INNOCOM TECHNOLOGY HOLDINGS, INC.
Form 10-Q
November 02, 2009

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarter ended September 30, 2009

Commission File Number 0-50164

INNOCOM TECHNOLOGY HOLDINGS, INC.
(Exact Name of small business issuer as specified in Its charter)

NEVADA (State or other jurisdiction of incorporation or organization)	87-0618756 (I.R.S. Employer Identification No.)
Suite 1501, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong, PRC (Address of principal executive offices)	(Zip code)

Issuer's telephone number, including area code: (852) 3102 1602

(Former name, former address or former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) 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.
Yesþ 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 ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rue 12b-2of the Exchange Act).
Yes ¨ No þ
The number of shares outstanding of each of the Registrant's classes of common stock, as of November 2, 2009 was 37,900,536 shares, all of one class of $0.001 par value Common Stock.

INNOCOM TECHNOLOGY HOLDINGS, INC.
FORM 10-Q
Quarter Ended September 30, 2009
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SPECIAL NOTE ON FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I of this report include forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "proposed," "intended," or "continue" or the negative of these terms or other comparable terminology. You should read statements that contain these words carefully, because they discuss our expectations about our future operating results or our future financial condition or state other "forward-looking" information. There may be events in the future that we are not able to accurately predict or control. Before you invest in our securities, you should be aware that the occurrence of any of the events described in this Annual Report could substantially harm our business, results of operations and financial condition, and that upon the occurrence of any of these events, the trading price of our securities could decline and you could lose all or part of your investment. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, growth rates, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report to conform these statements to actual results.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)

INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2009 AND DECEMBER 31, 2008
(Currency expressed in United States Dollars ("US$"), except for number of shares)

	September 30, 2009 (Unaudited)	December 31, 2008 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,740	$ 11,553
Prepayments and other receivables	72,870	72,869
Total current assets	75,610	84,422
Non-current assets:		
Intangible assets, net	-	-
Land use right, net	-	-
Property, plant and equipment, net	735,457	737,859
TOTAL ASSETS	$ 811,067	$ 822,281
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 80,688	$ 80,692
Amount due to a related party	4,441,554	4,152,410
Other payables and accrued liabilities	175,673	210,866
Total current liabilities	4,697,915	4,443,968
Commitments and contingencies		
Stockholders' deficit:		
Common stock, $0.001 par value; 50,000,000 shares authorized; 37,898,251 shares issued and outstanding as of September 30, 2009 and December 31, 2008	37,898	37,898
Additional paid-in capital	6,901,232	6,901,232
Accumulated other comprehensive income	532,344	532,248
Retained earnings	5,086,568	5,351,825
Deficit accumulated during the development stage	(16,444,890)	(16,444,890)
Total stockholders' deficit	(3,886,848)	(3,621,687)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 811,067	$ 822,281

See accompanying notes to condensed consolidated financial statements.

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INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (LOSS)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008
AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION)
THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"), except for number of shares)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,		Period from January 19, 2007 (inception) through September 30, 2009
	2009	2008	2009	2008	
Revenues, net	$ -	$ -	$ -	$ -	$ -
Cost of revenue	-	-	-	-	-
Gross profit	-	-	-	-	-
Operating expenses:					
Impairment loss on long-lived assets	-	-	-	-	14,481,991
General and administrative	91,470	295,505	265,257	1,194,887	2,198,256
Total operating expenses	91,470	295,505	265,257	1,194,887	16,680,247
LOSS FROM OPERATIONS	(91,470)	(295,505)	(265,257)	(1,194,887)	(16,680,247)
Other income (expense):					
Interest expense	-	(167,699)	-	(270,403)	(240,498)
Interest income	-	9,719	-	20,796	20,727
Loss on disposal of plant & equipment	-	-	-	-	(1,669)
Foreign exchange gain	-	98,346	-	191,540	191,540
LOSS BEFORE INCOME TAXES	(91,470)	(355,139)	(265,257)	(1,252,954)	(16,710,147)
Income tax expense	-	-	-	-	-
LOSS FROM CONTINUING OPERATIONS, NET OF TAX	(91,470)	(355,139)	(265,257)	(1,252,954)	(16,710,147)
Income from discontinued operations, net of tax	-	73,078	-	324,490	401,190

NET LOSS	$	(91,470)	$	(282,061)	$	(265,257)	$	(928,464)	$	(16,308,957)

See accompanying notes to condensed consolidated financial statements.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (LOSS)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008
AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION)
THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"), except for number of shares)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,		Period from January 19, 2007 (inception) through September 30, 2009
	2009	2008	2009	2008	
Other comprehensive income:					
Foreign currency translation gain	(5,380)	188,384	96	617,919	351,926
COMPREHENSIVE LOSS	$ (96,850)	$ (93,677)	$ (265,161)	$ (310,545)	$ (15,957,031)
Loss from continuing operations per share - Basic and diluted	$ (0.00)	$ (0.01)	$ (0.01)	$ (0.03)	$ (0.44)
Income from discontinued operations per share - Basic and diluted	$ -	$ 0.00	$ -	$ 0.01	$ 0.01
Net loss per share – Basic and diluted	$ (0.00)	$ (0.01)	$ (0.01)	$ (0.02)	$ (0.43)
Weighted average shares outstanding – basic and diluted	37,898,251	37,898,251	37,898,251	37,898,251	37,898,251

See accompanying notes to condensed consolidated financial statements.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
(Unaudited)

	Nine months ended September 30,		Period from January 19, 2007 (inception) through September 30,
	2009	2008	2009
Cash flows from operating activities:			
Loss from continuing operations	$ (265,257)	$ (1,252,954)	$ (16,710,147)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities:			
Depreciation	2,365	2,384	5,927
Amortization of intangible assets	-	447,472	598,562
Impairment of long-lived assets	-	-	14,481,991
Write-off of obsolete inventories	-	-	87,299
Loss on disposal of plant and equipment	-	1,667	1,669
Change in operating assets and liabilities:			
Inventories	-	(139,430)	(87,299)
Prepayments and other receivables	-	(211,849)	(46,233)
Deferred revenue	-	(323,879)	-
Accounts payable, trade	-	-	80,692
Accounts receivable, trade	-	81,491	-
Amount due to related party	-	99,937	-
Other payables and accrued liabilities	(35,193)	37,562	(22,024)
Net cash used in operating activities	(298,085)	(1,257,599)	(1,609,563)
Net cash provided by discontinued operations	-	324,490	401,190
Cash flows from investing activities:			
Proceeds from disposal of subsidiary	-	5,617,101	-
Payment to the investment in an unconsolidated entity	-	-	(8,448,584)
Acquisition of property, plant and equipment	-	(240,722)	(262,313)
Acquisition of land use right	-	(261,840)	(185,402)
Acquisition of intangible assets	-	-	(5,960,775)
Net cash used in investing activities	-	5,114,539	(14,857,074)
Net cash provided by (used in) discontinued operations	-	-	(2,382)
Cash flows from financing activities:			
Advances from (repayment to) a related party	289,144	(4,797,925)	15,537,885
Net increase in bank overdraft	-	33,503	-
Proceeds from short-term borrowings	-	512,065	6,080,032
Proceeds from (repayment of) bills payable	-	-	(6,080,032)
Net cash provided by (used in) financing activities	289,144	(4,252,357)	15,537,885

Effect of exchange rate changes on cash and cash equivalents	128	594,476	532,684
Net change in cash and cash equivalents	(8,813)	523,549	2,740
BEGINNING OF PERIOD	11,553	3,597	-
END OF PERIOD	$ 2,740	$ 527,146	$ 2,740
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for income taxes	$ -	$ -	$ -
Cash paid for interest	$ -	$ -	$ -

See accompanying notes to condensed consolidated financial statements.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"), except for number of shares)
(Unaudited)

	Common stock			Accumulated		Deficit accumulated	
	No. of shares	Amount	Additional paid-in capital	other comprehensive (loss) income	Retained earnings	during development stage	Total stockholders' equity (deficit)
Balance as of January 19, 2007	37,898,251	$ 37,898	$ 6,901,232	$ 180,418	$ 8,585,184	$ -	$ 15,704,732
Net loss for the year	-	-	-	-	(3,634,549)	-	(3,634,549)
Foreign currency translation adjustment	-	-	-	(8,766)	-	-	(8,766)
Balance as of December 31, 2007	37,898,251	37,898	6,901,232	171,652	4,950,635	-	12,061,417
Net income (loss) for the year	-	-	-	-	401,190	(16,444,890)	(16,043,700)
Foreign currency translation adjustment	-	-	-	360,596	-	-	360,596
Balance as of December 31, 2008	37,898,251	37,898	6,901,232	532,248	5,351,825	(16,444,890)	(3,621,687)
Net loss for the period	-	-	-	-	(265,257)	-	(265,257)
Foreign currency translation adjustment	-	-	-	96	-	-	96
Balance as of September 30, 2009	37,898,251	$ 37,898	$ 6,901,232	$ 532,344	$ 5,086,568	$ (16,444,890)	$ (3,886,848)

See accompanying notes to condensed consolidated financial statements.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by management in accordance with both accounting principles generally accepted in the United States ("GAAP"), and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and note disclosures normally included in audited financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

In the opinion of management, the consolidated balance sheet as of December 31, 2008 which has been derived from audited financial statements and these unaudited condensed consolidated financial statements reflect all normal and recurring adjustments considered necessary to state fairly the results for the periods presented. The results for the period ended September 30, 2009 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2009 or for any future period.

These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the Management's Discussion and the audited financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2008.

NOTE 2 ORGANIZATION AND BUSINESS BACKGROUND

Innocom Technology Holdings, Inc. (the "Company" or "INCM") was incorporated in the State of Nevada on June 26, 1998. On June 20, 2006, the Company changed its name from "Dolphin Productions, Inc." to "Innocom Technology Holdings, Inc."

The Company, through its subsidiaries, is principally engaged in trading and manufacture of mobile phone handsets and components in Hong Kong and the People's Republic of China ("the PRC").

In February, the Company has temporarily ceased its planned principal operation in the manufacturing facility in Changzhou City, Zhejiang Province, the PRC. Starting from the fourth quarter 2008, global economic conditions have deteriorated significantly across the countries and the demand for communication products and components was adversely slowed down. During such challenging economic times, the Company discontinued operation in the manufacture of mobile communication products and components in the PRC. The Company intends to continue to operate the manufacturing facility depending upon the market recovery condition and demands from the customers.

INCM and its subsidiaries are hereinafter referred to as (the "Company").

NOTE 3 GOING CONCERN UNCERTAINTIES

These condensed consolidated financial statements have been prepared assuming that Company will continue as a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The accompanying condensed consolidated financial statements do not reflect any adjustments that might result if the Company is unable to continue as a going concern. The Company does not generate significant revenue, and has negative cash flows from operations, which raise substantial doubt about the Company's ability to continue as a going concern.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
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The continuation of the Company is dependent upon the continuing financial support from its shareholders throughout September 30, 2010. Management believes this funding will continue, and is also actively seeking new investors. Management believes the existing shareholders will provide the additional cash to meet the Company's obligations as they become due, and will allow its planned principal business to commence and assembly the production lines of mobile handsets and components in the PRC.

NOTE 4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

l Use of estimates

In preparing these condensed consolidated financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheets and revenues and expenses during the periods reported. Actual results may differ from these estimates.

l Basis of consolidation

The condensed consolidated financial statements include the financial statements of INCM and its subsidiaries. All significant inter-company balances and transactions within the Company have been eliminated upon consolidation.

l Development stage company

The Company has no substantive operations as of September 30, 2009 and the historical operations of the Company relating to its planned manufacturing facility in the PRC are presented for the period from January 19, 2007 (date of inception). The Company is considered as a development stage company in accordance with the provisions of Accounting Standards Codification ("ASC") Topic 915 "Development Stage Entities".

l Revenue recognition

The Company will recognize its revenue in accordance with the ASC Topic 605, "Revenue Recognition in Financial Statements". Revenue will be recognized upon shipment, provided that evidence of an arrangement exists, title and risk of loss have passed to the customer, fees are fixed or determinable and collection of the related receivable is reasonably assured. Revenue will be recorded net of taxes and estimated product returns, which is based upon the Company's return policy, sales agreements, management estimates of potential future product returns related to current period revenue, current economic trends, changes in customer composition and historical experience. To date, the Company has had no revenues and is in the development stage.

l Cash and cash equivalents

Cash and cash equivalents are carried at cost and represent cash on hand, demand deposits placed with banks or other financial institutions and all highly liquid investments with an original maturity of three months or less as of the purchase date of such investments.

l Intangible assets

Intangible assets include trademarks of mobile phone handsets purchased from a third party. In accordance with ASC Subtopic 350-50 “General Intangibles Other Than Goodwill”, intangible assets with finite useful lives related to developed technology, customer lists, trade names and other intangibles are being amortized on a straight-line basis over the estimated useful life of the related asset.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
(Unaudited)

Trademarks are carried at cost less accumulated amortization and impairment loss, are amortized on a straight-line basis over their estimated useful lives of 10 years beginning at the time the related trademarks are granted. They will be used in the planned assembly line for mobile phone communication products and components in the PRC and subject to amortization when they are in operational use.

For the three and nine months ended September 30, 2009, amortization is no longer required since their carrying values were fully provided for impairment loss in 2008.

l Land use right

All lands in the People's Republic of China (the "PRC") are owned by the PRC government. The government in the PRC, according to the relevant PRC law, may sell the right to use the land for a specified period of time. Thus, all of the Company's land purchases in the PRC are considered to be leasehold land and are stated at cost less accumulated amortization and any recognized impairment loss. Amortization is provided over the term of the land use right agreements on a straight-line basis, which is 45 years and they will expire in 2054.

For the three and nine months ended September 30, 2009, amortization is no longer required since its carrying value was fully provided for impairment loss during 2008.

l Plant and equipment, net

Plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Depreciation is calculated on the straight-line basis (after taking into account their respective estimated residual values) over the following expected useful lives from the date on which they become fully operational:

	Depreciable life	Residual value
Plant and machinery	5-10 years	5%
Furniture, fixtures and office equipment	5 years	5%
Leasehold improvement	2 years	0%

Expenditure for repairs and maintenance is expensed as incurred. When assets have retired or sold, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in the results of operations.

l Valuation of long-lived assets

Long-lived assets primarily include plant and equipment, land use right and intangible assets. In accordance with ASC Subtopic 360-10- "Impairment or Disposal of Long-Lived Assets", the Company periodically reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives are no longer appropriate. Each impairment test is based on a comparison of the undiscounted cash flows to the recorded value of the asset. If an impairment is indicated, the asset is written down to its estimated fair value based on a discounted cash flow analysis. Determining the fair value of long-lived assets includes significant judgment by management, and different judgments could yield different results. There has been no impairment as of September 30, 2009.

l Comprehensive (loss) income

ASC Topic 220 “Comprehensive Income” establishes standards for reporting and display of comprehensive income, its components and accumulated balances. Comprehensive income as defined includes all changes in equity during a period from non-owner sources. Accumulated comprehensive income, as presented in the accompanying consolidated statements of stockholders’ equity consists of changes in unrealized gains and losses on foreign currency translation. This comprehensive income is not included in the computation of income tax expense or benefit.

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
(Unaudited)

l Income taxes

The Company adopts the ASC Topic 740 "Income Taxes", regarding accounting for uncertainty in income taxes prescribes the recognition threshold and measurement attributes for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. In addition, the guidance requires the determination of whether the benefits of tax positions will be more likely than not sustained upon audit based upon the technical merits of the tax position. For tax positions that are determined to be more likely than not sustained upon audit, a company recognizes the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not determined to be more likely than not sustained upon audit, a company does not recognize any portion of the benefit in the financial statements. The guidance provides for de-recognition, classification, penalties and interest, accounting in interim periods and disclosure.

The Company did not have any unrecognized tax positions or benefits and there was no effect on the financial condition or results of operations for the period ended September 30, 2009. The Company and its subsidiaries are subject to local and various foreign tax jurisdictions. The Company's tax returns remain open subject to examination by major tax jurisdictions.

l Net (loss) income per share

The Company calculates net (loss) income per share in accordance with ASC Topic 260, "Earnings per Share". Basic (loss) income per share is computed by dividing the net (loss) income by the weighted-average number of common shares outstanding during the period. Diluted (loss) income per share is computed similar to basic (loss) income per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common stock equivalents had been issued and if the additional common shares were dilutive.

l Foreign currencies translation

Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency using the applicable exchange rates at the balance sheet dates. The resulting exchange differences are recorded in the statement of operations.

The reporting currency of the Company is the United States dollar ("US$"). The Company's subsidiaries operating in Hong Kong maintained their books and records in its local currency, Hong Kong Dollars ("HK$"), which are functional currencies as being the primary currency of the economic environment in which these entities operate.

In general, assets and liabilities are translated into US$, in accordance with ASC Subtopic 830-30 "Translation of Financial Statement", using the exchange rate on the balance sheet date. Revenues and expenses are translated at average rates prevailing during the period. The gains and losses resulting from translation of financial statements of foreign subsidiaries are recorded as a separate component of accumulated other comprehensive income within the statement of stockholders’ equity.

Translation of amounts from HK$ into US$ has been made at the following exchange rates for the respective period:

INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars (“US$”))
(Unaudited)

	September 30, 2009	September 30, 2008
Period-end RMB:US$ exchange rate	6.838	6.855
Average monthly RMB:US$ exchange rate	6.843	6.999
Period-end HK$:US$ exchange rate	7.750	7.770
Average monthly HK$:US$ exchange rate	7.752	7.798

l Related parties

Parties, which can be a corporation or individual, are considered to be related if the Company has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence.

l Fair value measurement

ASC Topic 820 “Fair Value Measurements and Disclosures” ("ASC 820") establishes a new framework for measuring fair value and expands related disclosures. Broadly, ASC 820 framework requires fair value to be determined based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. ASC 820 establishes a three-level valuation hierarchy based upon observable and non-observable inputs. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

For financial assets and liabilities, fair value is the price the Company would receive to sell an asset or pay to transfer a liability in an orderly transaction with a market participant at the measurement date. In the absence of active markets for the identical assets or liabilities, such measurements involve developing assumptions based on market observable data and, in the absence of such data, internal information that is consistent with what market participants would use in a hypothetical transaction that occurs at the measurement date.

l Recent accounting pronouncements

The Company has reviewed all recently issued, but not yet effective, accounting pronouncements and does not believe the future adoption of any such pronouncements may be expected to cause a material impact on its financial condition or the results of its operations.

In April 2009, the FASB issued an update to ASC Topic 820 “Fair Value Measurements and Disclosures” to provide additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. Additionally, additional disclosures are required regarding fair value in interim and annual reports. These provisions are effective for interim and annual periods ending after June 15, 2009. The Company adopted this guidance and it did not materially affect the Company's financial position and results of operations.

In May 2009, the FASB issued ASC Topic 855 "Subsequent Events" which established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Furthermore, this requires disclosure of the date through which subsequent events were evaluated. These requirements are effective for interim and annual periods after June 15, 2009. The Company adopted these requirements for the quarter ended September 30, 2009, and have evaluated subsequent events through November 2, 2009.

INNOCOM TECHNOLOGY HOLDINGS, INC.
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JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
(Unaudited)

In June 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-1, "Topic 105 — Generally Accepted Accounting Principles" which amended ASC 105, "Generally Accepted Accounting Principles" to establish the Codification as the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification superseded all then-existing non-SEC accounting and reporting standards. All previous references to the superseded standards in our consolidated financial statements have been replaced by references to the applicable sections of the Codification. The adoption of these sections did not have a material impact on the Company's condensed consolidated financial statements.

In August 2009, the FASB issued an update of ASC Topic 820 "Measuring Liabilities at Fair Value ". The new guidance provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using prescribed techniques. The Company adopted the new guidance in the third quarter of 2009 and it did not materially affect the Company's financial position and results of operations.

In October 2009, the FASB issued ASU No. 2009-13, "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force)" which amends ASC 605-25, "Revenue Recognition: Multiple-Element Arrangements." ASU No. 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how to allocate consideration to each unit of accounting in the arrangement. This ASU replaces all references to fair value as the measurement criteria with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. ASU No. 2009-13 also eliminates the use of the residual value method for determining the allocation of arrangement consideration. Additionally, ASU No. 2009-13 requires expanded disclosures. This ASU will become effective for us for revenue arrangements entered into or materially modified on or after April 1, 2011. Earlier application is permitted with required transition disclosures based on the period of adoption. The Company is currently evaluating the application date and the impact of this standard on its condensed consolidated financial statements.

NOTE 5 DISCONTINUED OPERATIONS

Starting from the fourth quarter of 2008, global economic conditions have deteriorated significantly across the countries and the demand for communication products and components was adversely slowed down. The Company has discontinued its trading business in the mobile communication products and components in Hong Kong since the customers no longer demanded for sales orders during the first, second and third quarters of 2009.

NOTE 6 AMOUNT DUE TO A RELATED PARTY

As of September 30, 2009, a balance of $4,441,554 due to a director and a major shareholder of the Company, Mr. William Hui, represented temporary advance to the Company which was unsecured, interest-free with no fixed repayment term.

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INNOCOM TECHNOLOGY HOLDINGS, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND FOR THE PERIOD FROM JANUARY 19, 2007 (INCEPTION) THROUGH SEPTEMBER 30, 2009
(Currency expressed in United States Dollars ("US$"))
(Unaudited)

NOTE 7 INCOME TAXES

The Company operates in various countries: United States, British Virgin Island, Hong Kong and the PRC that are subject to taxes in the jurisdictions in which they operate, as follows:

United States of America

The Company is registered in the State of Nevada and is subject to United States current tax law.

British Virgin Island

Under the current BVI law, the Company is not subject to tax on income.

Hong Kong

For the nine months ended September 30, 2009 and 2008 and for the period from January 19, 2007 (Inception) through September 30, 2009, no provision for Hong Kong Profits Tax is provided for since the Company's income neither arises in, nor is derived form Hong Kong under its applicable tax law.

The PRC

The Company's subsidiary, CICTL is subject to the unified income rate of 25% on the taxable income. For the nine months ended September 30, 2009 and 2008 and for the period from January 19, 2007 (Inception) through September 30, 2009, CICTL generated net operating losses and accordingly, no provision for income tax has been recorded.

NOTE 8 COMMITMENTS AND CONTINGENCIES

Operating lease commitment

The Company leases an office premise under a non-cancelable operating lease for a term of 2 years due June 15, 2010. Costs incurred under this operating lease are recorded as rent expense and totaled approximately $98,893, $76,368 and $326,968 for the nine months ended September 30, 2009 and 2008, and the period from January 19, 2007 (Inception) through September 30, 2009.

