COMTECH TELECOMMUNICATIONS CORP /DE/
Form 10-Q
March 09, 2009

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

FORM
10-Q

(Mark One)

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

For the quarterly period ended January 31, 2009

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

Commission File Number: 0-7928

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation /organization)	11-2139466 (I.R.S. Employer Identification Number)
68 South Service Road, Suite 230, Melville, NY (Address of principal executive offices)	11747 (Zip Code)

(631) 962-7000
(Registrant's telephone number, including area code)

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

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

Large accelerated filer T Accelerated filer o Non-accelerated filer o

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

o Yes T No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of March 5, 2009, the number of outstanding shares of Common Stock, par value $.10 per share, of the registrant was 28,128,573 shares.

COMTECH TELECOMMUNICATIONS CORP.
INDEX

PART I
FINANCIAL INFORMATION
COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

Item 1.

Assets	January 31, 2009 (Unaudited)	July 31, 2008
Current assets:		
Cash and cash equivalents	$ 232,207,000	410,067,000
Accounts receivable, net	95,672,000	70,040,000
Inventories, net	111,622,000	85,966,000
Prepaid expenses and other current assets	12,041,000	5,891,000
Deferred tax asset	17,297,000	10,026,000
Total current assets	468,839,000	581,990,000
Property, plant and equipment, net	39,433,000	34,269,000
Goodwill	147,677,000	24,363,000
Intangibles with finite lives, net	59,275,000	7,505,000
Deferred financing costs, net	1,080,000	1,357,000
Other assets, net	708,000	3,636,000
Total assets	$ 717,012,000	653,120,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 22,588,000	31,423,000
Accrued expenses and other current liabilities	48,238,000	49,671,000
Customer advances and deposits	17,514,000	15,287,000
Current installments of other obligations	37,000	108,000
Interest payable	1,050,000	1,050,000
Total current liabilities	89,427,000	97,539,000
Convertible senior notes	104,616,000	105,000,000
Other liabilities	2,480,000	-
Income taxes payable	3,714,000	1,909,000
Deferred tax liability	22,464,000	5,870,000
Total liabilities	222,701,000	210,318,000
Commitments and contingencies (See Note 17)		
Stockholders' equity:		
Preferred stock, par value $.10 per share; shares authorized and unissued 2,000,000	-	-
Common stock, par value $.10 per share; authorized 100,000,000 shares; issued 25,017,923 shares and 24,600,166 shares at January 31, 2009 and July 31, 2008, respectively	2,502,000	2,460,000
Additional paid-in capital	202,502,000	186,246,000
Retained earnings	289,492,000	254,281,000
	494,496,000	442,987,000

Less:		
Treasury stock (210,937 shares)	(185,000)	(185,000)
Total stockholders' equity	494,311,000	442,802,000
Total liabilities and stockholders' equity	$ 717,012,000	653,120,000

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended January 31, 2009	Three months ended January 31, 2008	Six months ended January 31, 2009	Six months ended January 31, 2008
Net sales	$ 143,886,000	152,030,000	335,801,000	267,085,000
Cost of sales	84,409,000	85,705,000	189,345,000	150,282,000
Gross profit	59,477,000	66,325,000	146,456,000	116,803,000
Expenses:				
Selling, general and administrative	25,969,000	21,304,000	54,947,000	41,703,000
Research and development	12,522,000	9,140,000	26,647,000	20,181,000
Amortization of acquired in-process research and development (See Note 6)	-	-	6,200,000	-
Amortization of intangibles	1,796,000	434,000	3,589,000	813,000
	40,287,000	30,878,000	91,383,000	62,697,000
Operating income	19,190,000	35,447,000	55,073,000	54,106,000
Other expenses (income):				
Interest expense	711,000	670,000	1,377,000	1,347,000
Interest income and other	(626,000)	(4,095,000)	(1,903,000)	(8,542,000)
Income before provision for income taxes	19,105,000	38,872,000	55,599,000	61,301,000
Provision for income taxes	6,265,000	13,403,000	20,388,000	21,138,000
Net income	$ 12,840,000	25,469,000	35,211,000	40,163,000
Net income per share (See Note 5):				
Basic	$ 0.52	1.06	1.43	1.67
Diluted	$ 0.46	0.91	1.26	1.45
Weighted average number of common shares outstanding – basic	24,759,000	24,099,000	24,673,000	24,012,000
Weighted average number of common and common equivalent shares outstanding assuming dilution – diluted	28,633,000	28,303,000	28,585,000	28,256,000

