition to all annual and interim periods presented and is effective for the Company in the next fiscal year. The Company has not determined the full impact of implementation of this standard, however the Company is determining if the stock options offered would require any type of transition under the new pronouncement and expects that, when adopted beginning in fiscal 2019, the new standard will have an immaterial effect on the Company's financials.

In February 2016, the FASB issued ASU No. 2016-02 Leases (Topic 842). The objective of the update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The standard requires a modified retrospective transition approach for existing leases. The amendments of the ASU 2016-02 are effective for fiscal years beginning after December 31, 2018 and early adoption is permitted. The Company is currently evaluating the impact of this standard on our consolidated financial statements, however the Company has minimal leases and expects that when adopted beginning in fiscal 2019, the new standard to have an immaterial effect on the Company's financials.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendments in ASU 2015-17 seek to simplify the presentation of deferred income taxes and require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods, with early application permitted for all entities as of the beginning of an interim or annual reporting period. The Company has adopted the guidance during fiscal 2017 on a prospective basis in order to simplify balance sheet classification. Prior periods have not been retrospectively adjusted.

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In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory which changes the measurement principle for inventory from the lower of cost or market to the lower of cost or net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new guidance must be applied on a prospective basis and is effective for periods beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the effect that the new guidance will have on its consolidated financial statements, however based upon the preliminary work that has been done when adopted this pronouncement is expected to have minimal, if any effect, on the financial statements. This pronouncement will be adopted for the Company’s next fiscal year.

In May 2014, the FASB issued 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. In July 2015, the FASB approved a one-year deferral of the effective date of this ASU. This ASU is effective for public companies for annual reporting periods beginning on or after December 15, 2017 and for the Company, must be adopted for its fiscal year 2019 beginning on May 1, 2018. The Company is currently evaluating the impact that ASU 2014-09 may have on its financial statements when the statement is adopted for its fiscal year 2019.

OTHER MATTERS

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

INFLATION

During fiscal year 2017, as in fiscal year 2016, the impact of inflation on the Company’s business has not been materially significant.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

This item is not required for smaller reporting companies.

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Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders of
Frequency Electronics, Inc.

We have audited the accompanying consolidated balance sheets of Frequency Electronics, Inc. and Subsidiaries (the "Company") as of April 30, 2017 and 2016, and the related consolidated statements of operations, comprehensive (loss) income, cash flows and changes in stockholders' equity for each of the years then ended. The financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Frequency Electronics, Inc. and Subsidiaries as of April 30, 2017 and 2016, and the consolidated results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ EisnerAmper LLP
New York, New York
July 31, 2017

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Consolidated Balance Sheets
April 30, 2017 and 2016
(In thousands, except par value)

	2017	2016
ASSETS:		
Current assets:		
Cash and cash equivalents	$2,163	$5,818
Marketable securities	7,815	11,111
Accounts receivable, net of allowance for doubtful accounts of $187 in 2017 and $189 in 2016	10,986	7,166
Costs and estimated earnings in excess of billings, net	7,964	12,377
Inventories, net	29,051	36,280
Prepaid income taxes	2,606	3,213
Prepaid expenses and other	1,105	1,059
Current assets of discontinued operations	8,165	8,838
Total current assets	69,855	85,862
Property, plant and equipment, at cost, net of accumulated depreciation and amortization	14,813	12,314
Deferred income taxes	11,902	7,702
Goodwill and other intangible assets	617	617
Cash surrender value of life insurance	13,376	12,819
Other assets	2,187	2,091
Non-current assets of discontinued operations	569	772
Total assets	$113,319	$122,177
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable - trade	$2,437	$3,165
Accrued liabilities	3,425	4,479
Current liabilities of discontinued operations	2,249	2,664
Total current liabilities	8,111	10,308
Long-term debt - noncurrent	-	6,000
Deferred compensation	13,252	11,773
Deferred rent and other liabilities	1,409	103
Non-current liabilities of discontinued operations	1,215	641
Total liabilities	23,987	28,825
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $1.00 par value authorized 600 shares, no shares issued	-	-
Common stock, $1.00 par value; authorized 20,000 shares, 9,164 shares issued and 8,817 outstanding in 2017; 8,753 outstanding in 2016	9,164	9,164
Additional paid-in capital	55,767	55,576
Retained earnings	23,712	28,533
	88,643	93,273
Common stock reacquired and held in treasury - at cost (347 shares in 2017 and 411 shares in 2016)	(1,592)	(1,885)
Accumulated other comprehensive income	2,281	1,964