As of September 30, 2009, the Company has the future minimum rental payments of $99,174 under a non-cancelable operating lease in the next 12 months.

NOTE 9 SUBSEQUENT EVENTS

The Company evaluated subsequent events through November 2, 2009, the date the financial statements were issued, and there were no subsequent events which impacted the Company's financial position or results of operations as of

September 30, 2009 or which required disclosure.

ITEM 2. MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION OR PLAN OF OPERATION

The following review concerns three months ended September 30, 2009 and September 30, 2008, and nine months ended September 30, 2009 and September 30, 2008, which should be read in conjunction with the financial statements and notes thereto presented in the Form 10-K.

Forward Looking Statements

The information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding our capital needs, business strategy and expectations. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. We disclaim any obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

History

Innocom Technology Holdings, Inc. (the “Company” or “INCM”) was incorporated in the State of Nevada on June 26, 1998.

On June 20, 2006, the Company changed its name from “Dolphin Productions, Inc.” to “Innocom Technology Holdings, Inc.”

On January 19, 2007, Changzhou Innocom Communication Technology Limited is incorporated and registered in the People’s Republic of China (“the PRC”).

On May 16, 2007, the Company purchased a 10 years mobile phone manufacturing license in a consideration of RMB45 million (approximately $5,770,000) and annual license fee of RMB500,000 (approximately $64,000).

On May 8, 2008, the Company completed the establishment of a new subsidiary, Changzhou Innocom Communication Technology Limited in the PRC upon the approval of its local government.

Overview and Future Plan of Operations

In February 2009, the Company determined to have a temporary closure in the manufacturing facility in Changzhou City, Zhejiang Province, the PRC. Starting from the fourth quarter 2008, global economic conditions have deteriorated significantly across the countries and the demand for communication products and components was adversely slowed down. During such challenging economic times, the Company has discontinued operation in the manufacture of mobile communication products and components in the PRC. However, the Company did not intend to dispose by sale and may continue to operate the manufacturing facility depending upon the market recovery condition in the next 12 months.

Results of Operations for Three Months ended September 30, 2009 and September 30, 2008 and Nine Months Ended September 30, 2009 and September 30, 2008

During the three months ended September 30, 2009, we experienced a net loss of $91,470 compared to a net loss of $282,061 for three months ended September 30, 2008. During nine months ended September 30, 2009, we experienced a net loss of $265,257 compared to a net loss of $928,464 for nine months ended September 30, 2008. The loss is attributable to the significant deteriorated environment and the challenging economic crisis of the period.

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Revenue

As a result of temporary discontinue of business and operation in the manufacture of mobile communication products and components in the PRC, no revenue is recorded during both three and nine months ended September 30, 2009.

Cost of Sales

As a result of temporary discontinue of business and operation in the manufacture of mobile communication products and components in the PRC, no cost of sale is recorded during both three and nine months ended September 30, 2009.

Administrative Expenses

Administrative expenses mainly included office rental charges, salaries and professional fee.

Below table sets out the components of non-cash items:

	Three Months ended September 30,		Nine Months ended September 30,	
	2009	2008	2009	2008
Depreciation	$ 788	$ 1,138	$ 2,365	$ 2,384
Amortization of intangible assets	-	150,213	-	447,472
	$ 788	$ 151,351	$ 2,365	$ 449,856

The depreciation policy adopted in for the fiscal year 2009 was consistent with that adopted in 2008.

The decrease in amortization of intangible assets is due to intangible assets being written off during the last quarter of 2008.

Other Income

Total other income for both periods presented was immaterial and consisted of the following:

	Three Months ended September 30, 2009	Three Months ended September 30, 2008	Nine Months ended September 30, 2009	Nine Months ended September 30, 2008
Interest income	$ -	$ 9,719	$ -	$ 20,796
Interest expense	$ -	$ 167,699	$ -	$ 270,403

Net Loss

Net loss for the nine months ended September 30, 2009 was $265,527 compared to net loss of $928,464 for the nine months ended September 30, 2008. Loss of both periods is attributable to the significant deteriorated environment and the challenging economic crisis of the periods. .

Trends, Events, and Uncertainties

On May 8, 2008, we have completed the establishment of a new subsidiary, Changzhou Innocom Communication Technology Limited in Changzhou, Jiangsu Province, China upon the approval of its local government. Trial assembling of mobile phones has been completed. We will assemble mobile phones under the purchased trade mark namely "Tsinghua Unisplendour" and other mobile phone components on OEM basis. On August 13, 2008, this subsidiary has entered into an annual assembling service agreement for a brand-name mobile phone manufacturer on OEM basis. We expect to start assembling service in first quarter of 2009.

However, starting from the fourth quarter 2008, global economic conditions have deteriorated significantly across the countries and the demand for communication products and components was adversely slowed down. During challenging economic times, the Company determined to discontinue operation in the manufacture of mobile communication products and components in February 2009.

Liquidity and Capital Resources for Nine Months Ended September 30, 2009 and 2008

Cash flows from operating activities

We experienced negative cash flows used in operations in the amount of $298,085 for nine months ended September 30, 2009 as compared with negative cash flow used in the operations in the amount of $933,109 for nine months ended September 30, 2008.

Cash flows from investing activities

During nine months ended September 30, 2009, there are no investment activities.

During nine months ended September 30, 2008, we had positive cash flow provided by investment activities in the amount of $5,114,539. We received proceed from disposal of subsidiaries of $5,617,101. We used $240,722 to purchase property, plant and equipment and made a capital payment of $261,840 in acquisition of land use right.

Cash flows from financing activities

During nine months ended September 30, 2009 we experienced positive cash flow advanced from a related party in the amount of $289,144.

During nine months ended September 30, 2008, we experienced negative cash flows in financing activities in the amount of $4,252,357. We repay advance from a related party in the amount of $4,797,925. On the other hand, we obtained short-term bank loans and note payable of $512,065 and $33,503 respectively.

Liquidity

On a long-term basis, our liquidity will be dependent on establishing profitable operations, receipt of revenues, additional infusions of capital and additional financing. If necessary, we may raise capital through an equity or debt offering. The funds raised from this offering will be used to develop and execute our business plan. However, there can be no assurance that we will be able to obtain additional equity or debt financing in the future, if at all. If we are unable to raise additional capital, our growth potential will be adversely affected. Additionally, we will have to significantly modify our plans.

Critical Accounting Policies

The financial statements are prepared in accordance with accounting principles generally accepted in the U.S., which requires us to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying financial statements and related footnotes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. We do not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Details of critical accounting policies are set out in notes to the financial statements included in Item 1.

Employees

As of September 30, 2009, we had approximately 5 full-time employees employed in Hong Kong. From time to time we employ independent contractors to support our production, engineering, marketing, and sales departments.

Website Access to our SEC Reports

Our Internet website address is www.innocomtechnology.com. Through our Internet website, we will make available, free of charge, the following reports as soon as reasonably practicable after electronically filing them with, or furnishing them to, the SEC: our Annual Reports on Form 10-K; our Quarterly Reports on Form 10-Q; our Current Reports on Form 8-K; and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Our Proxy Statements for our Annual Stockholder Meetings are also available through our Internet website. Our Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

You may also obtain copies of our reports without charge by writing to:

Attn: Investor Relations
Suite 1501, Bank of East Asia Harbour View Centre
56 Gloucester Road
Wanchai, Hong Kong, PRC

The public may also read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549, or through the SEC website at www.sec.gov. The Public Reference Room may be contact at (800) SEC-0330. You may also access our other reports via that link to the SEC website.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Foreign Exchange Risk

While our reporting currency is the U.S. Dollar, all of our consolidated revenues and consolidated costs and expenses are denominated in Renminbi. All of our assets are denominated in RMB except for cash. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be affected by fluctuations in the exchange rate between U.S. Dollars and RMB. If the RMB depreciates against the U.S. Dollar, the value of our RMB revenues, earnings and assets as expressed in our U.S. Dollar financial statements will decline. We have not entered into any hedging transactions in an effort to reduce our exposure to foreign exchange risk.

Inflation

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenues if the selling prices of our products do not increase with these increased costs.

ITEM 4T. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures.

Based on an evaluation under the supervision and with the participation of management, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as defined in Section 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act") were effective as of March 31, 2008 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2009, which were identified in connection with management's evaluation required by paragraph (d) of rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not involved in any material pending legal proceedings at this time, and management is not aware of any contemplated proceeding by any governmental authority.

ITEM 1A. RISK FACTORS

N/A

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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INDEX TO EXHIBITS
OF
INNOCOM TECHNOLOGY HOLDINGS, INC.

31.1	Rule 13a-14 (a)/15d-14 (a) Certification of Chief Executive Officer
31.2	Rule 13a-14 (a)/15d-14 (a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INNOCOM TECHNOLOGY HOLDINGS, INC.

	/s/ William Yan Sui Hui, Chief Executive Officer
Dated: November 2, 2009	(Principal executive officer)
	/s/ Cheung Wai Hung, Eddie, Chief Financial Officer
Dated: November 2, 2009	(Principal financial officer)

w:hidden;height:20px;font-size:10pt;">

Net income (loss) per share:

Basic

$
1.25

0.68

(0.46
)

1.43

1.58

Diluted

$
1.24

0.67

(0.46
)

1.42

1.37

Weighted average number of common shares outstanding – basic

23,825

23,433

16,972

16,203

15,943

Weighted average number of common and common equivalent shares outstanding – diluted

24,040

23,489

16,972

16,418

20,906

Dividends declared per issued and outstanding common share as of the applicable dividend record date

$

0.40

0.60

1.20

1.20

1.175

45

	Fiscal Years Ended July 31, (In thousands)				
	2018	2017	2016	2015	2014
Other Consolidated Operating Data:					
Backlog at period-end	$630,695	446,230	484,005	117,744	133,412
New orders	755,054	512,593	451,278	291,621	290,820
Research and development expenditures - internal and customer funded	70,793	81,310	59,622	45,144	47,211
Adjusted EBITDA	78,374	70,705	48,062	51,761	61,336

	As of July 31, (In thousands)				
	2018	2017	2016	2015	2014
Consolidated Balance Sheet Data:					
Total assets	$845,157	832,063	921,196	473,877	473,852
Working capital	114,477	96,833	119,493	236,419	224,656
Debt, including capital leases and other obligations	167,899	195,802	258,649	—	—
Other long-term obligations	4,117	2,655	4,105	3,633	4,364
Stockholders’ equity	505,684	480,150	470,401	401,409	396,925

Non-GAAP Financial Data

This Annual Report on Form 10-K contains a Non-GAAP financial metric for the Company titled Adjusted EBITDA, which represents earnings (loss) before income taxes, interest (income) and other expense, interest expense, amortization of stock-based compensation, amortization of intangibles, depreciation expense, settlement of intellectual property litigation, acquisition plan expenses, restructuring (benefits) charges related to the wind-down of the microsatellite product line and strategic alternatives analysis expenses and other. In future periods, we expect to incur expenses similar to the aforementioned items and investors should not infer from our presentation of Adjusted EBITDA that these costs are unusual, infrequent or non-recurring. These items, while periodically affecting our results, may vary significantly from period to period and may have a disproportionate effect in a given period, thereby affecting the comparability of results.

Adjusted EBITDA is a Non-GAAP financial measure used by management in assessing Comtech’s operating results. Although closely aligned, Comtech's definition of Adjusted EBITDA is different than the Consolidated EBITDA (as such term is defined in our Secured Credit Facility, as amended) utilized for financial covenant calculations and also may differ from the definition of EBITDA or Adjusted EBITDA used by other companies and therefore, may not be comparable to similarly titled measures used by other companies. Our Adjusted EBITDA is also a measure frequently requested by Comtech’s investors and analysts. We believe that investors and analysts may use Adjusted EBITDA, along with other information contained in our SEC filings, in assessing our performance and comparability of our results with other companies.

Non-GAAP financial measures have limitations as an analytical tool as they exclude the financial impact of transactions necessary to conduct our business, such as the granting of equity compensation awards, and are not intended to be an alternative to financial measures prepared in accordance with GAAP. Non-GAAP financial measures should be considered in addition to, and not as a substitute for or superior to, financial measures determined in accordance with GAAP. Investors are advised to carefully review the GAAP financial results that are disclosed in our SEC filings.

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The following is a reconciliation of net income (loss), the most comparable GAAP measure, to Adjusted EBITDA:

	Fiscal Years Ended July 31, (In thousands)				
	2018	2017	2016	2015	2014
Adjusted EBITDA:					
Net income (loss)	$29,769	15,827	(7,738)	23,245	25,151
Income taxes	(5,143)	9,654	(454)	10,758	13,356
Interest (income) and other expense	254	(68)	(134)	(405)	(913)
Interest expense	10,195	11,629	7,750	479	6,304
Amortization of stock-based compensation	8,569	8,506	4,117	4,363	4,263
Amortization of intangibles	21,075	22,823	13,415	6,211	6,285
Depreciation	13,655	14,354	9,830	6,525	6,721
Settlement of intellectual property litigation	—	(12,020)	—	—	—
Acquisition plan expenses	—	—	21,276	—	—
Strategic alternatives analysis and other	—	—	—	585	225
Restructuring (benefits) charges related to the wind-down of microsatellite product line	—	—	—	—	(56)
Adjusted EBITDA	$78,374	70,705	48,062	51,761	61,336

Our historical results prior to February 23, 2016 do not include TCS; as such, you should not rely on period-to-period comparisons as an indicator of future performance as these comparisons may not be meaningful.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a leading provider of advanced communications solutions for both commercial and government customers worldwide. Our solutions fulfill our customers' needs for secure wireless communications in some of the most demanding environments, including those where traditional communications are unavailable or cost-prohibitive, and in mission-critical and other scenarios where performance is crucial.

We manage our business through two reportable operating segments:

- Commercial Solutions - serves commercial customers and smaller governments, such as state and local governments, that require advanced communication technologies to meet their needs. This segment also serves certain large government customers (including the U.S. government) that have requirements for off-the-shelf commercial equipment. We believe this segment is a leading provider of satellite communications (such as satellite earth station modems and traveling wave tube amplifiers ("TWTA")), public safety systems (such as next generation 911 ("NG911") technologies) and enterprise application technologies (such as a messaging and trusted location-based technologies).

- Government Solutions - serves large government end-users (including those of foreign countries) that require mission critical technologies and systems. We believe this segment is a leading provider of command and control applications (such as the design, installation and operation of data networks that integrate computing and communications (including both satellite and terrestrial links)), ongoing network operation and management support services including project management and fielding and maintenance solutions related to satellite ground terminals), troposcatter communications (such as digital troposcatter multiplexers, digital over-the-horizon modems, troposcatter systems, and frequency converter systems) and RF power and switching technologies (such as solid state high-power broadband amplifiers, enhanced position location reporting system (or commonly known as "EPLRS") amplifier assemblies, identification friend or foe amplifiers, and amplifiers used in the counteraction of improvised explosive devices).

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Our Quarterly Financial Information
Quarterly and period-to-period sales and operating results may be significantly affected by either short-term or long-term contracts with our customers. In addition, our gross profit is affected by a variety of factors, including the mix of products, systems and services sold, production efficiencies, estimates of warranty expense, price competition and general economic conditions. Our gross profit may also be affected by the impact of any cumulative adjustments to contracts that are accounted for over time.

Our contracts with the U.S. government can be terminated for convenience by it at any time and orders are subject to unpredictable funding, deployment and technology decisions by the U.S. government. Some of these contracts are indefinite delivery/indefinite quantity ("IDIQ") contracts and, as such, the U.S. government is not obligated to purchase any equipment or services under these contracts. We have, in the past, experienced and we continue to expect significant fluctuations in sales and operating results from quarter-to-quarter and period-to-period. As such, comparisons between periods and our current results may not be indicative of a trend or future performance.

Our historical results prior to February 23, 2016 do not include TeleCommunication Systems, Inc. ("TCS"). Given the integration of TCS into our business and the joint marketing of our products, historical sales patterns and mix trends are not relevant. As a result, period-to-period comparisons of sales, margins, operating income and Adjusted EBITDA contributions between TCS and Comtech legacy products will not be meaningful and you should not rely on period-to-period comparisons as an indicator of future performance.

Critical Accounting Policies

We consider certain accounting policies to be critical due to the estimation process involved in each.

Revenue Recognition. We earn revenue from the sale of advanced communication solutions to customers around the world. Sales of advanced communication solutions can consist of any one or a combination of items required by our customer including hardware, technology platforms and related support. A large portion of our revenue from advanced communication solutions is derived from contracts relating to the design, development or manufacture of complex electronic equipment to a buyer’s specification or to provide services relating to the performance of such contracts and is recognized in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 605-35. For these contracts, we primarily apply the percentage-of-completion accounting method and generally recognize revenue based on the relationship of total costs incurred to total projected costs, or, alternatively, based on output measures, such as units delivered or produced. Profits expected to be realized on such contracts are based on total estimated sales for the contract compared to total estimated costs, including warranty costs, at completion of the contract.

Direct costs which include materials, labor and overhead are charged to work-in-progress (including our contracts-in-progress) inventory or cost of sales. Indirect costs relating to long-term contracts, which include expenses such as general and administrative, are charged to expense as incurred and are not included in our work-in-process (including our contracts-in-progress) inventory or cost of sales. Total estimates are reviewed and revised periodically throughout the lives of the contracts, and adjustments to profits resulting from such revisions are made cumulative to the date of the change. Estimated losses on long-term contracts are recorded in the period in which the losses become evident. Long-term U.S. government cost-reimbursable type contracts are also specifically covered by FASB ASC 605-35.

We have been engaged in the production and delivery of goods and services on a continual basis under contractual arrangements for many years. Historically, we have demonstrated an ability to accurately estimate total revenues and total expenses relating to our long-term contracts. However, there exist inherent risks and uncertainties in estimating revenues, expenses and progress toward completion, particularly on larger or longer-term contracts. If we do not accurately estimate the total sales, related costs and progress towards completion on such contracts, the estimated gross margins may be significantly impacted or losses may need to be recognized in future periods. Any such resulting changes in margins or contract losses could be material to our results of operations and financial condition.

In addition, most government contracts have termination for convenience clauses that provide the customer with the right to terminate the contract at any time. Such terminations could impact the assumptions regarding total contract revenues and expenses utilized in recognizing profit under the percentage-of-completion method of accounting. Changes to these assumptions could materially impact our results of operations and financial condition. Historically, we have not experienced material terminations of our long-term contracts. We also address customer acceptance provisions in assessing our ability to perform our contractual obligations under long-term contracts. Our inability to perform on our long-term contracts could materially impact our results of operations and financial condition. Historically, we have been able to perform on our long-term contracts.

We also derive a portion of our revenues for advanced communication solutions from contracts and purchase orders where revenue is recorded on delivery of products or performance of services. Such revenues are recognized in accordance with the authoritative guidance contained in FASB ASC 605-25 "Revenue Recognition - Multiple Deliverable Revenue Arrangements" ("FASB ASC 605-25") and, as applicable, FASB ASC 605-20 "Revenue Recognition - Services" ("FASB ASC 605-20") and Accounting Standards Update ("ASU") No. 2009-14 (FASB ASC Topic 985) "Certain Revenue Arrangements That Include Software Elements." Revenue recognition for multiple-element arrangements requires judgment to determine if multiple elements exist, whether elements can be accounted for as separate units of accounting, and if so, the fair value for each of the elements. In summary, we recognize revenue for each separate unit of accounting when the applicable revenue recognition criteria for each element have been met. We allocate revenue to each separate unit of accounting in a multi-element arrangement based on the relative fair value of each element, using vendor-specific objective evidence ("VSOE") of their fair values, if available. VSOE is generally determined based on the price charged when an element is sold separately. In the absence of VSOE of fair value, the fee is allocated among each element based on third-party evidence ("TPE") of fair value, which is determined based on competitor pricing for similar deliverables when sold separately. When we are unable to establish fair value using VSOE or TPE, we use estimated selling price ("ESP") to allocate value to each element. The objective of ESP is to determine the price at which we would transact a sale if the product or service were sold separately. We determine ESP for deliverables by considering multiple factors including, but not limited to, prices we charge for similar offerings, market conditions, competitive landscape, and pricing practices. For multiple element arrangements that contain only software and software-related elements, we allocate the fees to each element based on the VSOE of fair value of each element. Due to the nature of some of the agreements it may be difficult to establish VSOE of separate elements of an agreement; in these circumstances the appropriate recognition of revenue may require the use of judgment based on the particular facts and circumstances.

As further discussed in "Notes to Consolidated Financial Statements - Note (1)(c) - Summary of Significant Accounting and Reporting Policies - Revenue Recognition" included in "Part II - Item 8. - Financial Statements and Supplementary Data," on August 1, 2018 (the start of our first quarter of fiscal 2019), we adopted FASB ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)," which replaces numerous requirements in U.S. GAAP, including industry specific requirements, and provides a single revenue recognition model for contracts with customers. The ASU applies to all open contracts existing as of August 1, 2018. As provided by the ASU, we adopted the new revenue recognition model using the modified retrospective method and there was no material impact on our business, results of operations and financial condition. In fiscal 2019, we expect to recognize a significant portion of our contracts over time, as there is a continuous transfer of control to the customer over the contractual period of performance. The remainder of our contracts will be recognized at a point in time. Both of these methods are similar to what we did prior to August 1, 2018.

Impairment of Goodwill and Other Intangible Assets. As of July 31, 2018, total goodwill recorded on our Consolidated Balance Sheet aggregated $290.6 million (of which $231.4 million relates to our Commercial Solutions segment and $59.2 million relates to our Government Solutions segment). Additionally, as of July 31, 2018, net intangibles recorded on our Consolidated Balance Sheet aggregated $240.8 million (of which $199.0 million relates to our Commercial Solutions segment and $41.8 million relates to our Government Solutions segment). Each of our two operating segments constitutes a reporting unit and we must make various assumptions in determining their estimated fair values.

In accordance with FASB ASC 350 "Intangibles - Goodwill and Other," we perform a goodwill impairment analysis at least annually (in the first quarter of each fiscal year), unless indicators of impairment exist in interim periods. If we fail the quantitative assessment of goodwill impairment ("quantitative assessment"), pursuant to our adoption of FASB ASU No. 2017-04 in fiscal 2017, we would be required to recognize an impairment loss equal to the amount that a reporting unit's carrying value exceeded its fair value; however, any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

On August 1, 2018 (the first day of our fiscal 2019), we performed our annual quantitative assessment using market participant assumptions to determine if the fair value of each of our reporting units with goodwill exceeded its carrying value. In making this assessment, we considered, among other things, expectations of projected net sales and cash flows, assumptions impacting the weighted average cost of capital, trends in trading multiples of comparable companies, changes in our stock price and changes in the carrying values of our reporting units with goodwill. We also considered overall business conditions.