See accompanying notes to condensed consolidated financial statements.

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

	Six months ended January 31, 2009	2008
Cash flows from operating activities:		
Net income	$ 35,211,000	40,163,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of property, plant and equipment	5,965,000	4,371,000
Amortization of acquired in-process research and development	6,200,000	-
Amortization of intangible assets with finite lives	3,589,000	813,000
Amortization of stock-based compensation	4,710,000	5,271,000
Amortization of fair value inventory step-up	1,520,000	-
Deferred financing costs	273,000	273,000
Loss on disposal of property, plant and equipment	10,000	-
Provision for (benefit from) allowance for doubtful accounts	785,000	(5,000)
Provision for excess and obsolete inventory	2,012,000	1,236,000
Excess income tax benefit from stock award exercises	(2,491,000)	(1,523,000)
Deferred income tax benefit	(717,000)	(97,000)
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(4,489,000)	(38,786,000)
Inventories	1,087,000	(16,883,000)
Prepaid expenses and other current assets	(2,900,000)	(1,313,000)
Other assets	(63,000)	69,000
Accounts payable	(14,549,000)	1,858,000
Accrued expenses and other current liabilities	(15,169,000)	(3,986,000)
Customer advances and deposits	(935,000)	4,010,000
Other liabilities	212,000	-
Income taxes payable	4,104,000	3,564,000
Net cash provided by (used in) operating activities	24,365,000	(965,000)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(7,844,000)	(6,386,000)
Purchases of other intangibles with finite lives	(100,000)	(193,000)
Payments for business acquisitions, net of cash acquired	(205,223,000)	(265,000)
Net cash used in investing activities	(213,167,000)	(6,844,000)
Cash flows from financing activities:		
Principal payments on other obligations	(71,000)	(66,000)
Excess income tax benefit from stock award exercises	2,491,000	1,523,000
Proceeds from exercises of stock options	7,864,000	3,939,000
Proceeds from issuance of employee stock purchase plan shares	658,000	448,000
Net cash provided by financing activities	10,942,000	5,844,000
Net decrease in cash and cash equivalents	(177,860,000)	(1,965,000)
Cash and cash equivalents at beginning of period	410,067,000	342,903,000
Cash and cash equivalents at end of period	$ 232,207,000	340,938,000

Supplemental cash flow disclosures:			
Cash paid during the period for:			
Interest	$	1,054,000	1,068,000
Income taxes	$	17,214,000	17,881,000
Non cash investing and financing activities:			
Radyne acquisition transaction costs not yet paid (See Note 9)	$	428,000	-
Common stock issued in exchange for convertible senior notes (See Note 11)	$	384,000	-

See accompanying notes to condensed consolidated financial statements.

4

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

(1) General

The accompanying condensed consolidated financial statements of Comtech Telecommunications Corp. and Subsidiaries (the "Company") as of and for the three and six months ended January 31, 2009 and 2008 are unaudited. In the opinion of management, the information furnished reflects all material adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the unaudited interim periods. The results of operations for such periods are not necessarily indicative of the results of operations to be expected for the full fiscal year. For the three and six months ended January 31, 2009 and 2008, comprehensive income was equal to net income.

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

These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the fiscal year ended July 31, 2008 and the notes thereto contained in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission ("SEC"), and all of the Company's other filings with the SEC.