Total stockholders' equity	89,332	93,352
Total liabilities and stockholders' equity	$113,319	$122,177

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

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive (Loss) Income
Years ended April 30, 2017 and 2016

	2017	2016
	(In thousands, except per share data)	
Revenues	$50,351	$55,416
Cost of revenues	39,102	36,141
Gross margin	11,249	19,275
Selling and administrative expenses	11,898	11,379
Research and development expenses	6,876	5,428
Operating (loss) profit	(7,525)	2,468
Other income (expense):		
Investment income	549	490
Interest expense	(150)	(131)
Other income (expense), net	87	447
(Loss) Income before provision for income taxes	(7,039)	3,274
(Benefit) Provision for income taxes	(2,115)	1,070
Net (loss) income from continuing operations	(4,924)	2,204
Income (loss) from discontinued operations, net of tax	103	(1,199)
Net (loss) income	$(4,821)	$1,005
Net (loss) income per common share:		
Basic (loss) earnings from continued operations	$(0.56)	$0.25
Basic earnings (loss) from discontinued operations	$0.01	$(0.13)
Basic (loss) earnings per share	$(0.55)	$0.12
Diluted (loss) earnings from continued operations	$(0.56)	$0.24
Diluted earnings (loss) from discontinued operations	$0.01	$(0.13)
Diluted (loss) earnings per share	$(0.55)	$0.11
Average shares outstanding:		
Basic	8,787	8,728
Diluted	8,787	8,937

Consolidated Statements of Comprehensive (Loss) Income

	2017	2016
Net (loss) income	$(4,821)	$1,005
Other comprehensive (loss) income:		
Foreign currency translation adjustment	(38)	(753)
Unrealized gain (loss) on marketable securities:		
Change in market value of marketable securities before reclassification, net of tax of ($182) and $51, respectively	352	(99)
Reclassification adjustment for realized gains included in net income, net of tax of ($25) and $57, respectively	3	(74)
Total unrealized gain (loss) on marketable securities, net of tax	355	(173)
Total other comprehensive income (loss)	317	(926)
Comprehensive (loss) income	$(4,504)	$79

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

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Consolidated Statements of Cash Flows
Years ended April 30, 2017 and 2016

	2017	2016
	(In thousands)	
Cash flows from operating activities:		
Net (loss) income from continuing operations	$(4,924)	$2,204
Net income (loss) from discontinued operations	103	(1,199)
Net (loss) income	(4,821)	1,005
Adjustments to reconcile net (loss) income to net cash provided in operating activities:		
Deferred income tax benefit	(1,355)	(1,265)
Depreciation and amortization	2,638	2,498
Deferred lease obligation and other liabilities	1,265	(75)
Provision for losses on accounts receivable, inventories and warranty reserve	4,788	(15)
Losses (gains) on marketable securities	28	(131)
Loss (gain) on sale of fixed and other assets, net	42	(367)
Employee benefit plans expense	2,519	1,450
Stock-based compensation expense	662	824
Tax effect (benefit) from exercise of stock-based compensation	671	(141)
Changes in operating assets and liabilities:		
Accounts receivable	(3,602)	(911)
Costs and estimated earnings in excess of billings	4,663	3,340
Inventories	2,172	(3,737)
Prepaid expenses and other	(143)	135
Other assets	(470)	(570)
Accounts payable - trade	(746)	1,223
Accrued liabilities	(829)	(975)
Income taxes (payable) refundable	(3,099)	1,013
Other liabilities	(877)	(519)
Cash provided by operating activities – continuing operations	3,506	2,782
Cash provided by operating activities – discontinued operations	382	141
Net cash provided by operating activities	3,888	2,923
Cash flows from investing activities:		
Purchase of marketable securities	(575)	(1,356)
Proceeds from sale or redemption of marketable securities	4,397	1,267
Capital expenditures	(5,233)	(3,263)
Cash used in investing activities – continuing operations	(1,411)	(3,352)
Cash used in investing activities – discontinued operations	(40)	(174)
Net cash (used in) investing activities	(1,451)	(3,526)