In performing the quantitative assessment, we estimated the fair value of each of our reporting units using a combination of the income and market approaches. The income approach, also known as the discounted cash flow ("DCF") method, utilizes the present value of cash flows to estimate fair value. The future cash flows for our reporting units were projected based on our estimates, at that time, of future revenues, operating income and other factors (such as working capital and capital expenditures). For purposes of conducting our impairment analysis, we assumed revenue growth rates and cash flow projections that are below our actual long-term expectations. The discount rates used in our DCF method were based on a weighted-average cost of capital ("WACC") determined from relevant market comparisons, adjusted upward for specific reporting unit risks (primarily the uncertainty of achieving projected operating cash flows). A terminal value growth rate was applied to the final year of the projected period and reflected our estimate of stable, perpetual growth. We then calculated a present value of the respective cash flows for each reporting unit to arrive at an estimate of fair value under the income approach. Under the market approach, we estimated a fair value based on comparable companies' market multiples of revenues and earnings before interest, taxes, depreciation and amortization and factored in a control premium. Finally, we compared our estimates of fair values to our August 1, 2018 total public market capitalization and assessed implied control premiums based on our common stock price of $33.70 as of August 1, 2018.

Based on our quantitative evaluation, we determined that our Commercial Solutions and Government Solutions reporting units had estimated fair values in excess of their carrying values of at least 42.5% and 105.5%, respectively, and concluded that our goodwill was not impaired and that neither of our two reporting units was at risk of failing the quantitative assessment. It is possible that, during fiscal 2019 or beyond, business conditions (both in the U.S. and internationally) could deteriorate from the current state, our current or prospective customers could materially postpone, reduce or even forgo purchases of our products and services to a greater extent than we currently anticipate, or our common stock price could decline. A significant decline in our customers' spending that is greater than we anticipate or a shift in funding priorities may also have a negative effect on future orders, sales, income and cash flows and we might be required to perform a quantitative assessment during fiscal 2019 or beyond. If assumed net sales and cash flow projections are not achieved in future periods or our common stock price significantly declines from current levels, our Commercial Solutions and Government Solutions reporting units could be at risk of failing the quantitative assessment and goodwill and intangibles assigned to the respective reporting units could be impaired.

In any event, we are required to perform the next annual goodwill impairment analysis on August 1, 2019 (the start of our fiscal 2020). If our assumptions and related estimates change in the future, or if we change our reporting unit structure or other events and circumstances change (e.g., a sustained decrease in the price of our common stock (considered on both absolute terms and relative to peers)), we may be required to record impairment charges when we perform these tests, or in other future periods. In addition to our impairment analysis of goodwill, we also review net intangible assets with finite lives when an event occurs indicating the potential for impairment. We believe that the carrying values of our net intangible assets were recoverable as of July 31, 2018. Any impairment charges that we may record in the future could be material to our results of operations and financial condition.

Provision for Warranty Obligations. We provide warranty coverage for most of our products, including products under long-term contracts, for a period of at least one year from the date of shipment. We record a liability for estimated warranty expense based on historical claims, product failure rates and other factors. Costs associated with some of our warranties that are provided under long-term contracts are incorporated into our estimates of total contract costs. There exist inherent risks and uncertainties in estimating warranty expenses, particularly on larger or longer-term contracts. If we do not accurately estimate our warranty costs, any changes to our original estimates could be material to our results of operations and financial condition.

Accounting for Income Taxes. Our deferred tax assets and liabilities are determined based on temporary differences between financial reporting and tax bases of assets and liabilities, and applying enacted tax rates expected to be in effect for the year in which we expect the differences to reverse. Our provision for income taxes is based on domestic (including federal and state) and international statutory income tax rates in the tax jurisdictions where we operate, permanent differences between financial reporting and tax reporting and available credits and incentives. We recognize interest and penalties related to uncertain tax positions in income tax expense. The U.S. federal government is our most significant income tax jurisdiction.

Significant judgment is required in determining income tax provisions and tax positions. We may be challenged upon review by the applicable taxing authority and positions taken by us may not be sustained. We recognize all or a portion of the benefit of income tax positions only when we have made a determination that it is more likely than not that the tax position will be sustained upon examination, based upon the technical merits of the position and other factors. For tax positions that are determined as more likely than not to be sustained upon examination, the tax benefit recognized is the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The development of valuation allowances for deferred tax assets and reserves for income tax positions requires consideration of timing and judgments about future taxable income, tax issues and potential outcomes, and are subjective critical estimates. A portion of our deferred tax assets consist of federal net operating losses and federal research and experimentation tax credit carryforwards, most of which was acquired in connection with our acquisition of TCS. No valuation allowance has been established on these deferred tax assets based on our evaluation that our ability to realize such assets has met the criteria of "more likely than not." We continuously evaluate additional facts representing positive and negative evidence in determining our ability to realize these deferred tax assets. In certain circumstances, the ultimate outcome of exposures and risks involves significant uncertainties. If actual outcomes differ materially from these estimates, they could have a material impact on our results of operations and financial condition.

On December 22, 2017, H.R.1, also known as the Tax Cuts and Jobs Act ("Tax Reform") was enacted in the U.S. Tax Reform significantly revised the U.S. tax code and lowered the amount of our current and future income tax expense primarily due to the reduction in the U.S. statutory income tax rate from 35.0% to 21.0%. This provision went into effect on January 1, 2018 and required us to remeasure our deferred tax assets and liabilities. In fiscal 2019 and beyond, Tax Reform will result in the loss of our ability to take the domestic production activities deduction, which has been repealed, and is likely to result in lower tax deductions for certain executive compensation expenses.

During the fiscal year ended July 31, 2018, we recorded an estimated net discrete tax benefit of $11.8 million which, as a result of Tax Reform, primarily related to the remeasurement of deferred tax liabilities associated with non-deductible amortization related to intangible assets. The remeasurement was recorded pursuant to ASC 740 "Income Taxes" and SEC Staff Accounting Bulletin ("SAB") 118. All amounts recorded were based on available guidance on interpretation of Tax Reform and what we believe to be reasonable approaches to estimating its impact; however, such amounts are provisional estimates at this time and are subject to adjustment as future guidance becomes available, additional facts become known or estimation approaches are refined. See "Notes to Consolidated Financial Statements - Note (10) - Income Taxes" included in "Part II - Item 8.- Financial Statements and Supplementary Data," included in this Annual Report on Form 10-K, for further information on the provisions of Tax Reform and its currently expected impact on our business. The overall actual impact of Tax Reform is currently uncertain, and could have a material adverse effect on our consolidated results of operations and financial condition.

Since November 2017, our federal income tax return for fiscal 2016 has been under audit by the IRS. The audit is ongoing and we are unaware of any proposed adjustments by the IRS. Our federal income tax returns for fiscal 2015 and 2017 are also subject to potential future IRS audit. None of our state income tax returns prior to fiscal 2014 are subject to audit. TCS' federal income tax returns for tax years 2014 and 2015 and tax period from January 1, 2016 to February 23, 2016 are subject to potential future IRS audit. None of TCS' state income tax returns prior to calendar year 2013 are subject to audit. The results of the IRS tax audit for fiscal 2016, future tax assessments or settlements could have a material adverse effect on our consolidated results of operations and financial condition.

Research and Development Costs. We generally expense all research and development costs. Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other personnel-related expenses associated with product development. Research and development expenses also include third-party development and programming costs. Costs incurred internally in researching and developing software to be sold are charged to expense until technological feasibility has been established for the software. Judgment is required in determining when technological feasibility of a product is established. Technological feasibility for our advanced communication software solutions is generally reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to customers and when we are able to validate the marketability of such product. Once technological feasibility is established, all software costs are capitalized until the product is available for general release to customers. To-date, we have not capitalized any of our internally developed software costs.

Provisions for Excess and Obsolete Inventory. We record a provision for excess and obsolete inventory based on historical and future usage trends. Other factors may also influence our provision, including decisions to exit a product line, technological change and new product development. These factors could result in a change in the amount of excess and obsolete inventory on hand. Additionally, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In the future, if we determine that our inventory was overvalued, we would be required to recognize such costs in our financial statements at the time of such determination. Any such charge could be material to our results of operations and financial condition.

Allowance for Doubtful Accounts. We perform credit evaluations of our customers and adjust credit limits based upon customer payment history and current creditworthiness, as determined by our review of our customers' current credit information. Generally, we will require cash in advance or payment secured by irrevocable letters of credit before an order is accepted from an international customer that we do not do business with regularly. In addition, we seek to obtain insurance for certain domestic and international customers.

We monitor collections and payments from our customers and maintain an allowance for doubtful accounts based upon our historical experience and any specific customer collection issues that we have identified. In light of ongoing tight credit market conditions, we continue to see requests from our customers for higher credit limits and longer payment terms. Because of our strong cash position and the nominal amount of interest we are earning on our cash and cash equivalents, we have, on a limited basis, approved certain customer requests.

We continue to monitor our accounts receivable credit portfolio. Our overall credit losses have historically been within our expectations of the allowances established; however, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Measurement of credit losses requires consideration of historical loss experience, including the need to adjust for changing business conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and the financial health of specific customers. Changes to the estimated allowance for doubtful accounts could be material to our results of operations and financial condition.

Results of Operations

The following table sets forth, for the periods indicated, certain income and expense items expressed as a percentage of our consolidated net sales:

	Fiscal Years Ended July 31,		
	2018	2017	2016
Gross margin	39.2%	39.6 %	41.7 %
Selling, general and administrative expenses	20.0%	21.1 %	23.1 %
Research and development expenses	9.4 %	9.9 %	10.3 %
Settlement of intellectual property litigation	— %	(2.2)%	— %
Acquisition plan expenses	— %	— %	5.2 %
Amortization of intangibles	3.7 %	4.1 %	3.3 %
Operating income (loss)	6.2 %	6.7 %	(0.1)%
Interest expense (income) and other, net	1.8 %	2.1 %	1.9 %
Income (loss) before (benefit from) provision for income taxes	4.3 %	4.6 %	(2.0)%
Net income (loss)	5.2 %	2.9 %	(1.9)%
Adjusted EBITDA (a Non-GAAP measure)	13.7%	12.8 %	11.7 %

For a definition and explanation of Adjusted EBITDA, see "Item 6. Selected Consolidated Financial Data - Non-GAAP Financial Data" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Comparison of Fiscal 2018 and 2017 - Adjusted EBITDA."

Business Outlook for Fiscal 2019

In almost every respect, fiscal 2018 exceeded our expectations and we generated consolidated:

- Net sales of $570.6 million;
- Operating income of $35.1 million;
- Net income of $29.8 million;
- Cash flows from operating activities of $50.3 million; and
- Adjusted EBITDA (a Non-GAAP financial measure discussed below) of $78.4 million.

Our fiscal 2018 results reflect the impact of strong demand for almost all of our products.

Our pipeline of opportunities remains strong and overall business activity is at the highest level it has been in several years. During fiscal 2018, we achieved a consolidated book-to-bill ratio (a measure defined as bookings divided by net sales) of 1.32 and finished fiscal 2018 with a record high consolidated backlog of $630.7 million. Our backlog, as more fully defined in "Part I - Item 1. Business" included in this Annual Report on Form 10-K, generally consists of funded and firm contract orders and does not include the unfunded portions of multi-year U.S. government contracts. As such, the total value of multi-year contracts that we have received is substantially higher than our reported backlog.

As of July 31, 2018, our cash and cash equivalents were $43.5 million and our total debt outstanding was $171.3 million (excluding unamortized deferred financing costs). Given our strong fiscal 2018 operating cash flows, we have successfully reduced the level of our total indebtedness since the beginning of our fiscal year by $29.2 million.

Looking forward, we believe that fiscal 2019 will be even better and have established the following consolidated financial targets:

- Net sales goal with a range of approximately $600.0 million to $625.0 million.

- Achievement of a consolidated fiscal 2019 book-to-bill ratio in excess of 1.0.

- Total annual amortization of intangibles to approximate $17.2 million.

- Total depreciation expense is expected to range from $13.0 million to $14.0 million.

- Total amortization of stock-based compensation is expected to range from approximately $10.0 million to $12.0 million, which represents an increase from the $8.6 million amortized in fiscal 2018.

- GAAP operating income, as a percentage of net sales, to be higher than the 6.2% we achieved in fiscal 2018.

- Our interest expense rate (including amortization of deferred financing costs) is expected to range from 6.0% to 6.4% and our current cash borrowing rate is approximately 4.5%.

- Our effective income tax rate (excluding discrete tax items in fiscal 2019) is expected to approximate 23.25% and reflects the full year benefit of the reduced U.S. statutory income tax rate resulting from Tax Reform. If the Internal Revenue Service issues clarifying or interpretive guidance, and/or new information becomes available, our estimated effective tax rate may change.

- Adjusted EBITDA goal in a range of approximately $80.0 million to $86.0 million.

Given our strong growth prospects and the opportunities we see, we expect to continue making investments in sales, marketing and research and development efforts. In particular, we continue to invest in our HEIGHTS technology as well as our NG911 solutions. The markets for these technologies are expected to grow for many years ahead. In addition, we believe that fiscal 2019 will show the financial benefits of our tactical shift in strategy in our Government Solutions segment away from bidding on large commodity-type service contracts and toward pursuing contracts for our niche solutions with higher margins. In this regard, net sales in our Government Solutions segment are expected to increase both in dollars and as a percentage of our consolidated net sales.

Comparable to Comtech's business cycle for the past several years, financial performance in the second half of fiscal 2019 is expected to be higher than the first half of fiscal 2019. In addition, given the straight-line amortization expense associated with intangible assets with finite lives, we expect to report GAAP operating income slightly above break-even in the first quarter of fiscal 2019, with each of the remaining fiscal 2019 quarters achieving GAAP operating income. Our GAAP operating income and Adjusted EBITDA in our first quarter of fiscal 2019 are expected to be a bit better than the amounts we achieved in the first quarter of fiscal 2018. After considering the impact of expected fiscal 2019 interest expense and income taxes, like in fiscal 2018, we expect to report a slight GAAP net loss in the first quarter of fiscal 2019 and GAAP net income for the remainder of the year.

In addition, based on the anticipated timing of shipments and performance related to orders currently in our backlog and the timing of expected new orders, consolidated net sales and Adjusted EBITDA for each of our first three quarters of fiscal 2019 are expected to be a bit better when compared to the respective quarters of fiscal 2018. Our fourth quarter of fiscal 2019 is expected to be the peak quarter, by far, for consolidated net sales, operating income and Adjusted EBITDA.

Our revenue goal reflects our adoption of the Financial Accounting Standards Board's Accounting Standards Codification Topic 606 - "Revenue from Contracts with Customers," the impact of which was not material. In fiscal 2019, we expect to recognize a significant portion of our contracts over time, as there is a continuous transfer of control to the customer over the contractual period of performance. The remainder of our contracts will be recognized at a point in time. Both of these methods are similar to what we did prior to August 1, 2018. Although the amount and timing of orders are difficult to predict, we expect to receive at least one additional order for our Blue Force Tracker-2 High Capacity ("BFT-2-HC") mobile satellite transceivers in fiscal 2019. If we receive and can ship multiple or very large orders for our BFT-2-HC mobile satellite transceivers, actual fiscal 2019 net sales, operating income and Adjusted EBITDA could ultimately be higher.

If order flow remains strong and we are able to achieve all of our fiscal 2019 business goals, it is possible that financial results could be higher than our targeted amounts.

Our Business Outlook for Fiscal 2019 and related targets reflect the following:

- Our Commercial Solutions segment is expected to benefit from increased sales of satellite earth station products (which include satellite modems and solid-state power amplifiers ("SSPAs")). In fiscal 2018, we experienced significant growth in our sales to U.S. government customers and we expect demand to remain strong. During fiscal 2018, we received a multi-year follow-on contract with a potential value of up to $19.1 million to provide the U.S. Navy's Space and Naval Warfare Systems Command with Advanced Time Division Multiple Access ("TDMA") Interface Processor ("ATIP") production terminals. We also recently received a strategic $59.0 million multi-year contract award from the U.S. Navy to purchase our SLM-5650B satellite modems, upgrade kits and related services. During fiscal 2019, we expect to receive additional funding against this IDIQ contract and make additional shipments during the second half of fiscal 2019.

- In addition to increased demand from our U.S. government customers, we believe we will benefit from increased sales of our HEIGHTS solutions which continue to gain traction. During fiscal 2018, Orange Business Services, one of the largest telecommunications operators and IT services companies in the world, selected HEIGHTS to support relief projects in two African countries. This award is a testament to our HEIGHTS products and bodes well for future orders from this and other similar customers. Although the sales cycle for this product is longer than our historical satellite earth station product line, during fiscal 2018, we continued to seed and invest in the market. During fiscal 2019, HEIGHTS will continue to be a focus of our marketing and sales efforts. We also expect incremental fiscal 2019 revenue contributions from our new high-frequency amplifier products which support high-speed satellite networks. We believe we have a market leading technology and recently received an award of over $20.0 million from a systems integrator for these products. This is the first large scale deployment of this technology and we expect such products to be delivered over the next two fiscal years. All-in-all, after several years of sequentially lower sales, we believe that fiscal 2019 will be our second consecutive year of revenue growth for our satellite earth station product line.

- Our Commercial Solutions segment sales contributions from enterprise technology solutions (such as our location and messaging platforms) and safety and security technology solutions (such as our wireless and next generation 911 ("NG911") platforms) in fiscal 2019 are expected to be similar to what we achieved in fiscal 2018. These technologies have been deployed around the U.S., are used by wireless carriers to provide Short-Message-Service ("SMS") texts to end-customers and are also used to communicate with 911 public safety answering points ("PSAPs"). During fiscal 2018, we were awarded several large multi-year strategic contracts. We were awarded a contract valued at $134.0 million to provide safety and security technology solutions to one of the largest wireless carriers in the U.S. As a result of this contract, we will become the leading provider to this wireless carrier for enhanced 911 ("E911") services for its nationwide 3G, 4G and 5G networks. We were also awarded a $10.1 million multi-year contract to provide this same wireless carrier with a hosted, advanced location services platform which leverages our Position Determining Engine ("PDE"). Under this competitively awarded contract, the U.S. wireless carrier is expected to migrate existing location services from a competing solution to our more advanced, secure and reliable technologies. Additionally, we received an aggregate of $96.2 million of contracts from AT&T, which provide for a variety of safety and security technology and enterprise technology solutions including NG911 public safety Call Handling and Emergency Services IP Network ("ESInet") and E911 solutions. We were also awarded multi-year contract renewals worth $19.5 million for various SMS related services and applications, of which $14.2 million was received during the fourth quarter of fiscal 2018. In our view, all of these contract awards validate that our enterprise technology solutions and safety and security technology solutions are more advanced, secure and reliable than any existing competitive technology. We believe that market conditions for safety and security technology solutions and enterprise technology solutions remain favorable, but they have long sales cycles and are subject to difficult-to-predict changes in the overall procurement strategies of wireless carrier customers.

- Our Government Solutions segment is anticipated to show significant revenue growth and improvement in operating income margins as a result of our tactical shift in strategy toward pursuing contracts for our niche solutions with higher margins, rather than large commodity-type service contracts. During fiscal 2018, we achieved a book-to-bill ratio of 1.31 in this segment and booked a number of important orders, including a three-year $123.6 million IDIQ contract from the U.S. Army to provide ongoing sustainment services for the AN/TSC-198A SNAP (Secret Internet Protocol Router ("SIPR") and Non-classified Internet Protocol Router ("NIPR") Access Point), Very Small Aperture Terminals ("VSATs"). In fiscal 2018, we received $33.5 million of funded orders related to such contract. We also received over $65.0 million of orders during fiscal 2018 to supply Manpack Satellite Terminals and networking equipment and other advanced VSAT products pursuant to our Global Tactical Advanced Communication Systems ("GTACS") contract with the U.S. Army's PM Tactical Network, which has a remaining contract value of $123.5 million as of July 31, 2018. Additionally, bookings in fiscal 2018 reflect an increase in orders from a major U.S. space contractor to source and test space level Electrical, Electronic and Electromechanical ("EEE") parts in support of critical NASA programs. Fiscal 2019 is expected to reflect sales and operating income contributions from these orders. We are also named as a final awardee on a ten-year, $2.5 billion IDIQ contract commonly referred to as "Complex Commercial SATCOM Solutions" (or "CS3") from the General Services Administration, which allows U.S. federal agencies to purchase end-to-end, turnkey solutions which incorporate commercial satellite solutions. Over time, we would expect to secure new orders from the CS3 contract.

- In our Government Solutions segment, our field-proven technologies and support services are ideally suited to meet the U.S. DoD's C4ISR needs and we are actively pursuing many opportunities. During fiscal 2018, in addition to those orders discussed above, we received $5.0 million of funding from the Consortium Management Group ("CMG") to support the U.S. Army Project Manager Mission Command ("PM MC") and the Blue Force Tracking-2 ("BFT-2") program to port additional waveforms onto the current BFT-2 transceivers. Separately, we continue to work with the U.S. Army to deploy several thousand of our next generation MT-2025 mobile satellite transceivers, which are also known as the Blue Force Tracker-2 High Capacity ("BFT-2-HC") satellite transceivers. The MT-2025 transceivers meet BFT-2 protocols, provide best-in-class reliability and are fully backward compatible with the BFT-1 system. Comtech currently provides sustaining support for the BFT-1 system and previously shipped over 100,000 BFT-1 mobile satellite transceivers. Shipments of our MT-2025 transceivers against our initial $11.7 million order began during the fourth quarter of fiscal 2018 and are expected to continue in fiscal 2019. Additional orders for our MT-2025 transceivers are ultimately expected. Although the amount and timing of orders are difficult to predict, we believe we will receive at least one additional order for our MT-2025 transceivers in fiscal 2019.

- Our Government Solutions segment is expected to benefit from continued strong demand from customers for our over-the-horizon microwave systems and products. During the fourth quarter of fiscal 2018, we were awarded an order valued at $31.0 million for our Modular Transportable Transmission System ("MTTS") troposcatter terminals to be utilized as part of a deployable communications network for an Asia Pacific military service. In September 2018, we also just announced the receipt of a $9.1 million contract to supply another foreign military customer with our over-the-horizon microwave systems. We are also awaiting feedback from the U.S. government in response to a large multi-year RFP for the supply of new troposcatter communications equipment to replace hundreds of the U.S. DoD's AN/TRC-170 terminals. Although an award of this program is not expected to generate significant revenue or operating income in fiscal 2019, if the award is received, we would expect it to make significant contributions to revenue and operating income in subsequent years.