(2) Reclassifications

Certain reclassifications have been made to previously reported financial statements to conform to the Company's current financial statement format.

(3) Stock-Based Compensation

The Company applies the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," which establishes the accounting for employee stock-based awards. Under the provisions of SFAS No. 123(R), stock-based compensation for both equity and liability-classified awards is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period of the grant). The fair value of liability-classified awards is remeasured at the end of each reporting period until the award is settled, with changes in fair value recognized pro-rata for the portion of the requisite service period rendered. The Company used the modified prospective method upon adopting SFAS No. 123(R).

The Company recognized stock-based compensation for awards issued under the Company's Stock Option Plans and the Company's 2001 Employee Stock Purchase Plan (the "ESPP") in the following line items in the Condensed Consolidated Statements of Operations:

	Three months ended January 31,		Six months ended January 31,	
	2009	2008	2009	2008
Cost of sales	$ 267,000	106,000	352,000	327,000
	1,647,000	2,023,000	3,531,000	4,043,000

Selling, general and administrative expenses				
Research and development expenses	378,000	423,000	827,000	901,000
Stock-based compensation expense before income tax benefit	2,292,000	2,552,000	4,710,000	5,271,000
Income tax benefit	(838,000)	(888,000)	(1,620,000)	(1,829,000)
Net stock-based compensation expense	$ 1,454,000	1,664,000	3,090,000	3,442,000

5

Of the total stock-based compensation expense before income tax benefit recognized in the three months ended January 31, 2009 and 2008, $109,000 and $54,000, respectively, related to awards issued pursuant to the ESPP. Of the total stock-based compensation expense before income tax benefit recognized in the six months ended January 31, 2009 and 2008, $165,000 and $105,000, respectively, related to awards issued pursuant to the ESPP.

Included in total stock-based compensation expense before income tax benefit in the three months ended January 31, 2009 and 2008 is a benefit of $80,000 and $4,000, respectively, as a result of the required fair value remeasurement of the Company's liability-classified stock appreciation rights ("SARs") at the end of the reporting period. Included in total stock-based compensation expense before income tax benefit in the six months ended January 31, 2009 and 2008 is a benefit of $51,000 and a charge of $85,000, respectively, related to SARs.

Stock-based compensation that was capitalized and included in ending inventory at January 31, 2009 and July 31, 2008 was $314,000 and $215,000, respectively.

The Company estimates the fair value of stock-based awards using the Black-Scholes option pricing model. The Black-Scholes option pricing model includes assumptions regarding dividend yield, expected volatility, expected option term and risk-free interest rates. The assumptions used in computing the fair value of stock-based awards reflect the Company's best estimates, but involve uncertainties relating to market and other conditions, many of which are outside of its control. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the employees who receive stock-based awards.

The per share weighted average grant-date fair value of stock-based awards granted during the three months ended January 31, 2009 and 2008 approximated $14.95 and $17.43, respectively. The per share weighted average grant-date fair value of stock-based awards granted during the six months ended January 31, 2009 and 2008 approximated $15.59 and $15.73, respectively. In addition to the exercise and grant-date prices of the awards, certain weighted average assumptions that were used to estimate the initial fair value of stock-based awards in the respective periods are listed in the table below:

	Three months ended January 31,		Six months ended January 31,	
	2009	2008	2009	2008
Expected dividend yield	0%	0%	0%	0%
Expected volatility	40.44%	42.43%	40.36%	43.11%
Risk-free interest rate	1.02%	2.91%	2.81%	4.54%
Expected life (years)	3.52	3.41	3.61	3.55

Stock-based awards granted during the three and six months ended January 31, 2009 and 2008 have exercise prices equal to the fair market value of the stock on the date of grant, a contractual term of five years and a vesting period of three years. All stock-based awards granted through July 31, 2005 have exercise prices equal to the fair market value of the stock on the date of grant and a contractual term of ten years and generally a vesting period of five years. The Company settles employee stock option exercises with new shares. All SARs granted through January 31, 2009 may only be settled with cash. Included in accrued expenses at January 31, 2009 and July 31, 2008 is $141,000 and $192,000, respectively, relating to the cash settlement of SARs.