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

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Consolidated Statements of Cash Flows
Years ended April 30, 2017 and 2016
(Continued)

	2017	2016
	(In thousands)	
Cash flows from financing activities:		
Proceeds from credit line borrowing	$(6,000)	$-
Tax (effect) benefit from exercise of stock-based compensation	(671)	141
Cash used in financing activities – continuing operations	(6,671)	141
Cash used in financing activities – discontinued operations	-	-
Net cash (used in) provided by financing activities	(6,671)	141
Net decrease in cash and cash equivalents before effect of exchange rate changes	(4,234)	(462)
Effect of exchange rate changes on cash and cash equivalents	890	(678)
Net decrease in cash and cash equivalents	(3,344)	(1,140)
Cash and cash equivalents at beginning of year	6,082	7,222
Cash and equivalents at end of year	2,738	6,082
Less cash and equivalents of discontinued operations at end of year	575	264
Cash and cash equivalents of continuing operations at end of year	$2,163	$5,818
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$146	$128
Income taxes	$335	$1,311

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

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FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
Years ended April 30, 2017 and 2016
(In thousands, except share data)

	Common Stock		Additional paid in capital	Retained earnings	Treasury stock (at cost)		Accumulated other comprehensive income	Total
	Shares	Amount			Shares	Amount		
Balance at April 30, 2015	9,163,940	$9,164	$54,360	$27,528	465,163	$(2,132)	$ 2,890	$91,810
Contribution of stock to 401(k) plan			283		(46,743)	215		498
Stock-based compensation expense			818		(1,300)	6		824
Tax benefit from stock option exercise			141					141
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price			(26)		(5,736)	26		-
Change in unrealized gains and losses on marketable securities, net of taxes							(173)	(173)
Foreign currency translation adjustment							(753)	(753)
Net Income				1,005				1,005
Balance at April 30, 2016	9,163,940	9,164	55,576	28,533	411,384	(1,885)	1,964	93,352
Contribution of stock to 401(k) plan			274		(47,839)	219		493
Stock-based compensation expense			658		(850)	4		662
Change in excess tax benefits from stock-based compensation			(671)					(671)
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price			(70)		(15,273)	70		-
Change in unrealized gains and losses on marketable securities, net of taxes							355	355
Foreign currency translation adjustment							(38)	(38)
Net Loss				(4,821)				(4,821)
Balance at April 30, 2017	9,163,940	$9,164	$55,767	$23,712	347,422	$(1,592)	$ 2,281	$89,332

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

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1. Summary of Accounting Policies

Principles of Consolidation:

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

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

Cash Equivalents:

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

Marketable Securities:

Marketable securities consist of investments in common stocks, including exchange-traded funds, corporate debt securities and debt securities of U.S. Government agencies. All marketable securities were held in the custody of financial institutions; two institutions at April 30, 2017 and three institutions at April 30, 2016. Investments in debt and equity securities are categorized as available for sale and are carried at fair value, with unrealized gains and losses excluded from income and recorded directly to stockholders' equity. The Company recognizes gains or losses when securities are sold using the specific identification method.

Allowance for Doubtful Accounts:

Losses from uncollectible accounts receivable are provided for by utilizing the allowance for doubtful accounts method based upon management's estimate of uncollectible accounts. Management analyzes accounts receivable and the potential for bad debts, customer concentrations, credit worthiness, current economic trends and changes in customer payment terms when evaluating the amount recorded for the allowance for doubtful accounts.