Our Business Outlook for Fiscal 2019 depends, in large part, on timely deliveries and the receipt of and performance on orders from our customers and could be adversely impacted if orders and/or deliveries are delayed, business conditions deteriorate or our current or prospective customers materially postpone, reduce or even forgo purchases of our products and services. Additionally, we continue to evaluate cost reduction initiatives in our business. Such actions primarily relate to reducing the size and cost of our facilities. Our Business Outlook for Fiscal 2019 does not consider the financial impact of any actions we may take.

On September 26, 2018, our Board of Directors declared a dividend of $0.10 per common share, payable on November 16, 2018 to stockholders of record at the close of business on October 17, 2018. Future dividends remain subject to compliance with financial covenants under our Secured Credit Facility, as amended, as well as Board approval.

Additional information related to our Business Outlook for Fiscal 2019 and a definition and explanation of Adjusted EBITDA
is included in the below section "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Comparison of Fiscal 2018 and 2017."

Comparison of Fiscal 2018 and 2017

Net Sales. Consolidated net sales were $570.6 million and $550.4 million for fiscal 2018 and 2017, respectively, representing an increase of $20.2 million, or 3.7%. The period-over-period increase in net sales was due to higher net sales in both our Commercial Solutions and Government Solutions segments. Net sales by operating segment are discussed below.

Commercial Solutions
Net sales in our Commercial Solutions segment were $345.1 million for fiscal 2018, as compared to $330.9 million for fiscal 2017, an increase of $14.2 million, or 4.3%. Our Commercial Solutions segment represented 60.5% of consolidated net sales for fiscal 2018 as compared to 60.1% for fiscal 2017.

Bookings in fiscal 2018 were strong and reflect strength in almost all of our Commercial Solutions product lines. Our book-to-bill ratio (a measure defined as bookings divided by net sales) in this segment for fiscal 2018 was 1.33 and, as further discussed below, we have a growing pipeline of opportunities.

Net sales of our satellite earth station products (which include SSPAs) in fiscal 2018 were higher than fiscal 2017, as we experienced significant growth in our sales to government customers. During fiscal 2018, we received a strategic $59.0 million multi-year contract award from the U.S. Navy to purchase our SLM-5650B satellite modems, upgrade kits and related services. Given the U.S. Navy's pressing operational needs, we shipped most of the SLM-5650B satellite modems during fiscal 2018, which positively impacted our operating income. Although timing for U.S.

government orders are generally difficult to predict, we are optimistic that we will receive and ship additional orders for this equipment in fiscal 2019, as there are over eight-hundred older generation modems currently utilized by multiple Navy programs. We also received a multi-year follow-on contract with a potential value of up to $19.1 million to provide the U.S. Navy's Space and Naval Warfare Systems Command with Advanced Time Division Multiple Access ("TDMA") Interface Processor ("ATIP") production terminals. While international markets have become more volatile of late (including the unknown impact of ongoing international trade discussions) and we experienced lower sales to international customers in fiscal 2018 as compared to fiscal 2017, we do expect an increase in international sales in fiscal 2019. Our Heights™ Dynamic Network Access Technology ("HEIGHTS" or "HDNA") solutions experienced year-over-year revenue growth in fiscal 2018. Although the sales cycle for this product is longer than our historical satellite earth station product line, we believe this growth trend will continue into fiscal 2019.

Net sales in fiscal 2018 of both enterprise technology solutions (such as our location and messaging platforms) and safety and security technology solutions (such as our wireless and next generation 911 ("NG911") platforms) were higher as compared to the net sales we achieved in fiscal 2017. During fiscal 2018, we were awarded several large multi-year strategic contracts which are expected to contribute to fiscal 2019 sales. For instance, we were awarded a contract valued at $134.0 million to provide safety and security technology solutions to one of the largest wireless carriers in the U.S. As a result of this contract, we will become the leading provider to this wireless carrier for enhanced 911 ("E911") services for its nationwide 3G, 4G and 5G networks. We were also awarded a $10.1 million multi-year contract to provide this same wireless carrier with a hosted, advanced location services platform which leverages our Position Determining Engine ("PDE"). Under this competitively awarded contract, the U.S. wireless carrier is expected to migrate existing location services from a competing solution to our more advanced, secure and reliable technologies. Additionally, we received an aggregate of $96.2 million of contracts from AT&T, which provide for a variety of safety and security technology and enterprise technology solutions including NG911 public safety Call Handling and Emergency Services IP Network ("ESInet") and E911 solutions. We were also awarded multi-year contract renewals worth $19.5 million for various SMS related services and applications, of which $14.2 million was received during the fourth quarter of fiscal 2018. In our view, all of these contract awards validate that our enterprise technology solutions and safety and security technology solutions are more advanced, secure and reliable than any existing competitive technology. We believe that market conditions for safety and security technology solutions and enterprise technology solutions remain favorable and expect related net sales in fiscal 2019 to increase as compared to the level achieved in fiscal 2018. However, they have long sales cycles and are subject to difficult-to-predict changes in the overall procurement strategies of wireless carrier customers.

Bookings, sales and profitability in our Commercial Solutions segment can fluctuate from period-to-period due to many factors, including changes in the general business environment. As such, period-to-period comparisons of our results may not be indicative of a trend or future performance.

Government Solutions

Net sales in our Government Solutions segment were $225.5 million for fiscal 2018 as compared to $219.5 million for fiscal 2017, an increase of $6.0 million or 2.7%. Our Government Solutions segment represented 39.5% of consolidated net sales for fiscal 2018, as compared to 39.9% for fiscal 2017.

The increase in net sales primarily reflects significantly higher net sales of our command and control solutions offset, in part, by significantly lower net sales of over-the-horizon microwave systems products and the absence of $6.7 million of BFT-1 intellectual property license fees in fiscal 2018.

Bookings in fiscal 2018 were strong and reflect strength in almost all of our Government Solutions product lines. Our book-to-bill ratio (a measure defined as bookings divided by net sales) in this segment for fiscal 2018 was 1.31 and, as further discussed below, we have a growing pipeline of opportunities.

We believe we are seeing benefits of our tactical shift in strategy in our Government Solutions segment away from bidding on large commodity-type service contracts and toward pursuing contracts for our niche solutions with higher margins. We believe our field-proven technologies and support services are ideally suited to meet the U.S. DoD’s C4ISR needs and we are actively pursuing many opportunities in this area. During fiscal 2018, we booked a number of important orders. For instance, we received $33.5 million of orders to provide ongoing sustainment services for the AN/TSC-198A SNAP (Secret Internet Protocol Router ("SIPR") and Non-classified Internet Protocol Router ("NIPR") Access Point), Very Small Aperture Terminals ("VSATs"). These orders were issued pursuant to a three-year $123.6 million IDIQ contract that we received in fiscal 2018 from the U.S. Army. SNAP terminals provide quick and mobile satellite communications capability to personnel in the field and Comtech is the sole provider to the U.S. Army of these sustainment services. We also received over $65.0 million of orders during fiscal 2018 related to our $223.4 million Global Tactical Advanced Communication Systems ("GTACS") contract with the U.S. Army's PM

Tactical Network, which has a remaining contract value of $123.5 million as of July 31, 2018. These GTACS orders principally call for the supply of Manpack Satellite Terminals and networking equipment and other advanced VSAT products. Additionally, bookings and net sales in fiscal 2018 reflect an increase in orders from a major U.S. space contractor to source and test space level Electrical, Electronic and Electromechanical ("EEE") parts in support of critical NASA programs, as well as our performance on a contract with an international space agency for the design, development and installation of multiple launch vehicle tracking stations in the South Pacific.

Our Government Solutions segment received $5.0 million of funding in fiscal 2018 from the Consortium Management Group ("CMG") to support the U.S. Army Project Manager Mission Command ("PM MC") and the Blue Force Tracking-2 ("BFT-2") program to port additional waveforms onto the current BFT-2 transceivers. The BFT-2 system, which is part of the U.S. Army's JBC-P program, provides global real-time situational awareness and networking capabilities for U.S. warfighters and is the successor to the BFT-1 system. Separately, we continue to work with the U.S. Army to deploy several thousand of our next generation MT-2025 mobile satellite transceivers, which are also known as the Blue Force Tracker-2 High Capacity ("BFT-2-HC") satellite transceivers. The MT-2025 transceivers meet BFT-2 protocols, provide best-in-class reliability and are fully backward compatible with the BFT-1 system. Comtech currently provides sustaining support for the BFT-1 system and previously shipped over 100,000 BFT-1 mobile satellite transceivers. Shipments of our MT-2025 transceivers against our initial $11.7 million order began during the fourth quarter of fiscal 2018 and are expected to continue in fiscal 2019. Although the amount and timing of orders are difficult to predict, we expect to receive at least one additional order for our MT-2025 transceivers in fiscal 2019.

Although net sales of our over-the-horizon microwave systems products for fiscal 2018 were significantly lower than fiscal 2017, business activity in this product line picked up. Our marketing and sales efforts and investments to expand this product line and the level of our international business into new countries are yielding positive results. Earlier in fiscal 2018, we received $8.5 million in contracts to supply our Modular Transportable Transmission System ("MTTS") troposcatter terminals to two new international customers. During the fourth quarter of fiscal 2018, we were awarded an order valued at $31.0 million for our MTTS troposcatter terminals to be utilized as part of a deployable communications network for an Asia Pacific military service. Also, we announced in September 2018 the receipt of a $9.1 million contract to supply another foreign military with our over-the-horizon microwave systems. We believe demand for our over-the-horizon microwave systems will continue to increase. Teaming with a large prime contractor, we recently submitted a proposal to supply a significant quantity of our over-the-horizon microwave systems to the U.S. Army, and are hopeful that we can win this multi-million dollar award in fiscal 2019.

Backlog for this segment is at the highest level since our acquisition of TCS in February 2016. We see a growing pipeline of potential orders from large government end-users (including those of foreign countries) who have a growing need to mitigate threats using command and control technology solutions to increase decision-maker’s situational awareness. Based on the mix and anticipated timing of performance on orders in backlog and expected new orders, we anticipate that fiscal 2019 net sales for our Government Solutions segment will be significantly higher than fiscal 2018.

Bookings, sales and profitability in our Government Solutions segment can fluctuate dramatically from period-to-period due to many factors, including unpredictable funding, deployment and technology decisions by our U.S. and international government customers. As such, period-to-period comparisons of our results may not be indicative of a trend or future performance.

Geography and Customer Type

Sales by geography and customer type, as a percentage of related sales, for the fiscal years ended July 31, 2018 and 2017 are as follows:

	Fiscal Years Ended July 31,					
	2018	2017	2018	2017	2018	2017
	Commercial Solutions		Government Solutions		Consolidated	
U.S. government	18.1 %	15.1 %	62.2 %	59.2 %	35.5 %	32.7 %
Domestic	54.6 %	54.4 %	14.9 %	15.5 %	38.9 %	38.9 %
Total U.S.	72.7 %	69.5 %	77.1 %	74.7 %	74.4 %	71.6 %

International	27.3 %	30.5 %	22.9 %	25.3 %	25.6 %	28.4 %
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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

Domestic sales include sales to commercial customers, as well as to U.S. state and local governments. Included in domestic sales, are sales to Verizon Communications Inc. ("Verizon"), which represented 10.0% of consolidated net sales for fiscal 2018. There were no customers that represented more than 10% of consolidated net sales for fiscal 2017.

International sales for fiscal 2018 and 2017 (which include sales to U.S. domestic companies for inclusion in products that are sold to international customers) were $145.8 million and $156.5 million, respectively. Except for the U.S., no individual country (including sales to U.S. domestic companies for inclusion in products that are sold to a foreign country) represented more than 10% of consolidated net sales for fiscal 2018 and 2017.

Gross Profit. Gross profit was $223.9 million and $218.2 million for fiscal 2018 and 2017, respectively. The increase of $5.7 million in gross profit dollars was largely driven by higher net sales and increased gross margins in our Commercial Solutions segment, partially offset by lower gross profit contributions from the Government Solutions segment. Gross profit in fiscal 2018 also benefited from a $0.7 million favorable warranty settlement and a $1.0 million favorable sales and use tax settlement, both of which are reflected in our unallocated segment. Gross profit, as a percentage of consolidated net sales, for fiscal 2018 was 39.2% (or 38.9% when excluding the aforementioned favorable settlements), which was slightly lower than the 39.6% achieved in fiscal 2017. This decrease was primarily driven by lower gross margins in our Government Solutions segment that was partially offset by an improvement in gross margins in our Commercial Solutions segment and the aforementioned favorable settlements. Gross profit, as a percentage of related segment net sales, is further discussed below.

Our Commercial Solutions segment's gross profit, as a percentage of related segment net sales, for fiscal 2018 was higher than fiscal 2017. The increase was primarily due to higher net sales and overall favorable product mix changes. Our Business Outlook for Fiscal 2019 assumes we continue to seed and invest in the market for our HEIGHTS solutions and that related sales will grow significantly from the level we achieved in fiscal 2018. Today, HEIGHTS solutions have lower gross margins than our traditional Single Channel per Carrier ("SCPC") satellite earth station modems and given expected sales growth, our gross profit, as a percentage of satellite earth station product sales in fiscal 2019, will be lower as compared to fiscal 2018. Overtime, we believe that margins will improve as HEIGHTS volume increases. Overall, looking forward, based on the mix and anticipated timing of shipments and performance related to orders currently in our backlog and the mix and timing of expected new orders, gross profit for this segment, as a percentage of related segment net sales, for fiscal 2019 is expected to be lower than the level achieved in fiscal 2018.

Our Government Solutions segment's gross profit, as a percentage of related segment net sales, for fiscal 2018 was lower than fiscal 2017. The decrease was primarily driven by significantly lower net sales of over-the-horizon microwave systems products and the absence of $6.7 million of BFT-1 intellectual property license fees. Based on the mix and anticipated timing of shipments and performance related to orders currently in our backlog and the mix and timing of expected new orders, gross profit for this segment, as a percentage of related segment net sales, for fiscal 2019 is expected to be comparable to the level achieved in fiscal 2018.

Included in consolidated cost of sales for fiscal 2018 and 2017 are provisions for excess and obsolete inventory of $5.6 million and $2.9 million, respectively. As discussed in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Provisions for Excess and Obsolete Inventory," we regularly review our inventory and record a provision for excess and obsolete inventory based on historical and projected usage assumptions.

Because our consolidated gross profit, as a percentage of consolidated net sales, depends on the volume of sales, sales mix and related gross profit for each individual segment, it is inherently difficult to forecast. Nevertheless, based on expected bookings, expected timing of our performance on orders, the absence of favorable settlements recorded in fiscal 2018 and the increase of Government Solutions segment sales as a percentage of consolidated net sales, we currently expect our consolidated gross profit, as a percentage of consolidated net sales, for fiscal 2019 to be similar to the percentage we achieved in fiscal 2018.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $113.9 million and $116.1 million for fiscal 2018 and 2017, respectively, representing a decrease of $2.2 million. As a percentage of consolidated net sales, selling, general and administrative expenses were 20.0% and 21.1% (or 22.1% in fiscal 2017 when excluding $5.5 million of favorable adjustments related to a recovery of legal expenses from a third party and adjustments related to reserves associated with the TCS acquisition that were no longer required). There were no comparable adjustments in fiscal 2018.

The decrease in fiscal 2018 spending, both in dollars and as a percentage of consolidated net sales, is primarily attributable to the benefit of cost reduction actions previously initiated and, to a lesser extent, higher consolidated net sales during fiscal 2018, as discussed above. We continue to evaluate and implement cost reduction initiatives to reduce unnecessary spending, reduce the size and cost of our facilities and improve our productivity. Our Business Outlook for Fiscal 2019 does not consider the financial impact of any actions we may take.

Amortization of stock-based compensation expense recorded as selling, general and administrative expenses was $6.9 million in fiscal 2018 as compared to $7.1 million in fiscal 2017. Amortization in fiscal 2018 includes the benefit of a $0.4 million reversal of stock-based compensation expense related to certain performance shares previously expected to be earned.

Based on our current spending plans, we expect fiscal 2019 selling, general and administrative expenses, in dollars, to be higher and, as a percentage of consolidated net sales, to be similar to the percentage recorded in fiscal 2018.

Research and Development Expenses. Research and development expenses were $53.9 million and $54.3 million for fiscal 2018 and 2017, respectively, representing a decrease of $0.4 million, or 0.7%. As a percentage of consolidated net sales, research and development expenses were 9.4% and 9.9% for fiscal 2018 and 2017, respectively.

For fiscal 2018 and 2017, research and development expenses of $46.0 million and $44.7 million, respectively, related to our Commercial Solutions segment, and $7.0 million and $8.9 million, respectively, related to our Government Solutions segment. The remaining research and development expenses of $0.9 million and $0.7 million in fiscal 2018 and 2017, respectively, related to the amortization of stock-based compensation expense.

Whenever possible, we seek customer funding for research and development to adapt our products to specialized customer requirements. During fiscal 2018 and 2017, customers reimbursed us $16.9 million and $27.1 million, respectively, which is not reflected in the reported research and development expenses, but is included in net sales with the related costs included in cost of sales.

We continue to invest in enhancements to existing products as well as in new products across almost all of our product lines. Based on our current spending plans, we expect fiscal 2019 research and development expenses, in dollars, to be higher and, as a percentage of consolidated net sales, to be comparable to fiscal 2018.

Amortization of Intangibles. Amortization relating to intangible assets with finite lives was $21.1 million (of which $17.7 million was for the Commercial Solutions segment and $3.4 million was for the Government Solutions segment) for fiscal 2018 and $22.8 million (of which $17.7 million was for the Commercial Solutions segment and $5.1 million was for the Government Solutions segment) for fiscal 2017. The decrease in fiscal 2018 amortization was the result of certain intangibles in our Government Solutions segment that became fully amortized in fiscal 2017. Looking forward to fiscal 2019, we currently anticipate amortization of intangibles to further decline from $21.1 million to approximately $17.2 million (with all of the decline occurring the Commercial Solutions segment).

Settlement of Intellectual Property Litigation. In fiscal 2017, we recorded favorable adjustments to operating income of $12.0 million, net of estimated legal fees, to reflect lower losses than originally estimated for TCS intellectual property matters which were settled during that period. There was no comparable adjustments in fiscal 2018.

Operating Income. Operating income for fiscal 2018 was $35.1 million as compared $37.0 million for fiscal 2017. Operating income by reportable segment is shown in the table below:

	Fiscal Years Ended July 31,							
	2018	2017	2018	2017	2018	2017	2018	2017
($ in millions)	Commercial Solutions		Government Solutions		Unallocated		Consolidated	
Operating income (loss)	$40.8	$33.2	$11.0	$9.4	$(16.7)	$(5.6)	$35.1	$37.0
Percentage of related net sales	11.8 %	10.0 %	4.9 %	4.3 %	NA	NA	6.2 %	6.7 %

The increase in our Commercial Solutions segment's operating income, in dollars and as a percentage of related segment net sales, was primarily due to higher net sales, overall favorable product mix changes and the benefit of cost reduction actions previously initiated, as discussed above. Looking forward, we expect fiscal 2019 operating income, in dollars to be higher and, as a percentage of related segment net sales, to be similar to fiscal 2018.

The increase in our Government Solutions segment's operating income, in dollars and as a percentage of related segment net sales, was primarily due to lower operating expenses (including lower amortization of intangibles) that was partially offset by lower gross profit contributions, as discussed above. Looking forward, we expect fiscal 2019 operating income, in dollars and as a percentage of related segment net sales, to be significantly higher as compared to fiscal 2018.

Unallocated operating expenses for fiscal 2018 were $16.7 million and were offset by a $0.7 million favorable warranty settlement and a $1.0 million favorable sales and use tax settlement, as discussed above. Excluding these adjustments, unallocated operating expenses for fiscal 2018 would have been $18.4 million. Unallocated operating expenses for fiscal 2017 were $5.6 million and were offset by a number of items that aggregated $18.8 million and included: (i) a $12.0 million favorable adjustment related to the settlement of certain TCS intellectual property matters; (ii) $5.5 million of favorable adjustments which related to a recovery of legal expenses from a third party and reserves associated with the TCS acquisition that were no longer required; and (iii) a $1.3 million benefit (as compared to fiscal 2016) associated with our decision to pay certain fiscal 2017 incentive compensation awards in the form of share units. Excluding these adjustments, unallocated operating expenses for fiscal 2017 would have been $24.4 million. The decrease to $18.4 million in fiscal 2018 from the $24.4 million in fiscal 2017 primarily relates to lower spending. Unallocated expenses for fiscal 2018 and 2017 include amortization of stock-based compensation of $8.6 million and $8.5 million, respectively.

Looking forward, unallocated operating expenses are expected to be higher in fiscal 2019 as compared to the $18.4 million discussed above. This expected increase is primarily due to anticipated changes in compensation costs and other increased spending. Amortization of stock-based compensation expense (which is not allocated to our two reportable operating segments) is expected to increase to a range of $10.0 million to $12.0 million in fiscal 2019 as compared to the $8.6 million amortized in fiscal 2018. This increase is largely due to an increase in the number and value of annual non-equity incentive awards expected to be granted in fiscal 2019 as a result of anticipated increased operating income contributions from each of our two reportable operating segments. Like we did in fiscal 2018 and fiscal 2017, our Business Outlook for Fiscal 2019 assumes we continue to pay certain annual non-equity incentive awards in the form of fully vested share units. If we do not achieve our fiscal 2019 business goals, amortization of stock-based compensation expense would be lower than our current expected fiscal 2019 range.

Excluding the aforementioned $1.7 million and $18.8 million of favorable adjustments in fiscal 2018 and 2017, respectively, consolidated operating income for fiscal 2018 and 2017 would have been $33.4 million, or 5.9% of consolidated net sales, and $18.2 million, or 3.3% of consolidated net sales, respectively. This improvement from 3.3% to 5.9% is largely due to the benefit of cost reductions made and changes in gross profit mix and operating expenses, as discussed above. Based on expected sales growth, mix and anticipated timing of shipments and performance related to orders currently in our backlog and the mix and timing of expected new orders, our consolidated operating income (in dollars) in fiscal 2019 is anticipated to be higher than the $35.1 million we achieved in fiscal 2018 and we are targeting to achieve operating income, as a percentage of consolidated net sales, to be higher than the 6.2% we achieved in fiscal 2018.