The Company estimates expected volatility by considering the historical volatility of the Company's stock, the implied volatility of publicly traded stock options in the Company's stock and the Company's expectations of volatility for the expected term of stock-based compensation awards. The risk-free interest rate is based on the United States ("U.S.") treasury yield curve in effect at the time of grant. The expected life is the number of years that the Company estimates awards will be outstanding prior to exercise. The expected life of the awards issued after July 31, 2005 and through

July 31, 2007 was determined using the "simplified method" prescribed in SEC Staff Accounting Bulletin ("SAB") No. 107. Effective August 1, 2007, the expected life of awards was determined by employee groups with sufficiently distinct behavior patterns.

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

		Six months ended January 31, 2009	2008
Actual income tax benefit recorded for the tax deductions relating to the exercise of stock-based awards	$	3,718,000	2,088,000
Less: Tax benefit initially recognized on exercised stock-based awards vesting subsequent to the adoption of SFAS No. 123(R)		(1,227,000)	(565,000)
Excess income tax benefit recorded as an increase to additional paid-in capital		2,491,000	1,523,000
Less: Tax benefit initially disclosed but not previously recognized on exercised equity-classified stock-based awards vesting prior to the adoption of SFAS No. 123(R)		-	-
Excess income tax benefit from exercised equity-classified stock-based awards reported as a cash flow from financing activities in the Company's Condensed Consolidated Statements of Cash Flows	$	2,491,000	1,523,000

At January 31, 2009, total remaining unrecognized compensation cost related to unvested stock-based awards was $13,627,000, net of estimated forfeitures of $884,000. The net cost is expected to be recognized over a weighted average period of 1.9 years.

(4) Fair Value Measurement

Effective August 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It establishes a fair value hierarchy that distinguishes between (a) Level 1 inputs which are based on quoted market prices for identical assets or liabilities in active markets at the measurement date; (b) Level 2 inputs which are observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data; and (c) Level 3 inputs which reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date and which are both unobservable in the market and significant to the instrument's valuation.

The only assets or liabilities measured at fair value on a recurring basis as of January 31, 2009 were investments owned by the Company that are classified as cash and cash equivalents. As of January 31, 2009, substantially all of the Company's cash and cash equivalents consist of money market funds which were valued using Level 1 inputs.

(5) Earnings Per Share

The Company calculates earnings per share ("EPS") in accordance with SFAS No. 128, "Earnings per Share." Basic EPS is computed based on the weighted average number of shares outstanding. Diluted EPS reflects the dilution from potential common stock issuable pursuant to the exercise of equity-classified stock-based awards and convertible senior notes, if dilutive, outstanding during each period. Equity-classified stock-based awards to purchase 1,115,000 and 586,000 shares for the three months ended January 31, 2009 and 2008, respectively, were not included in the EPS calculation because their effect would have been anti-dilutive. Equity-classified stock-based awards to purchase

1,113,000 and 588,000 shares for the six months ended January 31, 2009 and 2008, respectively, were not included in the EPS calculation because their effect would have been anti-dilutive. Liability-classified stock-based awards do not impact, and are not included in, the denominator for EPS calculations.

In accordance with Emerging Issues Task Force (“EITF”) Issue No. 04-8, “The Effect of Contingently Convertible Instruments on Diluted Earnings per Share,” the Company includes the impact of the assumed conversion of its 2.0% convertible senior notes in calculating diluted EPS.

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

	Three months ended January 31,		Six months ended January 31,	
	2009	2008	2009	2008
Numerator:				
Net income for basic calculation				