Property, Plant and Equipment:

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

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

Inventories:

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

Depreciation and Amortization:

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

Amortization of identifiable intangible assets is based upon the expected lives of the assets and is recorded at a rate which approximates the Company’s utilization of the assets.

Intangible Assets:

Intangible assets consist of the ISO 9000 certification arising from the acquisition of FEI-Elcom in the assignment of fair value to its acquired assets including intangibles. The certification is valued at fair value and was amortized over the estimated useful life of 3 years from the date of acquisition.

Goodwill:

The Company records goodwill as the excess of purchase price over the fair value of identifiable net assets acquired. Goodwill is tested for impairment on at least an annual basis at year end. When it is determined that the carrying value of goodwill may not be recoverable, the Company writes down the goodwill to an amount commensurate with the revised value of the acquired assets. The Company measures impairment based on revenue projections, recent transactions involving similar businesses and price/revenue multiples at which they were bought and sold, price/revenue multiples of competitors, and the present market value of publicly-traded companies in the Company’s industry.

Revenue and Cost 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. For U.S. Government and other fixed-price contracts that require initial design and development of the product, revenue is recognized on the cost-to-cost method. Under this method, revenue is recorded based upon the ratio that incurred costs bear to total estimated contract costs with related cost of sales recorded as the costs are incurred. Costs and estimated earnings in excess of billings on uncompleted contracts, net of billings on uncompleted contracts in excess of costs and estimated earnings, are included in current assets.

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 and production-type orders may result in revisions to costs and revenue and are recognized in the period in which revisions are determined to be required. Provisions for the full amount of anticipated losses are made in the period in which they become determinable.

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

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
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
April 30, 2017 and 2016

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. Program costs for which production-level orders cannot be determined as probable are written down in the period in which that assessment is made.

Comprehensive (Loss) Income:

Comprehensive (loss) income consists of net income and other comprehensive (loss) income. Other comprehensive (loss) income includes changes in unrealized gains or losses, net of tax, on securities available for sale during the year and the effects of foreign currency translation adjustments.

Research and Development Expenses:

The Company engages in research and development activities to identify new applications for its core technologies, to improve existing products and to improve manufacturing processes to achieve cost reductions and manufacturing efficiencies. Research and development costs include direct labor, manufacturing overhead, direct materials and contracted services. Such costs are expensed as incurred. The Company also engages in customer-funded development activity. The customer funds received in connection therewith appear in revenues and are not included in R&D expenses.

Income Taxes:

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

The Company analyzes its tax positions under accounting standards which prescribe recognition thresholds that must be met before a tax benefit is recognized in the financial statements and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. An entity may only recognize or continue to recognize tax positions that meet a “more likely than not” threshold. When and if the Company were to recognize interest or penalties related to income taxes, it would be reported net of the federal tax benefit in the tax provision.

Earnings Per Share:

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

Fair Values of Financial Instruments:

Cash and cash equivalents, short-term credit obligations, long term debt and cash surrender value are reflected in the accompanying consolidated balance sheets at amounts considered by management to reasonably approximate fair value based upon the nature of the instrument and current market conditions. Management is not aware of any factors that would significantly affect the value of these amounts. The Company also has an investment in a privately-held company, Morion, Inc. ("Morion"). The Company is unable to reasonably estimate a fair value for this investment.

FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
April 30, 2017 and 2016

Foreign Operations and Foreign Currency Adjustments:

The Company maintains manufacturing operations in Belgium (see Note 2) 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.

Equity-based Compensation:

The Company values its share-based payment transactions using the Black-Scholes valuation model. Such value is recognized as expense on a straight-line basis over the service period of the awards, which is generally the vesting period, net of estimated forfeitures.