Interest Expense and Other. Interest expense was $10.2 million and $11.6 million for fiscal 2018 and 2017, respectively. The decline in interest expense primarily reflects lower total indebtedness (excluding unamortized deferred financing costs), which declined from $200.6 million as of July 31, 2017 to $171.3 million as of July 31, 2018. Interest expense for both periods primarily reflects interest on our Secured Credit Facility, as amended. Our effective interest rate (including amortization of deferred financing costs) in fiscal 2018 was approximately 5.4%. Based on the type, terms, amount of outstanding debt (including capital leases and other obligations) and current interest rates, our effective interest rate (including amortization of deferred financing costs) in fiscal 2019 is anticipated to range from 6.0% to 6.4%. Our current cash borrowing rate (which excludes the amortization of deferred financing costs) is approximately 4.5%.

Interest (Income) and Other. Interest (income) and other for both fiscal 2018 and 2017 was nominal. All of our available cash and cash equivalents are currently invested in bank deposits and money market deposit accounts which, at this time, are currently yielding a blended annual interest rate of approximately 0.6%.

(Benefit from) Provision for Income Taxes. The benefit from income taxes was $5.1 million for fiscal 2018 as compared to a tax provision of $9.7 million for fiscal 2017.

During fiscal 2018, we recorded a net discrete tax benefit of $11.8 million which, as a result of Tax Reform, primarily related to the remeasurement of deferred tax liabilities associated with non-deductible amortization related to intangible assets and discrete tax benefits associated with stock-based awards that were settled in fiscal 2018. These benefits were offset, in part, by the finalization of certain tax deductions in connection with the filing of our federal and state income tax returns for fiscal 2017. Excluding discrete tax items for fiscal 2018, our effective tax rate was 27.0%.

During fiscal 2017, we recorded a net discrete tax expense of $0.5 million, primarily related to the finalization of certain tax deductions in connection with the filing of our federal and state income tax returns for fiscal 2016, offset, in part, by the reversal of tax contingencies no longer required due to the settlement of the fiscal 2014 federal income tax audit and the expiration of applicable statutes of limitation. Our effective tax rate excluding discrete tax items for fiscal 2017 was 35.75%.

The decrease from 35.75% to 27.0% is principally attributable to the passage of Tax Reform which reduced the statutory income tax rate from 35.0% to 21.0%, or a blended income tax rate of approximately 27.0%. Looking forward, our effective tax rate in fiscal 2019, excluding discrete items, is expected to approximate 23.25%. If the Internal Revenue Service ("IRS") issues clarifying or interpretive guidance, and/or new information becomes available, our estimated effective tax rate may change.

Since November 2017, our federal income tax return for fiscal 2016 has been under audit by the IRS. The audit is ongoing and we are unaware of any proposed adjustments by the IRS. Our federal income tax returns for fiscal 2015 and 2017 are also subject to potential future IRS audit. None of our state income tax returns prior to fiscal 2014 are subject to audit. TCS' federal income tax returns for tax years 2014 and 2015 and the tax period from January 1, 2016 to February 23, 2016 are subject to potential future IRS audit. None of TCS' state income tax returns prior to calendar year 2013 are subject to audit. The results of the IRS tax audit for fiscal 2016, future tax assessments or settlements could have a material adverse effect on our consolidated results of operations and financial condition.

Net Income. During fiscal 2018, consolidated net income was $29.8 million as compared to $15.8 million during fiscal 2017.

Adjusted EBITDA. Adjusted EBITDA (both in dollars and as a percentage of related net sales) for both fiscal 2018 and 2017 are shown in the table below (numbers in the table may not foot due to rounding):

	Fiscal Years Ended July 31,							
	2018	2017	2018	2017	2018	2017	2018	2017
($ in millions)	Commercial Solutions		Government Solutions		Unallocated		Consolidated	
Net income (loss)	$40.3	32.9	10.8	9.4	(21.4)	(26.5)	$29.8	15.8
Provision for (benefit from) income taxes	0.3	0.3	—	—	(5.4)	9.4	(5.1)	9.7
Interest (income) and other	0.2	(0.1)	0.1	—	—	0.1	0.3	(0.1)
Interest expense	0.1	0.2	—	—	10.1	11.4	10.2	11.6
Amortization of stock-based compensation	—	—	—	—	8.6	8.5	8.6	8.5
Amortization of intangibles	17.7	17.7	3.4	5.1	—	—	21.1	22.8
Depreciation	9.5	9.9	3.1	2.9	1.1	1.5	13.7	14.4
Settlement of intellectual property litigation	—	—	—	—	—	(12.0)	—	(12.0)
Adjusted EBITDA	$68.0	60.9	17.4	17.5	(7.1)	(7.6)	$78.4	70.7
Percentage of related net sales	19.7 %	18.4%	7.7 %	8.0 %	NA	NA	13.7 %	12.8 %

The increase in consolidated Adjusted EBITDA during fiscal 2018 as compared to fiscal 2017 is primarily attributable to higher net sales and overall favorable product mix changes in our Commercial Solutions segment (which historically achieves higher gross margins than our Government Solutions segment), the benefit of cost reduction actions previously taken and the $1.7 million of benefits in fiscal 2018 that resulted from the favorable warranty and sales and use tax settlements, as discussed above.

The increase in our Commercial Solutions segment's Adjusted EBITDA, in dollars and as a percentage of related segment net sales, was primarily attributable to higher net sales, overall favorable product mix changes and the benefit of cost reduction actions previously initiated, as discussed above.

The decrease in our Government Solutions segment's Adjusted EBITDA, in dollars and as a percentage of related segment net sales, was primarily driven by significantly lower net sales of over-the-horizon microwave systems products and the absence of $6.7 million of BFT-1 intellectual property license fees, as discussed above.

Looking forward, based on the mix and anticipated timing of shipments and performance related to orders currently in our backlog and the mix and timing of expected new orders, we are targeting consolidated Adjusted EBITDA to be higher than fiscal 2018 and in a range from to $80.0 million to $86.0 million. As a percentage of consolidated net sales, Adjusted EBITDA in fiscal 2019 is expected to be similar to the amount we achieved in fiscal 2018.

If order flow remains strong and we are able to achieve all of our fiscal 2019 business goals, it is possible that our fiscal 2019 Adjusted EBITDA could be higher than our targeted amount.

Our Adjusted EBITDA is a Non-GAAP measure that represents earnings (loss) before income taxes, interest (income) and other expense, interest expense, amortization of stock-based compensation, amortization of intangibles, depreciation expense, settlement of intellectual property litigation, acquisition plan expenses or strategic alternatives analysis expenses and other. Our definition of Adjusted EBITDA may differ from the definition of EBITDA used by other companies and therefore may not be comparable to similarly titled measures used by other companies. Adjusted EBITDA is also a measure frequently requested by our investors and analysts. We believe that investors and analysts may use Adjusted EBITDA, along with other information contained in our SEC filings, in assessing our performance and comparability of our results with other companies. These Non-GAAP financial measures have limitations as an analytical tool as they exclude the financial impact of transactions necessary to conduct our business, such as the granting of equity compensation awards, and are not intended to be an alternative to financial measures prepared in accordance with GAAP. These measures are adjusted as described in the reconciliation of GAAP to Non-GAAP in the above table, but these adjustments should not be construed as an inference that all of these adjustments or costs are unusual, infrequent or non-recurring. Non-GAAP financial measures should be considered in addition to, and not as a substitute for or superior to, financial measures determined in accordance with GAAP. Investors are advised to carefully review the GAAP financial results that are disclosed in our SEC filings. We have not quantitatively reconciled our fiscal 2019 Adjusted EBITDA target to the most directly comparable GAAP measure because items such as stock-based compensation, adjustments to the provision for income taxes, amortization of intangibles and interest expense, which are specific items that impact these measures, have not yet occurred, are out of our control, or cannot be predicted. For example, quantification of stock-based compensation expense requires inputs such as the number of shares granted and market price that are not currently ascertainable. Accordingly, reconciliations to the Non-GAAP forward looking metrics are not available without unreasonable effort and such unavailable reconciling items could significantly impact our financial results.

Comparison of Fiscal 2017 and 2016

Net Sales. Consolidated net sales were $550.4 million and $411.0 million for fiscal 2017 and 2016, respectively, representing an increase of $139.4 million, or 33.9%. As TCS was acquired on February 23, 2016, fiscal 2017 includes a full year of TCS operations as compared to fiscal 2016 which only included approximately five months. The year-over-year increase in net sales was driven by incremental sales of $147.1 million from TCS products lines. Net sales by operating segment are discussed below.

Commercial Solutions
Net sales in our Commercial Solutions segment were $330.9 million for fiscal 2017, as compared to $249.0 million for fiscal 2016, an increase of $81.9 million, or 32.9%. The year-over-year increase in net sales reflects incremental sales of $82.3 million from TCS product lines (which include enterprise technology solutions such as our location and messaging platforms and safety and security technology solutions such as our wireless and next generation 911 ("NG911") platforms). Our Commercial Solutions segment represented 60.1% of consolidated net sales for fiscal 2017 as compared to 60.6% for fiscal 2016.

Our book-to-bill ratio (a measure defined as bookings divided by net sales) in this segment for fiscal 2017 was 0.89.

Net sales of our satellite earth station products in fiscal 2017 were lower than fiscal 2016. Although market conditions in fiscal 2017 for our international satellite earth station customers improved and related sales to these customers increased, sales and bookings from our U.S. government customers in fiscal 2017 were significantly lower as compared to fiscal 2016. We attribute this decline to delays in awarding and/or funding certain programs and a lull in ordering that resulted from political and budget uncertainty. During the second half of fiscal 2017, we saw a noticeable improvement in sales to U.S. government customers.

Net sales in fiscal 2017 of both enterprise technology solutions and safety and security technology solutions were higher than fiscal 2016, primarily due to the contribution of twelve months of TCS operations as compared to only five months in fiscal 2016.

Bookings, sales and profitability in our Commercial Solutions segment can fluctuate from period-to-period due to many factors, including changes in the general business environment. As such, period-to-period comparisons of our results may not be indicative of a trend or future performance.

Government Solutions

Net sales in our Government Solutions segment were $219.5 million for fiscal 2017 as compared to $162.0 million for fiscal 2016, an increase of $57.5 million or 35.5%. The year-over-year increase in net sales primarily reflects incremental sales of $64.8 million from TCS product lines (which include our advanced communication solutions such as field support, space components and cyber-training). Our Government Solutions segment represented 39.9% of consolidated net sales for fiscal 2017, as compared to 39.4% for fiscal 2016.

Our book-to-bill ratio (a measure defined as bookings divided by net sales) in this segment for fiscal 2017 was approximately 1.00.

Net sales of legacy Comtech products (which include over-the-horizon microwave system products, high-power broadband amplifiers and BFT-1 sustainment support services) were, in the aggregate, lower in fiscal 2017 than in fiscal 2016, primarily as a result of lower BFT-1 related sales. Net sales for fiscal 2017 and 2016 include $6.7 million and $10.0 million, respectively, of sales related to a BFT-1 intellectual property license contract which expired on March 31, 2017.

Bookings, sales and profitability in our Government Solutions segment can fluctuate dramatically from period-to-period due to many factors, including unpredictable funding, deployment and technology decisions by our U.S. and international government customers. As such, period-to-period comparisons of our results may not be indicative of a trend or future performance.

Geography and Customer Type
Sales by geography and customer type, as a percentage of related sales, for the fiscal years ended July 31, 2017 and 2016 are as follows:

	Fiscal Years Ended July 31,					
	2017	2016	2017	2016	2017	2016
	Commercial Solutions		Government Solutions		Consolidated	
U.S. government	15.1 %	25.0 %	59.2 %	65.0 %	32.7 %	40.8 %
Domestic	54.4 %	40.6 %	15.5 %	11.6 %	38.9 %	29.2 %
Total U.S.	69.5 %	65.6 %	74.7 %	76.6 %	71.6 %	70.0 %
International	30.5 %	34.4 %	25.3 %	23.4 %	28.4 %	30.0 %
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Sales to U.S. government customers include sales to the U.S. DoD, intelligence and civilian agencies, as well as sales directly to or through prime contractors. Domestic sales include sales to U.S. state and local governments. International sales include sales to U.S. companies for inclusion in products that are sold to international customers.

Gross Profit. Gross profit was $218.2 million and $171.2 million for fiscal 2017 and 2016, respectively, representing an increase of $47.0 million. This increase in gross profit dollars was driven by higher consolidated net sales as discussed above. Gross profit, as a percentage of consolidated net sales decreased from 41.7% for fiscal 2016 to 39.6% for fiscal 2017. This decrease is attributable to overall product mix changes resulting primarily from the TCS acquisition, in particular, the inclusion of net sales related to TCS government solutions, which have historically had lower gross margins than Comtech’s legacy products. Gross profit, as a percentage of related segment net sales is further discussed below.

Our Commercial Solutions segment's gross profit, as a percentage of related segment net sales, for fiscal 2017 was higher than in fiscal 2016. This increase was primarily driven by the inclusion of net sales related to TCS commercial solutions during fiscal 2017, which had higher gross margins than Comtech's legacy products. Gross margin, as a percentage of related net sales for Comtech’s legacy products, also increased primarily due to overall mix changes.

Our Government Solutions segment's gross profit, as a percentage of related segment net sales, for fiscal 2017 was significantly lower than in fiscal 2016. This decrease was primarily driven by the inclusion of net sales related to TCS government solutions during fiscal 2017, which have significantly lower gross margins than Comtech's legacy products. Gross profit in this segment, for fiscal 2017 and 2016 includes $6.7 million and $10.0 million, respectively, related to a prior BFT-1 intellectual property license contract which expired on March 31, 2017.

Included in consolidated cost of sales for fiscal 2017 and 2016 are provisions for excess and obsolete inventory of $2.9 million and $2.8 million, respectively. As discussed in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Provisions for Excess and Obsolete Inventory," we regularly review our inventory and record a provision for excess and obsolete inventory based on historical and projected usage assumptions.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $116.1 million and $94.9 million for fiscal 2017 and 2016, respectively, representing an increase of $21.2 million. The increase in spending is primarily attributable to incremental expenses associated with the increased size of our business as a result of the TCS acquisition which was partially offset by $5.5 million of favorable adjustments related to a recovery of legal expenses from a third party and adjustments related to reserves associated with the TCS acquisition that were no longer required. As a percentage of consolidated net sales, selling, general and administrative expenses were 21.1% and 23.1% for fiscal 2017 and 2016, respectively. This decrease in percentage is primarily due to higher consolidated net sales during fiscal 2017, the aforementioned $5.5 million of favorable adjustments, and the benefit of cost reduction actions previously initiated.

Amortization of stock-based compensation expense recorded as selling, general and administrative expenses was $7.1 million in fiscal 2017 as compared to $3.4 million in fiscal 2016. This increase is primarily related to the type and timing of stock-based awards. In fiscal 2017, we paid certain annual incentive compensation awards in the form of share units whereas in fiscal 2016, such annual incentives were paid in cash. The benefit of this change resulted in lower overall company-wide compensation expense of approximately $1.3 million in fiscal 2017.

Research and Development Expenses. Research and development expenses were $54.3 million and $42.2 million for fiscal 2017 and 2016, respectively, representing an increase of $12.1 million, or 28.7%. The increase in spending is primarily attributable to incremental expenses associated with the TCS product lines. As a percentage of consolidated net sales, research and development expenses were 9.9% and 10.3% for fiscal 2017 and 2016.

For fiscal 2017 and 2016, research and development expenses of $44.7 million and $33.8 million, respectively, related to our Commercial Solutions segment, and $8.9 million and $8.0 million, respectively, related to our Government Solutions segment. The remaining research and development expenses of $0.7 million and $0.4 million in fiscal 2017 and 2016, respectively, related to the amortization of stock-based compensation expense.

Whenever possible, we seek customer funding for research and development to adapt our products to specialized customer requirements. During fiscal 2017 and 2016, customers reimbursed us $27.1 million and $17.4 million, respectively, which is not reflected in the reported research and development expenses, but is included in net sales with the related costs included in cost of sales.

Amortization of Intangibles. Amortization relating to intangible assets with finite lives was $22.8 million (of which $17.7 million was for the Commercial Solutions segment and $5.1 million was for the Government Solutions segment) for fiscal 2017 and $13.4 million (of which $10.6 million was for the Commercial Solutions segment and $2.8 million was for the Government Solutions segment) for fiscal 2016. The significant increase in amortization of intangibles is a result of our acquisition of TCS on February 23, 2016.

Settlement of Intellectual Property Litigation. During fiscal 2017, we recorded favorable adjustments to operating income of $12.0 million, net of estimated legal fees, to reflect lower losses than originally estimated for TCS intellectual property matters which were settled during fiscal 2017. There were no comparable adjustments in fiscal 2016.

Acquisition Plan Expenses. Acquisition plan expenses during fiscal 2016 were $21.3 million and primarily consist of transaction costs related to our acquisition of TCS on February 23, 2016. There were no comparable expenses during fiscal 2017.

Operating Income (Loss). Operating income for fiscal 2017 was $37.0 million as compared to a loss of $0.6 million for fiscal 2016. Operating income by reportable segment is shown in the table below:

Fiscal Years Ended July 31,

($ in millions)	2017 Commercial Solutions		2016		2017 Government Solutions		2016		2017 Unallocated	2016	2017 Consolidated		2016
Operating income (loss)	$33.2		$23.3		$9.4		$23.0		$(5.6)	$(46.8)	$37.0		$(0.6)
Percentage of related net sales	10.0	%	9.3	%	4.3	%	14.2	%	NA	NA	6.7	%	NA

The increase in our Commercial Solutions segment’s operating income, in dollars, is primarily due to an increase in this segment's net sales during fiscal 2017, substantially offset by incremental amortization of intangibles associated with the TCS acquisition. The increase in operating income, as a percentage of related segment net sales, is primarily due to increased operating income contribution from Comtech's legacy products.

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The decrease in our Government Solutions segment’s operating income, in dollars, was primarily driven by lower operating income contribution from TCS' government solutions' net sales (which includes the impact of incremental amortization of intangibles associated with the TCS acquisition) and lower operating income contribution from Comtech’s legacy products. The decrease in operating income, as a percentage of related segment net sales, is primarily due to the inclusion of TCS government solutions' net sales and operating results, including the impact of incremental amortization of intangibles associated with the TCS acquisition.

Unallocated operating expenses for fiscal 2017 were $5.6 million. During fiscal 2017, unallocated operating expenses were offset by a number of items throughout the fiscal year, which aggregated $18.8 million. Such items include: (i) a $12.0 million favorable adjustment related to the settlement of certain TCS intellectual property matters, as discussed above; (ii) $5.5 million of favorable adjustments which related to a recovery of legal expenses from a third party and reserves associated with the TCS acquisition that were no longer required; and (iii) a $1.3 million benefit associated with our decision (which is further described below) to pay certain fiscal 2017 incentive compensation awards in the form of share units. Unallocated operating expenses for fiscal 2016 were $46.8 million and included $21.3 million of acquisition plan expenses, as discussed above. Excluding the $18.8 million and $21.3 million amounts, unallocated operating expenses for fiscal 2017 and 2016 would have been $24.4 million and $25.5 million, respectively.

Unallocated expenses for fiscal 2017 and 2016 include amortization of stock-based compensation of $8.5 million and $4.1 million, respectively. The increase in fiscal 2017 related to our decision to pay certain fiscal 2017 non-equity incentive awards in the form of fully vested share units, whereas in fiscal 2016 our non-equity incentive awards were settled in cash. Although this change resulted in higher amortization of stock-based compensation in fiscal 2017 as compared to fiscal 2016, the overall impact of this decision resulted in lower company-wide compensation expense of approximately $1.3 million for fiscal 2017.

Excluding the $18.8 million of favorable adjustments described above, consolidated operating income for fiscal 2017 would have been $18.2 million, or 3.3% of consolidated net sales.

Interest Expense and Other. Interest expense was $11.6 million and $7.8 million for fiscal 2017 and 2016, respectively. Interest expense for both periods primarily reflects interest on our Secured Credit Facility, as amended. The increase in interest expense and other was primarily due to a full-year of outstanding borrowings in fiscal 2017 related to the TCS as compared to five months of outstanding borrowings in fiscal 2016.

Interest Income and Other. Interest income and other for both fiscal 2017 and 2016 was nominal. All of our available cash and cash equivalents are currently invested in bank deposits and money market deposit accounts which, at this time, are currently yielding a blended annual interest rate of approximately 0.56%.

Provision for Income Taxes. The provision for income taxes was $9.7 million for fiscal 2017 as compared to a tax benefit of $0.5 million during fiscal 2016. Our effective tax rate was 37.9% for fiscal 2017, as compared to 5.5% for fiscal 2016.

During fiscal 2017, we recorded a net discrete tax expense of $0.5 million, primarily related to the finalization of certain tax deductions in connection with the filing of our federal and state income tax returns for fiscal 2016, offset, in part, by the reversal of tax contingencies no longer required due to the settlement of the fiscal 2014 federal income tax audit and the expiration of applicable statutes of limitation. Our effective tax rate excluding discrete tax items for fiscal 2017 was 35.75%.

During fiscal 2016, we recorded a net discrete tax expense of approximately $1.0 million, primarily related to the establishment of tax contingencies for uncertain tax positions relating to the payment of certain expenses associated with the TCS acquisition, offset, in part, by the reversal of tax contingencies no longer required due to the expiration of applicable statutes of limitation; and the passage of legislation that included the permanent retroactive extension of the federal research and experimentation credit from December 31, 2014. Our effective tax rate excluding discrete tax items for fiscal 2016 was 18.0%.

The increase from 18.0% to 35.75% is principally attributable to the non-deductibility of certain transaction costs relating to the acquisition of TCS, which were incurred during fiscal 2016.

Since November 2017, our federal income tax return for fiscal 2016 has been under audit by the IRS. The audit is ongoing and we are unaware of any proposed adjustments by the IRS. Our federal income tax returns for fiscal 2015 and 2017 are also subject to potential future IRS audit. None of our state income tax returns prior to fiscal 2014 are subject to audit. TCS' federal income tax returns for tax years 2014 and 2015 and the tax period from January 1, 2016 to February 23, 2016 are subject to potential future IRS audit. None of TCS' state income tax returns prior to calendar year 2013 are subject to audit. The results of the IRS tax audit for fiscal 2016, future tax assessments or settlements could have a material adverse effect on our consolidated results of operations and financial condition.

Net Loss (Income). During fiscal 2017, consolidated net income was $15.8 million as compared to a consolidated net loss of $7.7 million during fiscal 2016.

Adjusted EBITDA. Our Adjusted EBITDA, a Non-GAAP financial measure, represents earnings before income taxes, interest (income) and other expense, interest expense, amortization of stock-based compensation, amortization of intangibles, depreciation expense, settlement of intellectual property litigation and acquisition plan expenses. These items, while periodically affecting our results, may vary significantly from period-to-period and may have a disproportionate effect in a given period, thereby affecting the comparability of our results. Our Adjusted EBITDA is also used by our management in assessing the Company's operating results. Although closely aligned, the Company's definition of Adjusted EBITDA is different than the Consolidated EBITDA (as such term is defined in our Secured Credit Facility, as amended) utilized for financial covenant calculations and also may differ from the definition of EBITDA or Adjusted EBITDA used by other companies and, therefore, may not be comparable to similarly titled measures used by other companies. Our Adjusted EBITDA is also a measure frequently requested by the Company's investors and analysts. We believe that investors and analysts may use our Adjusted EBITDA, along with other information contained in our SEC filings, in assessing our performance and comparability of our results with other companies.

Adjusted EBITDA (both in dollars and as a percentage of related net sales) for both fiscal 2017 and 2016 are shown in the table below (numbers in the table may not foot due to rounding):

	Fiscal Years Ended July 31,							
	2017	2016	2017	2016	2017	2016	2017	2016
($ in millions)	Commercial Solutions		Government Solutions		Unallocated		Consolidated	
Net income (loss)	$32.9	22.8	9.4	23.0	(26.5)	(53.5)	$15.8	(7.7)
Income taxes	0.3	0.1	—	—	9.4	(0.5)	9.7	(0.5)
Interest (income) and other expense	(0.1)	0.1	—	—	0.1	(0.2)	(0.1)	(0.1)
Interest expense	0.2	0.3	—	—	11.4	7.5	11.6	7.8
Amortization of stock-based compensation	—	—	—	—	8.5	4.1	8.5	4.1
Amortization of intangibles	17.7	10.6	5.1	2.8	—	—	22.8	13.4
Depreciation	9.9	7.1	2.9	2.0	1.5	0.8	14.4	9.8
Settlement of intellectual property litigation	—	—	—	—	(12.0)	—	(12.0)	—
Acquisition plan expenses	—	—	—	—	—	21.3	—	21.3
Adjusted EBITDA	$60.9	40.9	17.5	27.8	(7.6)	(20.7)	$70.7	48.1
Percentage of related net sales	18.4 %	16.4%	8.0 %	17.2%	NA	NA	12.8 %	11.7%

The increase in consolidated Adjusted EBITDA, in dollars and as a percentage of consolidated net sales, during fiscal 2017 as compared to fiscal 2016 is primarily attributable to earnings contributions associated with the TCS acquisition, period-to-period changes in sales mix and gross margin contributions and lower unallocated expenses during fiscal 2017, all of which are discussed above. The increase in our Commercial Solutions segment's Adjusted EBITDA, in dollars and as a percentage of related segment net sales, was primarily attributable to an increase in this segment's net sales and higher gross margins, as discussed above. The decrease in our Government Solutions segment's Adjusted EBITDA, in dollars and as a percentage of related segment net sales, was primarily driven by the inclusion of net sales related to TCS government solutions, which have historically had significantly lower gross margins than Comtech’s legacy products, as discussed above.

Liquidity and Capital Resources

Our cash and cash equivalents increased to $43.5 million at July 31, 2018 from $41.8 million at July 31, 2017, an increase of $1.6 million. The increase in cash and cash equivalents during fiscal 2018 was driven by the following:

- Net cash provided by operating activities was $50.3 million for fiscal 2018 as compared to $66.9 million for fiscal 2017. The period-over-period decrease in cash flow from operating activities is attributable to overall changes in net working capital requirements, principally the timing of shipments, billings and payments.

- Net cash used in investing activities for fiscal 2018 was $8.6 million as compared to $8.2 million for fiscal 2017. Both of these amounts primarily represent expenditures relating to ongoing equipment upgrades and enhancements.

- Net cash used in financing activities was $40.1 million for fiscal 2018 as compared to $83.7 million for fiscal 2017. During fiscal 2018, we made $8.8 million of net payments under our Revolving Loan Facility and $21.8 million of principal repayments related to our Term Loan Facility and capital lease and other obligations. During fiscal 2017, we made $26.5 million of net payments under our Revolving Loan Facility and $37.2 million of principal repayments related to our Term Loan Facility and capital lease and other obligations. During fiscal 2018 and 2017, we paid $9.5 million and $18.9 million, respectively, in cash dividends to our stockholders. We also made $1.1 million and $0.3 million, respectively, of payments to remit employees' statutory tax withholding requirements related to the net settlement of stock-based awards during fiscal 2018 and 2017.

Our investment policy relating to our cash and cash equivalents is intended to minimize principal loss while at the same time maximize the income we receive without significantly increasing risk. To minimize risk, we generally invest our cash and cash equivalents in money market mutual funds (both government and commercial), certificates of deposit, bank deposits, and U.S. Treasury securities. Many of our money market mutual funds invest in direct obligations of the U.S. government, bank securities guaranteed by the Federal Deposit Insurance Corporation, certificates of deposit and commercial paper and other securities issued by other companies. While we cannot predict future market conditions or market liquidity, we believe our investment policies are appropriate in the current environment. Ultimately, the availability of our cash and cash equivalents is dependent on a well-functioning liquid market.

The Secured Credit Facility, as amended, is discussed below and in "Notes to Consolidated Financial Statements - Note (8) - Secured Credit Facility" included in "Part II - Item 8. - Financial Statements and Supplementary Data."

As of July 31, 2018, our material short-term cash requirements primarily consist of: (i) fiscal 2019 mandatory principal repayments of $17.2 million associated with our Term Loan Facility and related interest payments of approximately $5.2 million; (ii) estimated interest payments for fiscal 2019 under our Revolving Loan Facility; (iii) payments related to our capital lease and other obligations; (iv) operating lease commitments; (v) our ongoing working capital needs, including income tax payments; and (vi) payment of accrued quarterly dividends.

In June 2016, we sold 7.1 million shares of our common stock in a public offering at a price of $14.00 per share, resulting in proceeds to us of $95.0 million, net of underwriting discounts and commissions. As of July 31, 2018 and September 26, 2018, an aggregate registered amount of $75.0 million under our existing shelf registration statement filed with the SEC remains available for sale of various types of securities, including debt.

As of July 31, 2018 and September 26, 2018, we were authorized to repurchase up to an additional $8.7 million of our common stock, pursuant to our current $100.0 million stock repurchase program. Our stock repurchase program has no time restrictions and repurchases may be made in open-market or privately negotiated transactions and may be made pursuant to SEC Rule 10b5-1 trading plans. There were no repurchases of our common stock during fiscal 2018 and 2017.

On September 27, 2017, December 6, 2017, March 7, 2018 and June 6, 2018, our Board of Directors declared a dividend of $0.10 per common share, which were paid on November 17, 2017, February 16, 2018, May 18, 2018 and August 17, 2018, respectively. On September 26, 2018, our Board of Directors declared a dividend of $0.10 per common share, payable on November 16, 2018 to stockholders of record at the close of business on October 17, 2018. Future dividends remain subject to compliance with financial covenants under our Secured Credit Facility, as amended, as well as Board approval.

Our material long-term cash requirements primarily consist of: (i) mandatory interest payments and principal repayments pursuant to our Secured Credit Facility, as amended; (ii) payments relating to our capital lease and other obligations and (iii) operating lease commitments.

We continue to receive (and approve on a limited basis) requests from our customers for higher credit limits and longer payment terms. We also continue to monitor our accounts receivable credit portfolio and have not had material negative customer credit experiences historically.

We have historically met both our short-term and long-term cash requirements with funds provided by a combination of cash and cash equivalent balances, cash generated from operating activities and cash generated from financing transactions. Based on our anticipated level of future sales and operating income, we believe that our existing cash and cash equivalent balances, our cash generated from operating activities and amounts potentially available under the Revolving Loan Facility under our Secured Credit Facility, as amended, will be sufficient to meet both our currently anticipated short-term and long-term operating cash requirements.

Although it is difficult in the current economic and credit environment to predict the terms and conditions of financing that may be available in the future, should our short-term or long-term cash requirements increase beyond our current expectations, we believe that we would have sufficient access to credit from financial institutions and/or financing from public and private debt and equity markets.

Secured Credit Facility

On February 23, 2016, in connection with our acquisition of TCS, we entered into a $400.0 million secured credit facility (the "Secured Credit Facility") with a syndicate of lenders. The Secured Credit Facility, as amended June 6, 2017 (the "June 2017 Amendment"), comprises a senior secured term loan A facility of $250.0 million (the "Term Loan Facility") and a secured revolving loan facility of up to $150.0 million, including a $25.0 million letter of credit sublimit (the "Revolving Loan Facility"), and, together with the Term Loan Facility, matures on February 23, 2021. The proceeds of these borrowings were primarily used to finance our acquisition of TCS, including the repayment of certain existing indebtedness of TCS. The Term Loan Facility requires quarterly repayments. During the fiscal year ended July 31, 2018 and 2017, we repaid $19.0 million and $33.6 million, respectively, principal amount of borrowings under the Term Loan Facility. The repayments in the fiscal year ended July 31, 2017 include a payment of $22.5 million made in connection with the June 2017 amendment to reduce the balloon or final payment of the Term Loan Facility, which is discussed further below. Under the Revolving Loan Facility, we had outstanding balances ranging from $34.9 million to $66.8 million during the fiscal year ended July 31, 2018.

The Revolving Loan Facility is primarily used for working capital and other general corporate purposes of the Company and its subsidiaries, including the issuance of letters of credit. Borrowings under the Secured Credit Facility, pursuant to terms defined in the Secured Credit Facility, shall be either (i) Alternate Base Rate ("ABR") borrowings, which bear interest from the applicable borrowing date at a rate per annum equal to (x) the greatest of (a) the Prime Rate in effect on such day, (b) the Federal Funds Effective Rate in effect on such day plus 0.50% per annum and (c) the Adjusted LIBO Rate on such day (or, if such day is not a business day, the immediately preceding business day) plus 1.00% per annum (provided that if the LIBO Rate is less than 1.00%, then the LIBO Rate shall be deemed to be 1.00%), plus (y) the Applicable Rate, or (ii) Eurodollar borrowings, which bear interest from the applicable borrowing date at a rate per annum equal to (x) the Adjusted LIBO Rate for such interest period (provided that if the LIBO Rate is less than 1.00%, then the LIBO Rate shall be deemed to be 1.00%) plus (y) the Applicable Rate. The Applicable Rate is determined based on a pricing grid that is dependent upon our leverage ratio as of the end of each fiscal quarter. The Secured Credit Facility contains customary representations, warranties and affirmative covenants and customary negative covenants, subject to negotiated exceptions, on (i) liens, (ii) investments, (iii) indebtedness, (iv) significant corporate changes, including mergers and acquisitions, (v) dispositions, (vi) restricted payments, including stockholder dividends, and (vii) certain other restrictive agreements. The Secured Credit Facility also contains certain financial covenants and customary events of default (subject to grace periods, as appropriate), such as payment defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency, the occurrence of a defined change in control and the failure to observe the negative covenants and other covenants related to the operation of our business.

We believe the June 2017 Amendment provides increased operating and acquisition flexibility and simplifies the calculations of our financial covenants. In particular, the June 2017 Amendment provides, among other things, that the:

(i) Consolidated EBITDA definition more closely aligns with our Adjusted EBITDA metric by eliminating favorable adjustments to operating income related to settlements of TCS intellectual property matters;

(ii) Leverage Ratio is calculated on a "gross" basis using the quotient of Total Indebtedness (excluding unamortized deferred financing costs) divided by our trailing twelve month ("TTM") Consolidated EBITDA. The prior Leverage Ratio was calculated on a "net" basis but did not include a reduction for any cash or cash equivalents above $50.0 million;

(iii) Fixed Charge Coverage Ratio includes a deduction for all cash dividends, regardless of the amount of our cash and cash equivalents and the related allowable Quarterly Dividend Amount, as defined, now aligns with our current quarterly dividend target of $0.10 per common share;

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(iv) Balloon or final payment of the Term Loan Facility, which is not due until February 23, 2021, was reduced by $22.5 million through increased borrowings from the Revolving Loan Facility, which does not expire until February 23, 2021; and

(v) Leverage Ratios will be adjusted, in certain conditions, to provide for additional flexibility for us to make acquisitions.

In connection with the June 2017 Amendment, there were no changes to: (i) the committed borrowing capacity; (ii) the maturity date; or (iii) interest rates payable (except that the interest rate pricing grid is now based on the new Leverage Ratio). Also, the June 2017 Amendment did not result in an extinguishment for accounting purposes (as such term is defined in ASC 470 "Debt"); instead, the June 2017 Amendment was accounted for as a debt modification. As a result, deferred financing costs (including incremental fees for the June 2017 Amendment) will continue to be amortized over the remaining maturity term of the Secured Credit Facility.

As of July 31, 2018, our Leverage Ratio was 2.19x TTM Consolidated EBITDA compared to the maximum allowable Leverage Ratio of 3.00x TTM Consolidated EBITDA. Our Fixed Charge Coverage Ratio as of July 31, 2018 was 2.33x compared to the minimum required Fixed Charge Coverage Ratio of 1.25x. Given our expected future business performance, we anticipate maintaining compliance with the terms and financial covenants in our Secured Credit Facility, as amended, for the foreseeable future.

The obligations under the Secured Credit Facility, as amended, are guaranteed by certain of our domestic subsidiaries (the "Subsidiary Guarantors"). As collateral security for amounts outstanding under our Secured Credit Facility, as amended, and the guarantees thereof, we and our Subsidiary Guarantors have granted to an administrative agent, for the benefit of the lenders, a lien on, and first priority security interest in, substantially all of our tangible and intangible assets.

Capitalized terms used but not defined herein have the meanings set forth for such terms in the Secured Credit Facility, dated as of February 23, 2016, and the First Amendment of the Secured Credit Facility, dated as of June 6, 2017, both of which have been documented and filed with the SEC.

Off-Balance Sheet Arrangements
As of July 31, 2018, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

Commitments
In the normal course of business, other than as discussed below, we routinely enter into binding and non-binding purchase obligations primarily covering anticipated purchases of inventory and equipment. We do not expect that these commitments, as of July 31, 2018, will materially adversely affect our liquidity.

At July 31, 2018, cash payments due under long-term obligations (including estimated interest expense on our Secured Credit Facility), excluding purchase orders that we entered into in our normal course of business, are as follows:

	Obligations Due by Fiscal Years or Maturity Date (in thousands)				
	Total	2019	2020 and 2021	2022 and 2023	After 2023

Secured Credit Facility - principal payments	$168,725	17,211	151,514	—	—
Secured Credit Facility - interest payments	16,919	7,211	9,708	—	—
Operating lease commitments	51,283	11,246	17,750	11,527	10,760
Capital lease and other obligations	2,752	1,972	780	—	—
Net contractual cash obligations	$239,679	37,640	179,752	11,527	10,760

As discussed further in "Notes to Consolidated Financial Statements - Note (8) - Secured Credit Facility" included in "Part II — Item 8. - Financial Statements and Supplementary Data," on June 6, 2017, we entered into the June 2017 Amendment to our Secured Credit Facility. In connection with this amendment, the balloon or final payment of the Term Loan Facility, which is not due until February 23, 2021, was reduced by $22.5 million through increased borrowings from the Revolving Loan Facility which is not required to be repaid in full until February 23, 2021.

As discussed further in "Notes to Consolidated Financial Statements - Note (17) - Stockholders' Equity" included in "Part II - Item 8. - Financial Statements and Supplementary Data," on September 26, 2018, our Board of Directors declared a dividend of $0.10 per common share, payable on November 16, 2018 to stockholders of record at the close of business on October 17, 2018. Future dividends remain subject to compliance with financial covenants under our Secured Credit Facility, as amended, as well as Board approval.

At July 31, 2018, we have approximately $3.2 million of standby letters of credit outstanding under our Secured Credit Facility, as amended, related to our guarantees of future performance on certain customer contracts. Such amounts are not included in the above table.

During fiscal 2018, we entered into a full and final warranty settlement with AT&T, the largest customer/distributor of a small product line that we refer to as the TCS 911 call handling software solution. AT&T had previously informed us that they did not believe we met certain contractual specifications related to performance and usability and had requested a refund of certain payments made by them. As discussed in "Notes to Consolidated Financial Statements - Note (6) - Accrued Expenses and Other Current Liabilities," included in "Part II - Item 8.- Financial Statements and Supplementary Data," included in this Annual Report on Form 10-K, in addition to this settlement, we agreed to issue thirty-six credits to AT&T of $0.2 million which AT&T can apply on a monthly basis to purchases of solutions from us, beginning October 2017 through September 2020. As of July 31, 2018, the total present value of these monthly credits is $3.6 million, of which $1.6 million is included in accrued expenses and other current liabilities and $2.0 million is reflected in other liabilities (non-current) on our Consolidated Balance Sheet. These amounts are not shown in the above commitment table.

In the ordinary course of business, we include indemnification provisions in certain of our customer contracts. Pursuant to these agreements, we have agreed to indemnify, hold harmless and reimburse the indemnified party for losses suffered or incurred by the indemnified party, including but not limited to losses related to third-party intellectual property claims. It is not possible to determine the maximum potential amount under these agreements due to a history of nominal claims in the Comtech legacy business and the unique facts and circumstances involved in each particular agreement. As discussed further in "Notes to Consolidated Financial Statements - Note (14) - Commitments and Contingencies," TCS is a party to a number of indemnification matters and we are incurring ongoing legal expenses in connection with these matters. Our insurance policies may not cover the cost of defending indemnification claims or providing indemnification. As a result, pending or future claims asserted against us by a party that we have agreed to indemnify could result in legal costs and damages that could have a material adverse effect on our consolidated results of operations and financial condition.

We have change in control agreements, severance agreements and indemnification agreements with certain of our executive officers and certain key employees. All of these agreements may require payments by us, in certain circumstances, including, but not limited to, a change in control of our Company or an involuntary termination of employment without cause.

Our consolidated balance sheet at July 31, 2018 includes total liabilities of $9.3 million for uncertain tax positions, including interest, any or all of which may result in a cash payment. The future payments related to uncertain tax positions have not been presented in the table above due to the uncertainty of the amounts and timing of any potential cash settlement with the taxing authorities.

Recent Accounting Pronouncements

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

As further discussed in "Notes to Consolidated Financial Statements – Note (1)(n) - Adoption of Accounting Standards and Updates" included in "Part II - Item 8. - Financial Statements and Supplementary Data," during fiscal 2018, we adopted:

- FASB ASU No. 2016-09, which amends several aspects of the accounting for and reporting of share-based payment transactions. Our adoption of this ASU, on August 1, 2017, did not have a material impact on our consolidated financial statements. See "Notes to Consolidated Financial Statements – Note (11) - Stock-Based Compensation" included in "Part II - Item 8. - Financial Statements and Supplementary Data" for further information regarding our adoption.

- FASB ASU No. 2016-15, which amends the guidance on the following cash flow related issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon and similar type debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims (including those related to certain life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and cash receipts or payments with more than one class of cash flows. Our adoption of this ASU on February 1, 2018 did not have any impact on our consolidated financial statements.

- FASB ASU No. 2017-09, which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in ASC Topic 718. An entity would not be required to account for changes to the terms or conditions of a share-based payment award as a modification if there were no changes to the award's fair value, vesting conditions and classification. Our adoption of this ASU on February 1, 2018 did not have any impact on our consolidated financial statements.

- FASB ASU Nos. 2016-01 and 2018-03, which address certain aspects of recognition, measurement, presentation and disclosure of financial instruments, such as: amending the initial and subsequent measurement requirements for certain equity investments; eliminating the disclosure requirements related to the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet; requiring the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset or liability on the balance sheet or the accompanying notes to the financial statements. Adoption of these ASUs did not have a material impact on our consolidated financial statements and disclosures.

In addition, the following FASB ASUs have been issued and incorporated into the FASB ASC and have not yet been adopted by us as of July 31, 2018:

- FASB ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)," issued in May 2014, which replaces numerous requirements in U.S. GAAP, including industry specific requirements, and provides a single revenue recognition model for contracts with customers. The core principle of the new standard is that a company should record revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, FASB ASU No. 2015-14 "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" was issued to defer the effective date of FASB ASU No. 2014-09 by one year. Additionally, FASB ASU 2016-08 "Revenue from Contracts with Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)," 2016-10 "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," 2016-12 "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" and 2017-05 "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets" were issued, respectively, to clarify certain implementation matters related to the new revenue standard. Such clarifications were effective upon our adoption of ASU No. 2014-09 which, as further discussed in "Notes to Consolidated Financial Statements - Note (1)(c) - Summary of Significant Accounting and Reporting Policies - Revenue Recognition" included in "Part II - Item 8. - Financial Statements and Supplementary Data," was on August 1, 2018 (our first quarter of fiscal 2019) using the modified retrospective method. There was no material impact on our business, results of operations and financial condition upon such adoption. In fiscal 2019, we expect to recognize a significant portion of our contracts over time, as there is a continuous transfer of control to the customer over the contractual period of performance. The remainder of our contracts will be recognized at a point in time. Both of these methods are similar to what we did prior to August 1, 2018.

- FASB ASU No. 2016-02, issued in February 2016, which requires lessees to recognize the following for all leases (with the exception of short-term leases): (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, initially measured at the present value of the lease payments; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. In January 2018, FASB ASU No. 2018-01 was issued to permit an entity to elect an optional transition practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842. In July 2018, the FASB issued ASU Nos. 2018-10 and 2018-11, which provide further codification improvements and relieves the requirement to present prior comparative year results when adopting the new lease standard. Instead, companies can choose to recognize the cumulative-effect of applying the new standard to leased assets and liabilities as an adjustment to opening retained earnings. These ASUs are effective for fiscal years beginning after December 15, 2018 (our fiscal year beginning on August 1, 2019), including interim periods within those fiscal years and should be applied with a modified retrospective approach. Early adoption is permitted. We are evaluating the impact of these ASUs on our consolidated financial statements and disclosures.

- FASB ASU No. 2016-13, issued in June 2016, which requires the measurement of expected credit losses for financial assets held at the reporting date to be based on historical experience, current conditions and reasonable and supportable forecasts. This ASU is effective for fiscal years beginning after December 15, 2019 (our fiscal year beginning on August 1, 2020), including interim periods within those fiscal years. All entities may adopt the amendments in this ASU earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Except for a prospective transition approach required for debt securities for which an other-than-temporary impairment had been recognized before the effective date, an entity will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, on a modified-retrospective approach). We are evaluating the impact of this ASU on our consolidated financial statements and disclosures.