The weighted average fair value of each option or stock appreciation right ("SAR") has been estimated on the date of grant using the Black-Scholes option pricing model with the following range of weighted average assumptions used for grants:

	Years ended April 30	
	2017	2016
Expected volatility	35 %	35 %
Dividend yield	0.0%	0.0 %
Risk-free interest rate	1.85% and 1.14%	1.35% and 1.50 %
Expected lives	5.0 years	5.0 years

The expected life assumption was determined based on the Company's historical experience as well as the term of recent SAR agreements. The expected volatility assumption was based on the historical volatility of the Company's common stock. The dividend yield assumption was determined based upon the Company's past history of dividend payments and the Company's current decision to suspend payment of dividends. The risk-free interest rate assumption was determined using the implied yield currently available for zero-coupon U.S. Government issues with a remaining term equal to the expected life of the stock options or SARs.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentration of credit risk, consist principally of cash and cash equivalents and trade receivables. The Company maintains accounts at several commercial banks at which the balances exceed Federal Deposit Insurance Corporation limits. The Company has not experienced any losses on such amounts. Concentration of credit risk with respect to trade receivables is generally diversified due to the large number of entities comprising the Company's customer base and their dispersion across geographic areas principally within the United States. The Company routinely addresses the financial strength of its customers and, as a consequence, believes that its receivable credit risk exposure is limited. The Company does not require customers to post collateral.

New Accounting Pronouncements:

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment ("ASU 2017-04"), which simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Under ASU 2017-04 goodwill impairment will be tested by comparing the fair value of a reporting unit with its carrying amount, and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The new guidance must be applied on a prospective basis and is effective for periods beginning after December 15, 2019, with early adoption permitted. The Company will not be early adopting and is in the process of determining the effect that ASU 2017-04 may have, however, the Company expects the new standard to have an immaterial effect on its financial statements.

In March 2016, the FASB amended the existing accounting standards for stock-based compensation, ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments impact several aspects of accounting for share-based payment transactions, including the income tax consequences, forfeitures, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This guidance requires a mix of prospective, modified retrospective, and retrospective transition to all annual and interim periods presented and is effective for the Company in the next fiscal year. The Company has not determined the full impact of implementation of this standard, however the Company is determining if the stock options offered would require any type of transition under the new pronouncement and expects that, when adopted beginning in fiscal 2019, the new standard will have an immaterial effect on the Company's financials.

In February 2016, the FASB issued ASU No. 2016-02 Leases (Topic 842). The objective of the update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The standard requires a modified retrospective transition approach for existing leases. The amendments of the ASU 2016-02 are effective for fiscal years beginning after December 31, 2018 and early adoption is permitted. The Company is currently evaluating the impact of this standard on our consolidated financial statements, however the Company has minimal leases and expects that when adopted beginning in fiscal 2019, the new standard to have an immaterial effect on the Company's financials.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendments in ASU 2015-17 seek to simplify the presentation of deferred income taxes and require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods, with early application permitted for all entities as of the beginning of an interim or annual reporting period. The Company has adopted the guidance during fiscal 2017 on a prospective basis in order to simplify balance sheet classification. Prior periods have not been retrospectively adjusted.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory which changes the measurement principle for inventory from the lower of cost or market to the lower of cost or net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new guidance must be applied on a prospective basis and is effective for periods beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the effect that the new guidance will have on its consolidated financial statements, however based upon the preliminary work that has been done when adopted this pronouncement is expected to have minimal, if any effect, on the financial statements. This pronouncement will be adopted for the Company's next fiscal year.

In May 2014, the FASB issued 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. In July 2015, the FASB approved a one-year deferral of the effective date of this ASU. This ASU is effective for public companies for annual reporting periods beginning on or after December 15, 2017 and for the Company, must be adopted for its fiscal year 2019 beginning on May 1, 2018. The Company is currently evaluating the impact that ASU 2014-09 may have on its financial statements when the statement is adopted for its fiscal year 2019.