- FASB ASU No. 2016-16 issued in October 2016, which eliminates a prior exception and now requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory (for example, intellectual property and property, plant and equipment) when the transfer occurs. This ASU is effective for fiscal years beginning after December 15, 2017 (our fiscal year beginning on August 1, 2018), and interim periods within those fiscal years and shall be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. We adopted this ASU on August 1, 2018. There was no material impact to our consolidated financial statements (including any cumulative-effect adjustment) and disclosures upon such adoption.

- FASB ASU No. 2017-11, issued in July 2017, which provides guidance on the accounting for certain financial instruments with embedded features that result in the strike price of the instrument or embedded conversion option being reduced on the basis of the pricing of future equity offerings (commonly referred to as "down round" features). This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (our fiscal year beginning on August 1, 2019) and early adoption is permitted, including adoption in an interim period. This ASU should be applied retrospectively in accordance with the provisions of the ASU. We are evaluating the impact of this ASU on our consolidated financial statements and disclosures.

- FASB ASU No. 2017-12, issued in August 2017, which expands and refines hedge accounting for both nonfinancial and financial risk components and simplifies and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This ASU is effective for fiscal years beginning after December 15, 2018 (our fiscal year beginning on August 1, 2019) and for interim periods therein, with early adoption permitted. We are evaluating the impact of this ASU on the consolidated financial statements and disclosures; however, we do not expect the adoption to have any effect given that we historically have not engaged in hedge transactions.

- FASB ASU No. 2018-07, issued in June 2018, which expands the scope of Topic 718 to include certain share-based payment transactions for acquiring goods and services from nonemployees. This ASU is effective for fiscal years beginning after December 15, 2018 (our fiscal year beginning on August 1, 2019), including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity’s adoption date of Topic 606. An entity should only remeasure liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. We are evaluating the impact of this ASU on our consolidated financial statements and disclosures; however, we do not expect the adoption to have any effect given that we historically have not engaged in such types of transactions with nonemployees.

- FASB ASU No. 2018-13, issued in August 2018, which modifies the disclosure requirements for fair value measurements in Topic 820. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (our fiscal year beginning on August 1, 2020). Upon their effective date, certain provisions are to be applied prospectively, while others are to be applied retrospectively to all periods presented. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. We are evaluating the impact of this ASU on our consolidated financial statement disclosures.

- FASB ASU No. 2018-15, issued in August 2018, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this ASU. This ASU is effective for fiscal years beginning after December 15, 2019 (our fiscal year beginning on August 1, 2020), and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period. This ASU should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are evaluating the impact of this ASU on our consolidated financial statements and disclosures.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our earnings and cash flows are subject to fluctuations due to changes in interest rates primarily from borrowings under our Secured Credit Facility, as amended. Based on the amount of outstanding debt under our Secured Credit Facility, as amended, a hypothetical change in interest rates by 10% would change interest expense by $0.8 million over a one-year period. Although we do not currently use interest rate derivative instruments to manage exposure to interest rate changes, we may choose to do so in the future in connection with our Secured Credit Facility, as amended.

Our earnings and cash flows are also subject to fluctuations due to changes in interest rates on our investment of available cash balances. As of July 31, 2018, we had cash and cash equivalents of $43.5 million, which consisted of cash and highly-liquid money market deposit accounts. Many of these investments are subject to fluctuations in interest rates, which could impact our results. Based on our investment portfolio balance as of July 31, 2018, a hypothetical change in interest rates of 10% would have a nominal impact on interest income over a one-year period. Ultimately, the availability of our cash and cash equivalents is dependent on a well-functioning liquid market.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Reports of Independent Registered Public Accounting Firm, Consolidated Financial Statements, Notes to Consolidated Financial Statements and Related Financial Schedule are listed in the Index to Consolidated Financial Statements and Schedule annexed hereto.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was carried out by us under the supervision and with the participation of our management, including our President, Chief Executive Officer and Chairman and Chief Financial Officer. Based on that evaluation, our President, Chief Executive Officer and Chairman and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by the report to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms and is accumulated and communicated to management, as appropriate, to allow timely decisions regarding required disclosure. A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Management’s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of July 31, 2018. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control – Integrated Framework (2013). Based on our assessment, we determined that, as of July 31, 2018, our internal control over financial reporting was effective based on those criteria.

Deloitte and Touche LLP, our independent registered public accounting firm, has performed an audit of our internal control over financial reporting as of July 31, 2018 based on criteria established in Internal Control – Integrated Framework (2013) issued by the COSO. This audit is required to be performed in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our independent auditors were given unrestricted access to all financial records and related data. Deloitte's audit reports appear on pages F-2 and F-3 of this annual report.

Changes In Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act that occurred during our fiscal quarter ended July 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Certain information concerning directors and officers is incorporated by reference to our Proxy Statement for the Annual Meeting of Stockholders (the "Proxy Statement") which will be filed with the Securities and Exchange Commission no more than 120 days after the close of our fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

Information regarding executive compensation is incorporated by reference to the Proxy Statement, which will be filed with the Securities and Exchange Commission no more than 120 days after the close of our fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS
AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding securities authorized for issuance under equity compensation plans and certain information regarding security ownership of certain beneficial owners and management is incorporated by reference to the Proxy Statement, which will be filed with the Securities and Exchange Commission no more than 120 days after the close of our fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS,
AND DIRECTOR INDEPENDENCE

Information regarding certain relationships and related transactions is incorporated by reference to the Proxy Statement, which will be filed with the Securities and Exchange Commission no more than 120 days after the close of our fiscal year.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information regarding principal accountant fees and services is incorporated by reference to the Proxy Statement, which will be filed with the Securities and Exchange Commission no more than 120 days after the close of our fiscal year.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) (1) The Registrant's financial statements together with a separate index are annexed hereto.
(2) The Financial Statement Schedule listed in a separate index is annexed hereto.
(3) Exhibits required by Item 601 of Regulation S-K are listed below.

Exhibit Number	Description of Exhibit	Incorporated By Reference to Exhibit
3(a)(i)	Restated Certificate of Incorporation of the Registrant	Exhibit 3(a)(i) to the Registrant's 2006 Form 10-K
3(a)(ii)	Third Amended and Restated By-Laws of the Registrant, as of September 26, 2017	Exhibit 3(a)(ii) to the Registrant's 2017 Form 10-K
10(a)(1)*	Sixth Amended and Restated Employment Agreement, dated November 18, 2016, between the Registrant and Fred Kornberg	Exhibit 10.1 to the Registrant's Form 10-Q, filed December 7, 2016
10(a)(2)*	Amendment to Sixth Amended and Restated Employment Agreement, dated June 6, 2017, between the Registrant and Fred Kornberg	Exhibit 10.7 to the Registrant's Form 8-K, filed June 7, 2017
10(a)(3)*	Lease agreement, dated September 23, 2011, on the Melville, New York Facility	Exhibit 10(s) to the Registrant's 2011 Form 10-K
10(b)*	2001 Employee Stock Purchase Plan	Appendix B to the Registrant's Proxy Statement, filed November 3, 2000
10(c)*	2000 Stock Incentive Plan, Amended and Restated, Effective March 6, 2018	Exhibit 10.1 to the Registrant's Form 10-Q, filed June 6, 2018
10(d)(1)*	Form of Stock Option Agreement pursuant to the 2000 Stock Incentive Plan	Exhibit 10(f)(7) to the Registrant's 2005 Form 10-K
10(d)(2)*	Form of Stock Option Agreement for Non-employee Directors pursuant to the 2000 Stock Incentive Plan	Exhibit 10(f)(8) to the Registrant's 2006 Form 10-K
10(e)(1)*	Form of Performance Share Agreement pursuant to the 2000 Stock Incentive Plan	Exhibit 10(s) to the Registrant's 2012 Form 10-K
10(e)(2)*	Form of Performance Share Agreement (eligible for dividend equivalents) (Auto Deferral) pursuant to the 2000 Stock Incentive Plan	Exhibit 10(z) to the Registrant's 2013 Form 10-K
10(f)(1)*	Form of Long-Term Performance Share Award Agreement pursuant to the 2000 Stock Incentive Plan - 2014	Exhibit 10(ab) to the Registrant's 2014 Form 10-K
10(f)(2)*	Form of Long-Term Performance Share Award Agreement pursuant to the 2000 Stock Incentive Plan - 2017	Exhibit 10.8 to the Registrant's Form 8-K, filed June 7, 2017

10(f)(3)*	Form of Long-Term Performance Share Award Agreement pursuant to the 2000 Stock Incentive Plan (long-term employees) - 2018
10(f)(4)*	Form of Long-Term Performance Share Award Agreement pursuant to the 2000 Stock Incentive Plan - 2018

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Exhibit Number	Description of Exhibit	Incorporated By Reference to Exhibit
10(g)(1)*	Form of Restricted Stock Agreement for Employees pursuant to the 2000 Stock Incentive Plan	Exhibit 10(y) to the Registrant’s 2016 Form 10-K
10(g)(2)*	Form of Restricted Stock Agreement for Non-employee Directors pursuant to the 2000 Stock Incentive Plan	Exhibit 10(ab) to the Registrant’s 2016 Form 10-K
10(h)(1)*	Form of Restricted Stock Unit Agreement for Employees pursuant to the 2000 Stock Incentive Plan - 2017	Exhibit 10(h)(1) to the Registrant’s 2017 Form 10-K
10(h)(2)*	Form of Restricted Stock Unit Agreement for Employees pursuant to the 2000 Stock Incentive Plan - 2016	Exhibit 10(z) to the Registrant’s 2016 Form 10-K
10(h)(3)*	Form of Restricted Stock Unit Agreement for Employees pursuant to the 2000 Stock Incentive Plan - 2013	Exhibit 10(w) to the Registrant's 2013 Form 10-K
10(h)(4)*	Form of Restricted Stock Unit Agreement for Non-employee Directors pursuant to the 2000 Stock Incentive Plan	Exhibit 10.2 to the Registrant's Form 10-Q, filed June 7, 2012
10(h)(5)*	Form of Restricted Stock Unit Agreement (eligible for dividend equivalents) for Non-employee Directors pursuant to the 2000 Stock Incentive Plan	Exhibit 10(aa) to the Registrant’s 2016 Form 10-K
10(h)(6)*	Form of Restricted Stock Unit Agreement (eligible for dividend equivalents) for Non-employee Directors pursuant to the 2000 Stock Incentive Plan - 2013	Exhibit 10(x) to the Registrant's 2013 Form 10-K
10(i)(1)*	Form of Stock Unit Agreement for Non-employee Directors pursuant to the 2000 Stock Incentive Plan	Exhibit 10.1 to the Registrant's Form 10-Q, filed June 7, 2012
10(i)(2)*	Form of Stock Unit Agreement (eligible for dividend equivalents) for Non-employee Directors pursuant to the 2000 Stock Incentive Plan	Exhibit 10(v) to the Registrant's 2013 Form 10-K
10(j)(1)*	Form of Share Unit Agreement (eligible for dividend equivalents) for Employees pursuant to the 2000 Stock Incentive Plan	Exhibit 10.2 to the Registrant's Form 10-Q, filed December 9, 2013
10(j)(2)*	Form of Share Unit Agreement (eligible for dividend equivalents) for Employees pursuant to the 2000 Stock Incentive Plan - 2018	
10(k)*	Form of Indemnification Agreement between the Registrant and the Named Executive Officers and Certain Other Executive Officers	Exhibit 10.1 to Registrant’s Form 8-K, filed on March 8, 2007
10(l)(1)*	Form of Change-in-Control Agreement (Tier 2) between the Registrant and Named Executive Officers (other than the CEO) and Certain Other Executive Officers	Exhibit 10.2 to the Registrant’s Form 8-K, filed June 7, 2017

10(l)(2)*	Form of Change-in-Control Agreement (Tier 2) between the Registrant and Named Executive Officers (other than the CEO) and Certain Other Executive Officers (California Employees)	Exhibit 10.3 to the Registrant's Form 8-K, filed June 7, 2017
10(l)(3)*	Form of Change-in-Control Agreement (Tier 2) between the Registrant and Named Executive Officers (other than the CEO) and Certain Other Executive Officers (Divisional/Subsidiary Presidents)	Exhibit 10.4 to the Registrant's Form 8-K, filed June 7, 2017

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Exhibit Number	Description of Exhibit	Incorporated By Reference to Exhibit
10(l)(4)*	Form of Change-in-Control Agreement (Tier 2) between the Registrant and Named Executive Officers (other than the CEO) and Certain Other Executive Officers (California Divisional/Subsidiary Presidents)	Exhibit 10.5 to the Registrant's Form 8-K, filed June 7, 2017
10(l)(5)*	Form of Change-in-Control Agreement (Tier 3) between the Registrant and Certain Non-Executive Officers	Exhibit 10.6 to the Registrant's Form 8-K, filed June 7, 2017
10(m)*	Agreement and Plan of Merger, dated as of November 22, 2015, among Comtech Telecommunications Corp., Typhoon Acquisition Corp. and TeleCommunication Systems, Inc.	Exhibit 2.1 to the Registrant's Form 8-K, filed November 23, 2015
10(n)(1)*	Credit Agreement, dated as of February 23, 2016, among Comtech Telecommunications Corp., the lenders party thereto and Citibank N.A., as administrative agent and issuing bank	Exhibit 10.1 to the Registrant's Form 8-K, filed February 29, 2016
10(n)(2)*	First Amendment to Credit Agreement, dated as of June 6, 2017, among Comtech Telecommunications Corp., the lenders party thereto and Citibank N.A., as administrative agent and issuing bank	Exhibit 10.1 to the Registrant's Form 8-K, filed June 7, 2017
21	Subsidiaries of the Registrant	
23.1	Consent of Independent Registered Public Accounting Firm	
31.1	Certification of President, CEO and Chairman pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
32.1	Certification of President, CEO and Chairman pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema Document	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	

101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

* Management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	COMTECH TELECOMMUNICATIONS CORP.
September 26, 2018	By: /s/Fred Kornberg
(Date)	Fred Kornberg, Chairman of the Board Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

	Signature	Title
September 26, 2018	/s/Fred Kornberg	Chairman of the Board
(Date)	Fred Kornberg	Chief Executive Officer and President (Principal Executive Officer)
September 26, 2018	/s/Michael D. Porcelain	Senior Vice President and
(Date)	Michael D. Porcelain	Chief Financial Officer (Principal Financial and Accounting Officer)
September 26, 2018	/s/Edwin Kantor	Director
(Date)	Edwin Kantor	
September 26, 2018	/s/Ira S. Kaplan	Director
(Date)	Ira S. Kaplan	
September 26, 2018	/s/Robert G. Paul	Director
(Date)	Robert G. Paul	
September 27, 2017	/s/Dr. Yacov A. Shamash	Director
(Date)	Dr. Yacov A. Shamash	
September 26, 2018	/s/Lawrence J. Waldman	Director
(Date)	Lawrence J. Waldman	

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Index to Consolidated Financial Statements and Schedule

Schedules not listed above have been omitted because they are either not applicable or the required information has been provided elsewhere in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and Board of Directors of
Comtech Telecommunications Corp.
Melville, New York

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Comtech Telecommunications Corp. and subsidiaries (the "Company") as of July 31, 2018 and 2017, the related consolidated statements of operations, stockholders' equity, and cash flows, for each of the three years in the period ended July 31, 2018, and the related notes and the schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of July 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended July 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of July 31, 2018, based on criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated September 26, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

Jericho, New York
September 26, 2018

We have served as the Company's auditor since 2015.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and Board of Directors of
Comtech Telecommunications Corp.
Melville, New York

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Comtech Telecommunications Corp. and subsidiaries (the "Company") as of July 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of July 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements and financial statement schedule as of and for the year ended July 31, 2018, of the Company and our report dated September 26, 2018, expressed an unqualified opinion on those financial statements and financial statement schedule.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Jericho, New York
September 26, 2018

COMTECH TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
Consolidated Balance Sheets
As of July 31, 2018 and 2017

Assets	2018	2017
Current assets:		
Cash and cash equivalents	$43,484,000	41,844,000
Accounts receivable, net	147,439,000	124,962,000
Inventories, net	75,076,000	60,603,000
Prepaid expenses and other current assets	13,794,000	13,635,000
Total current assets	279,793,000	241,044,000
Property, plant and equipment, net	28,987,000	32,847,000
Goodwill	290,633,000	290,633,000
Intangibles with finite lives, net	240,796,000	261,871,000
Deferred financing costs, net	2,205,000	3,065,000
Other assets, net	2,743,000	2,603,000
Total assets	$845,157,000	832,063,000
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$43,928,000	29,402,000
Accrued expenses and other current liabilities	65,034,000	68,610,000
Dividends payable	2,356,000	2,343,000
Customer advances and deposits	34,452,000	25,771,000
Current portion of long-term debt	17,211,000	15,494,000
Current portion of capital lease and other obligations	1,836,000	2,309,000
Interest payable	499,000	282,000
Total current liabilities	165,316,000	144,211,000
Non-current portion of long-term debt, net	148,087,000	176,228,000
Non-current portion of capital lease and other obligations	765,000	1,771,000
Income taxes payable	2,572,000	2,515,000
Deferred tax liability, net	10,927,000	17,306,000
Customer advances and deposits, non-current	7,689,000	7,227,000
Other liabilities	4,117,000	2,655,000
Total liabilities	339,473,000	351,913,000
Commitments and contingencies (See Note 14)		
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 38,860,571 shares and 38,619,467 shares at July 31, 2018 and 2017, respectively	3,886,000	3,862,000
Additional paid-in capital	538,453,000	533,001,000
Retained earnings	405,194,000	385,136,000
	947,533,000	921,999,000
Less:		
Treasury stock, at cost (15,033,317 shares at July 31, 2018 and 2017)	(441,849,000)	(441,849,000)
Total stockholders’ equity	505,684,000	480,150,000
Total liabilities and stockholders’ equity	$845,157,000	832,063,000

See accompanying notes to consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
Consolidated Statements of Operations
Fiscal Years Ended July 31, 2018, 2017 and 2016

	2018	2017	2016
Net sales	$570,589,000	550,368,000	411,004,000
Cost of sales	346,648,000	332,183,000	239,767,000
Gross profit	223,941,000	218,185,000	171,237,000
Expenses:			
Selling, general and administrative	113,922,000	116,080,000	94,932,000
Research and development	53,869,000	54,260,000	42,190,000
Amortization of intangibles	21,075,000	22,823,000	13,415,000
Settlement of intellectual property litigation	—	(12,020,000)	—
Acquisition plan expenses	—	—	21,276,000
	188,866,000	181,143,000	171,813,000
Operating income (loss)	35,075,000	37,042,000	(576,000)
Other expenses (income):			
Interest expense	10,195,000	11,629,000	7,750,000
Interest (income) and other	254,000	(68,000)	(134,000)
Income (loss) before (benefit from) provision for income taxes	24,626,000	25,481,000	(8,192,000)
(Benefit from) provision for income taxes	(5,143,000)	9,654,000	(454,000)
Net income (loss)	$29,769,000	15,827,000	(7,738,000)
Net income (loss) per share:			
Basic	$1.25	0.68	(0.46)
Diluted	$1.24	0.67	(0.46)
Weighted average number of common shares outstanding – basic	23,825,000	23,433,000	16,972,000
Weighted average number of common and common equivalent shares outstanding – diluted	24,040,000	23,489,000	16,972,000
Dividends declared per issued and outstanding common share as of the applicable dividend record date	$0.40	0.60	1.20

See accompanying notes to consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
Fiscal Years Ended July 31, 2018, 2017 and 2016

	Common Stock		Additional	Retained	Treasury Stock		Stockholders'
	Shares	Amount	Paid-in Capital	Earnings	Shares	Amount	Equity
Balance as of July 31, 2015	31,165,401	$3,117,000	$427,083,000	$413,058,000	15,033,317	$(441,849,000)	$401,409,000
Common stock issued from equity offering, net of issuance costs	7,145,000	715,000	93,355,000	—	—	—	94,070,000
Equity-classified stock award compensation	—	—	4,076,000	—	—	—	4,076,000
Proceeds from issuance of employee stock purchase plan shares	45,319	4,000	672,000	—	—	—	676,000
Net settlement of stock-based awards	12,277	1,000	(106,000)	—	—	—	(105,000)
Cash dividends declared	—	—	—	(21,549,000)	—	—	(21,549,000)
Accrual of dividend equivalents, net of reversal	—	—	—	(155,000)	—	—	(155,000)
Net income tax shortfall from settlement of stock-based awards	—	—	(27,000)	—	—	—	(27,000)
Reversal of deferred tax assets associated with expired and unexercised stock-based awards	—	—	(256,000)	—	—	—	(256,000)
Net loss	—	—	—	(7,738,000)	—	—	(7,738,000)
Balance as of July 31, 2016	38,367,997	3,837,000	524,797,000	383,616,000	15,033,317	(441,849,000)	470,401,000
Equity-classified stock award compensation	—	—	8,467,000	—	—	—	8,467,000
	64,367	7,000	687,000	—	—	—	694,000

Proceeds from issuance of employee stock purchase plan shares							
Issuance of restricted stock, net	144,988	14,000	(14,000)	—	—	—	—
Net settlement of stock-based awards	42,115	4,000	(266,000)	—	—	—	(262,000)
Cash dividends declared	—	—	—	(14,034,000)	—	—	(14,034,000)
Accrual of dividend equivalents, net of reversal	—	—	—	(273,000)	—	—	(273,000)
Net income tax shortfall from settlement of stock-based awards	—	—	(248,000)	—	—	—	(248,000)
Reversal of deferred tax assets associated with expired and unexercised stock-based awards	—	—	(422,000)	—	—	—	(422,000)
Net income	—	—	—	15,827,000	—	—	15,827,000
Balance as of July 31, 2017	38,619,467	3,862,000	533,001,000	385,136,000	15,033,317	(441,849,000)	480,150,000
Equity-classified stock award compensation	—	—	8,605,000	—	—	—	8,605,000
Proceeds from exercises of stock options	13,100	1,000	325,000	—	—	—	326,000
Proceeds from issuance of employee stock purchase plan shares	44,996	5,000	850,000	—	—	—	855,000
Forfeiture of restricted stock	(10,254)	(1,000)	1,000	—	—	—	—
Net settlement of stock-based awards	193,262	19,000	(4,329,000)	—	—	—	(4,310,000)
Cash dividends declared	—	—	—	(9,411,000)	—	—	(9,411,000)
	—	—	—	(300,000)	—	—	(300,000)

Accrual of dividend equivalents, net of reversal							
Net income	—	—	—	29,769,000	—	—	29,769,000
Balance as of July 31, 2018	38,860,571	$3,886,000	$538,453,000	$405,194,000	15,033,317	$(441,849,000)	$505,684,000

See accompanying notes to consolidated financial statements.