2. Discontinued Operations

In December 2016, the Company entered into a contingent share purchase agreement with certain foreign parties with respect to a potential sale of Gillam-FEI, the Company's Belgian subsidiary. However, these parties have not yet performed their obligations under that agreement, and the Company continues to negotiate with these parties with respect to a potential sale. Subsequently, in April 2017, the Company decided to sell its Gillam business in any event as soon as practicable. The Company is currently in discussions with a number of potential buyers and believes that the divestment is on a path to completion by the end of fiscal year 2018. Accordingly, the Company determined that the assets and liabilities of this reportable segment met the discontinued operations criteria in Accounting Standards Codification 205-20-45 in the quarter ended April 30, 2017. As such Gillam's results have been classified as discontinued operations in the accompanying Consolidated Statements of Operations and Comprehensive (Loss) Income.

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FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
April 30, 2017 and 2016

Summarized operating results for the Gillam discontinued operations, for the years ended April 30, 2017 and 2016 respectively, are as follows:

	For the years ended April 30,	
	2017	2016
Revenues	$5,985	$5,942
Cost of revenues	4,407	4,781
Gross Margin	1,578	1,161
Selling and administrative expenses	1,714	1,826
Research and development expenses	408	501
Operating Loss	(544)	(1,166)
Other income (expense):		
Investment (loss) income	(3)	2
Other income (expense), net	-	(35)
Loss before provision for income taxes	(547)	(1,199)
Provision for income taxes	650	-
Net income (loss)	$103	$(1,199)

The carrying amounts of assets and liabilities for the Gillam discontinued operations are as follows:

	April 30,	
	2017	2016
Cash and cash equivalents	$575	$264
Accounts receivable, net of allowance for doubtful accounts	3,202	3,384
Inventories, net	3,980	4,999
Prepaid expenses and other	408	191
Total current assets of discontinued operations	$8,165	$8,838
Property, plant and equipment, at cost, net of accumulated depreciation and amortization	$555	$757
Investments	14	15
Deferred taxes – non-current	-	-
Total non-current assets of discontinued operations	$569	$772
Accounts payable – trade	$949	$1,035
Accrued liabilities	1,300	1,629
Total current liabilities of discontinued operations	2,249	2,664
Deferred rent and other liabilities	1,215	641
Total non-current liabilities of discontinued operations	$1,215	$641

3. Earnings Per Share

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

Years ended April 30,

	2017	2016
Basic EPS Shares outstanding (weighted average)	8,787,082	8,727,874
Effect of Dilutive Securities	**	209,035
Diluted EPS Shares outstanding	8,787,082	8,936,909

** For the year ended April 30, 2017, dilutive securities are excluded since the inclusion of such shares would be antidilutive due to the net loss for the period. The exercisable shares excluded are 1,280,625.

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FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
April 30, 2017 and 2016

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

	Years ended April 30,	
	2017	2016
Outstanding options and SARS excluded	**	388,625

4. Costs and Estimated Earnings in Excess of Billings

At April 30, 2017 and 2016, costs and estimated earnings in excess of billings, net, consist of the following:

	2017	2016
	(in thousands)	
Costs and estimated earnings in excess of billings	$8,890	$12,460
Billings in excess of costs and estimated earnings	(926)	(83)
Net asset	$7,964	$12,377

Such amounts represent revenue recognized on long-term contracts that had not been billed at the balance sheet dates or represent a liability for amounts billed in excess of the revenue recognized. Amounts are billed to customers pursuant to contract terms. 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 years ended April 30, 2017 and 2016, revenue recognized under percentage of completion contracts was approximately $26.4 million and $32.5 million, respectively. If contract losses are anticipated, costs and estimated earnings in excess of billings are reduced for the full amount of such losses when they are determinable. Total contract losses at April 30, 2017 and 2016 were approximately $300,000 and $450,000, respectively.

5. Inventories

Inventories at April 30, 2017 and 2016, respectively, consisted of the following (in thousands):

	2017	2016
Raw Materials and Component Parts	$17,702	