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COMTECH TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
Consolidated Statements of Cash Flows
Fiscal Years Ended July 31, 2018, 2017 and 2016

	2018	2017	2016
Cash flows from operating activities:			
Net income (loss)	$29,769,000	15,827,000	(7,738,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization of property, plant and equipment	13,655,000	14,354,000	9,830,000
Amortization of intangible assets with finite lives	21,075,000	22,823,000	13,415,000
Amortization of stock-based compensation	8,569,000	8,506,000	4,117,000
Amortization of deferred financing costs	2,196,000	1,977,000	795,000
Loss (gain) on disposal of property, plant and equipment	79,000	(126,000)	(21,000)
Provision for allowance for doubtful accounts	573,000	497,000	907,000
Provision for excess and obsolete inventory	5,628,000	2,900,000	2,780,000
Deferred income tax (benefit) expense	(6,379,000)	9,056,000	(3,241,000)
Settlement of intellectual property litigation	—	(12,020,000)	—
Change in fair value of contingent liability	—	—	(359,000)
Excess income tax benefit from stock-based award exercises	—	(82,000)	(28,000)
Changes in assets and liabilities, net of effects of business acquisition:			
Accounts receivable	(24,578,000)	25,508,000	5,806,000
Inventories	(20,065,000)	7,812,000	8,280,000
Prepaid expenses and other current assets	787,000	(956,000)	2,112,000
Other assets	(140,000)	666,000	(86,000)
Accounts payable	13,728,000	(4,472,000)	(1,255,000)
Accrued expenses and other current liabilities	(3,374,000)	(21,796,000)	(13,360,000)
Customer advances and deposits	9,143,000	(2,431,000)	(6,397,000)
Other liabilities, non-current	(682,000)	(1,442,000)	(882,000)
Interest payable	234,000	(1,039,000)	1,292,000
Income taxes payable	126,000	1,355,000	(892,000)
Net cash provided by operating activities	50,344,000	66,917,000	15,075,000
Cash flows from investing activities:			
Purchases of property, plant and equipment	(8,642,000)	(8,150,000)	(5,667,000)
Payments for business acquisition, net of cash acquired	—	—	(280,535,000)
Net cash used in investing activities	(8,642,000)	(8,150,000)	(286,202,000)
Cash flows from financing activities:			
Repayment of long-term debt under Term Loan Facility	(18,960,000)	(33,567,000)	(77,353,000)
Cash dividends paid	(9,538,000)	(18,872,000)	(19,406,000)
Net (payments) borrowings under Revolving Loan Facility	(8,800,000)	(26,500,000)	83,904,000
Repayment of principal amounts under capital lease and other obligations	(2,802,000)	(3,592,000)	(1,753,000)
Remittance of employees' statutory tax withholdings for stock awards	(1,143,000)	(262,000)	(105,000)
Proceeds from issuance of employee stock purchase plan shares	855,000	694,000	676,000
Proceeds from exercises of stock options	326,000	—	—
Payment of deferred financing costs	—	(1,085,000)	(9,464,000)
Payment of issuance costs related to equity offering	—	(626,000)	(476,000)
Excess income tax benefit from stock-based award exercises	—	82,000	28,000
Borrowings of long-term debt under Term Loan Facility	—	—	250,000,000

Proceeds received from equity offering	—	—	95,029,000
Required payments for debt assumed for business acquisition	—	—	(134,101,000)
Net cash (used in) provided by financing activities	(40,062,000)	(83,728,000)	186,979,000

COMTECH TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
Consolidated Statements of Cash Flows (continued)
Fiscal Years Ended July 31, 2018, 2017 and 2016

	2018	2017	2016 (Continued)
Net increase (decrease) in cash and cash equivalents	$1,640,000	(24,961,000)	(84,148,000)
Cash and cash equivalents at beginning of year	41,844,000	66,805,000	150,953,000
Cash and cash equivalents at end of year	$43,484,000	41,844,000	66,805,000
Supplemental cash flow disclosure			
Cash paid (received) during the year for:			
Interest	$7,291,000	10,424,000	5,307,000
Income taxes, net	$1,112,000	(758,000)	3,678,000
Non-cash investing and financing activities:			
Accrued remittance of employees' statutory tax withholdings for fully-vested share units	$2,963,000	—	—
Cash dividends declared but unpaid (including accrual of dividend equivalents)	$2,656,000	2,616,000	7,462,000
Capital lease and other obligations incurred (excluding the effect of business acquisition)	$1,306,000	68,000	373,000
Accrued fixed asset additions	$719,000	1,221,000	346,000
(Forfeiture) issuance of restricted stock	$(1,000)	14,000	—
Accrued issuance costs related to equity offering	$—	—	636,000
Accrued deferred financing costs	$—	—	155,000

See accompanying notes to consolidated financial statements.

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting and Reporting Policies

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Comtech Telecommunications Corp. and its subsidiaries ("Comtech," "we," "us," or "our"), all of which are wholly-owned. All significant intercompany balances and transactions have been eliminated in consolidation.

(b) Nature of Business

We design, develop, produce and market innovative products, systems and services for advanced communications solutions. We conduct our business through two reportable operating segments: Commercial Solutions and Government Solutions.

Our business is highly competitive and characterized by rapid technological change. Our growth and financial position depends on our ability to keep pace with such changes and developments and to respond to the sophisticated requirements of an increasing variety of electronic equipment users, among other things. Many of our competitors are substantially larger, and have significantly greater financial, marketing and operating resources and broader product lines than us. A significant technological or sales breakthrough by others, including smaller competitors or new companies, could have a material adverse effect on our business. In addition, certain of our customers have technological capabilities in our product areas and could choose to replace our products with their own.

International sales expose us to certain risks, including barriers to trade, fluctuations in foreign currency exchange rates (which may make our products less price competitive), political and economic instability, availability of suitable export financing, export license requirements, tariff regulations, and other United States ("U.S.") and foreign regulations that may apply to the export of our products, as well as the generally greater difficulties of doing business abroad. We attempt to reduce the risk of doing business in foreign countries by seeking contracts denominated in U.S. dollars, advance or milestone payments, credit insurance and irrevocable letters of credit in our favor.

(c) Revenue Recognition

Through July 31, 2018 (prior to our adoption of Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") No. 2014-09 "Revenue from Contracts with Customers (Topic 606)"), revenue is generally recognized when the earnings process is complete, upon shipment or customer acceptance. Revenue from contracts relating to the design, development or manufacture of complex electronic equipment to a buyer's specification or to provide services relating to the performance of such contracts is generally recognized in accordance with the FASB ASC 605-35 "Revenue Recognition - Construction-Type and Production-Type Contracts" ("FASB ASC 605-35"). We primarily apply the percentage-of-completion method and generally recognize revenue based on the relationship of total costs incurred to total projected costs, or, alternatively, based on output measures, such as units delivered or produced. Profits expected to be realized on such contracts are based on total estimated sales for the contract compared to total estimated costs, including warranty costs, at completion of the contract. These estimates are reviewed and revised periodically throughout the lives of the contracts, and adjustments to profits resulting from such revisions are made cumulative to the date of the change. Provision for anticipated losses on uncompleted contracts is made in the period in which such losses become evident. Long-term, U.S. government, cost-reimbursable type contracts are also specifically covered by FASB ASC 605-35.

We have historically demonstrated an ability to estimate contract revenues and expenses in applying the percentage-of-completion method of accounting. However, there exist inherent risks and uncertainties in estimating future revenues and expenses, particularly on larger or longer-term contracts. Changes to such estimates could have a material effect on our consolidated financial condition and results of operations.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Revenues recognized in excess of amounts billable under long-term contracts accounted for under the percentage-of-completion method are recorded as unbilled receivables in the accompanying consolidated balance sheets. Unbilled receivables are billable upon various events, including the attainment of performance milestones, delivery of hardware, submission of progress bills based on time and materials, finalization of indirect rates or completion of the contract. We do not recognize revenue, or record unbilled receivables, until we receive fully funded orders.

In fiscal 2018, 75.2% and 24.8% of our consolidated U.S. government net sales were derived from firm fixed-price and cost-reimbursable type contracts, respectively. Under firm fixed-price contracts, we perform for an agreed-upon price and we can derive benefits from cost savings, but bear the risk of cost overruns. Our cost-reimbursable type contracts typically provide for reimbursement of allowable costs incurred plus a negotiated fee. Cost-plus-incentive-fee orders typically provide for sharing with the U.S. government savings accrued from orders performed for less than the target costs and costs incurred in excess of targets up to a negotiated ceiling price (which is higher than the target cost), and for the supplier to carry the entire burden of costs exceeding the negotiated ceiling price.

Most government contracts have termination for convenience clauses that provide the customer with the right to terminate the contract at any time. Historically, we have not experienced material contract terminations or write-offs of unbilled receivables. We address customer acceptance provisions in assessing our ability to perform our contractual obligations under long-term contracts. Historically, we have been able to perform on our long-term contracts.

Through July 31, 2018 (prior to our adoption of FASB ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)"), revenues from contracts that contain multiple elements that are not accounted for under the percentage-of-completion method are accounted for in accordance with FASB ASC 605-25 "Revenue Recognition - Multiple Element Arrangements" as amended by FASB ASU No. 2009-13 "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements - a Consensus of the FASB Emerging Issues Task Force," which, among other things, requires revenue to be allocated to each element based on the relative selling price method.

Adoption of New Revenue Standard

Effective on August 1, 2018 (the start of our first quarter of fiscal 2019), we adopted FASB ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)," which replaces numerous requirements in U.S. GAAP, including industry specific requirements, and provides a single revenue recognition model for contracts with customers. The core principle of the new standard is that a company should record revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In March 2016, April 2016, May 2016 and February 2017, FASB ASU Nos. 2016-08 "Revenue from Contracts with Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)," 2016-10 "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," 2016-12 "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" and 2017-05 "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets" were issued, respectively, to clarify certain implementation matters related to the new revenue standard. The effective dates for these ASUs coincide with our August 1, 2018 adoption. As provided by the ASU, we adopted the new revenue recognition model using the modified retrospective method and there was no material impact on our business, results of operations and financial condition. In fiscal 2019, we expect to recognize a significant portion of our contracts over time, as there is a continuous transfer of control to the customer over the contractual period of performance. The remainder of our contracts will be recognized at a point in time. Both of these methods are similar to what we did prior to August 1, 2018.

(d) Cash and Cash Equivalents

Our cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash and have insignificant risk of change in value as a result of changes in interest rates. Our cash and cash equivalents, as of July 31, 2018 and 2017, amounted to $43,484,000 and $41,844,000, respectively, and primarily consist of bank deposits and money market deposit accounts insured by the Federal Deposit Insurance Corporation. Cash equivalents are carried at cost, which approximates fair value.

(e) Inventories

Our inventories are stated at the lower of cost and net realizable value, the latter of which is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Our inventories are reduced to their estimated net realizable value by a charge to cost of sales in the period such excess costs are determined. Our inventories are principally recorded using either average or standard costing methods.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Work-in-process (including our contracts-in-progress) and finished goods inventory reflect all accumulated production costs, which are comprised of direct production costs and overhead, and is reduced by amounts recorded in cost of sales as the related revenue is recognized. Indirect costs relating to long-term contracts, which include expenses such as general and administrative, are charged to expense as incurred and are not included in our cost of sales or work-in-process (including our contracts-in-progress) and finished goods inventory.

(f) Long-Lived Assets

Our machinery and equipment, which are recorded at cost, are depreciated or amortized over their estimated useful lives (three to eight years) under the straight-line method. Capitalized values of properties and leasehold improvements under leases are amortized over the life of the lease or the estimated life of the asset, whichever is less.

Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. In accordance with FASB ASC 350 "Intangibles - Goodwill and Other" goodwill is not amortized. We periodically, at least on an annual basis in the first quarter of each fiscal year, review goodwill, considering factors such as projected cash flows and revenue and earnings multiples, to determine whether the carrying value of the goodwill is impaired. If we fail the quantitative assessment of goodwill impairment ("quantitative assessment"), pursuant to our adoption of FASB ASU No. 2017-04 in fiscal 2017, we would be required to recognize an impairment loss equal to the amount that a reporting unit's carrying value exceeded its fair value; however, any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. We define our reporting units to be the same as our operating segments.

We performed our annual goodwill impairment assessment for fiscal 2019 on August 1, 2018 (the first day of our fiscal 2019). See Note (15) - "Goodwill" for more information. Unless there are future indicators that the fair value of a reporting unit is more likely than not less than its carrying value, such as a significant adverse change in our future financial performance, our next impairment assessment for goodwill will be performed and completed in the first quarter of fiscal 2020. Any impairment charges that we may record in the future could be material to our results of operations and financial condition.

We assess the recoverability of the carrying value of our other long-lived assets, including identifiable intangible assets with finite useful lives, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. We evaluate the recoverability of such assets based upon the expectations of undiscounted cash flows from such assets. If the sum of the expected future undiscounted cash flows were less than the carrying amount of the asset, a loss would be recognized for the difference between the fair value and the carrying amount.

(g) Research and Development Costs

We charge research and development costs to operations as incurred, except in those cases in which such costs are reimbursable under customer funded contracts. In fiscal 2018, 2017 and 2016, we were reimbursed by customers for such activities in the amount of $16,924,000, $27,050,000 and $17,432,000, respectively. These amounts are not reflected in the reported research and development expenses in each of the respective periods, but are included in net sales with the related costs included in cost of sales in each of the respective periods.

(h) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

We determine the uncertain tax positions taken or expected to be taken in income tax returns in accordance with the provisions of FASB ASC 740-10-25 "Income Taxes" which prescribes a two-step evaluation process for tax positions. The first step is recognition based on a determination of whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step is to measure a tax position that meets the more-likely-than-not threshold. The tax position is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. Our policy is to recognize interest and penalties related to uncertain tax positions in income tax expense.

(i) Earnings Per Share

Our basic earnings per share ("EPS") is computed based on the weighted average number of common shares (including vested but unissued stock units, share units, performance shares and restricted stock units ("RSUs")), outstanding during each respective period. Our diluted EPS reflects the dilution from potential common stock issuable pursuant to the exercise of equity-classified stock-based awards, if dilutive, outstanding during each respective period. Pursuant to FASB ASC 260 "Earnings Per Share," equity-classified stock-based awards that are subject to performance conditions are not considered in our diluted EPS calculations until the respective performance conditions have been satisfied. When calculating our diluted earnings per share, we consider the amount an employee must pay upon assumed exercise of stock-based awards and the amount of stock-based compensation cost attributed to future services and not yet recognized. On August 1, 2017, we adopted ASU No. 2016-09, which amends several aspects of the accounting for and reporting of share-based payment transactions. As a result of our adoption of ASU No. 2016-09, the amount of excess tax benefits assuming exercise of in-the-money stock-based awards is no longer included in the calculation of diluted earnings per share on a prospective basis and the denominator for our diluted calculation could increase in the future as compared to prior calculations. See Note (11) - "Stock-Based Compensation" for more information on the impact of adopting ASU No. 2016-09.

Our basic and diluted EPS calculations for fiscal 2018, 2017 and 2016 include the impact of common shares issued from a public offering in June 2016. There were no purchases of our common stock during the fiscal years ended July 31, 2018, 2017 and 2016. See Note (17) - "Stockholders’ Equity" for more information.

Weighted average stock options, RSUs and restricted stock outstanding of 1,739,000, 1,986,000 and 2,350,000 shares for fiscal 2018, 2017 and 2016, respectively, were not included in our diluted EPS calculation because their effect would have been anti-dilutive.

Our EPS calculations exclude 258,000, 228,000 and 147,000 weighted average performance shares outstanding for fiscal 2018, 2017 and 2016, respectively, as the performance conditions have not yet been satisfied. However, the compensation expense related to these awards is included in net income (loss) (the numerator) for EPS calculations for each respective period.

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

	Fiscal Years Ended July 31,		
	2018	2017	2016
Numerator:			
Net income (loss) for basic calculation	$29,769,000	15,827,000	(7,738,000)

Numerator for diluted calculation	$29,769,000	15,827,000	(7,738,000)
Denominator:			
Denominator for basic calculation	23,825,000	23,433,000	16,972,000
Effect of dilutive securities:			
Stock-based awards	215,000	56,000	—
Denominator for diluted calculation	24,040,000	23,489,000	16,972,000

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(j) Fair Value Measurements and Financial Instruments

Using the fair value hierarchy described in FASB ASC 820 "Fair Value Measurements and Disclosures," we valued our cash and cash equivalents using Level 1 inputs that were based on quoted market prices.

We believe that the carrying amounts of our other current financial assets (such as accounts receivable) and other current liabilities (including accounts payable, accrued expenses and the current portions of our Secured Credit Facility and favorable AT&T warranty settlement) approximate their fair values due to their short-term maturities.

The fair value of the non-current portion of our Secured Credit Facility as of July 31, 2018 approximates its carrying amount due to its variable interest rate and pricing grid that is dependent upon our leverage ratio as of the end of each fiscal quarter. We believe the fair value of our non-current portion of capital lease and other obligations, which currently has a blended interest rate of 6.10%, would not be materially different than its carrying value as of July 31, 2018.

The fair value of the non-current portion of our favorable AT&T warranty settlement would not be materially different than its carrying value as of July 31, 2018, given our belief that the present value of such liability reflects market participants' assumptions for a similar junior, unsecured debt instrument. See Note (6) - "Accrued Expenses and Other Current Liabilities" for further discussion of the favorable AT&T warranty settlement.

As of July 31, 2018 and 2017, other than the financial instruments discussed above, we had no other significant assets or liabilities included in our Consolidated Balance Sheets recorded at fair value, as such term is defined by FASB ASC 820.

(k) Use of Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of net sales and expenses during the reported period. We make significant estimates in many areas of our accounting, including but not limited to the following: long-term contracts, stock-based compensation, intangible assets including goodwill, provision for excess and obsolete inventory, allowance for doubtful accounts, warranty obligations and income taxes. Actual results may differ from those estimates.

(l) Comprehensive Income

In accordance with FASB ASC 220 "Comprehensive Income," we report all changes in equity during a period, except those resulting from investment by owners and distribution to owners, for the period in which they are recognized. Comprehensive income is the total of net income and all other non-owner changes in equity (or other comprehensive income) such as unrealized gains/losses on securities classified as available-for-sale, foreign currency translation adjustments and minimum pension liability adjustments. Comprehensive income (loss) was the same as our net income (loss) in fiscal 2018, 2017 and 2016.

(m) Reclassifications

Certain reclassifications have been made to previously reported consolidated financial statements to conform to the fiscal 2018 presentation.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(n) Adoption of Accounting Standards and Updates

We are required to prepare our consolidated financial statements in accordance with the FASB ASC which is the source for all authoritative U.S. generally accepted accounting principles, which are commonly referred to as "GAAP." The FASB ASC is subject to updates by the FASB, which are known as Accounting Standard Updates ("ASUs"). During fiscal 2018, we adopted:

- FASB ASU No. 2016-09, which amends several aspects of the accounting for and reporting of share-based payment transactions. Our adoption of this ASU, on August 1, 2017, did not have a material impact on our consolidated financial statements. See Note (11) - "Stock-Based Compensation" for further information regarding our adoption of this ASU.

- FASB ASU No. 2016-15, which amends the guidance on the following cash flow related issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon and similar type debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims (including those related to certain life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and cash receipts or payments with more than one class of cash flows. Our adoption of this ASU on February 1, 2018 did not have any impact on our consolidated financial statements.

- FASB ASU No. 2017-09, which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in ASC Topic 718. An entity would not be required to account for changes to the terms or conditions of a share-based payment award as a modification if there were no changes to the award’s fair value, vesting conditions and classification. Our adoption of this ASU on February 1, 2018 did not have any impact on our consolidated financial statements.

- FASB ASU Nos. 2016-01 and 2018-03, which address certain aspects of recognition, measurement, presentation and disclosure of financial instruments, such as: amending the initial and subsequent measurement requirements for certain equity investments; eliminating the disclosure requirements related to the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet; requiring the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset or liability on the balance sheet or the accompanying notes to the financial statements. Adoption of these ASUs did not have a material impact on our consolidated financial statements and disclosures.

(2) Acquisition

On February 23, 2016, we completed the acquisition of TeleCommunication Systems, Inc. ("TCS"), pursuant to the Agreement and Plan of Merger, dated as of November 22, 2015 (the "Merger Agreement"), among Comtech, TCS and Typhoon Acquisition Corp., a Maryland corporation and a direct, wholly owned subsidiary of Comtech ("Merger Sub"). TCS is now a wholly-owned subsidiary of Comtech.

The acquisition has an aggregate purchase price for accounting purposes of $340,432,000 (also referred to as the transaction equity value) and an enterprise value of $423,629,000. The fair value of consideration transferred in connection with the TCS acquisition was $280,535,000 in cash, which is net of $59,897,000 of cash acquired. We funded the acquisition (including transaction and merger related expenditures) and repaid $134,101,000 of debt assumed in connection with the acquisition by redeploying a significant amount of our combined cash and cash equivalents, with the remaining funds coming from a $400,000,000 Secured Credit Facility (the "Secured Credit

Facility"), which is discussed further in Note (8) - "Secured Credit Facility."

The purchase price includes the final estimated fair value of contingent liabilities associated with TCS' intellectual property matters and the warranty obligations for TCS' 911 call handling software, which are discussed in more detail in Note (6) "Accrued Expenses and Other Current Liabilities" and Note (14)(b) "Commitments and Contingencies - Legal Proceedings and Other Matters." These estimated fair values reflect market participant assumptions, as required by FASB ASC 805 "Business Combinations" and do not reflect our settlement position or amounts we actually have paid or may pay in the future.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

We have incurred transaction and merger related expenditures which include significant amounts primarily for: (i) change-in-control payments, (ii) severance, (iii) costs associated with establishing our Secured Credit Facility, and (iv) professional fees for financial and legal advisors for both Comtech and TCS. For the fiscal year ended July 31, 2016, acquisition plan expenses were $21,276,000 and primarily related to the TCS acquisition. There were no such transaction and merger related expenses during fiscal 2018 or 2017. As discussed in prior SEC filings, we had embarked on a focused acquisition plan which culminated with the closing of the acquisition of TCS on February 23, 2016.

The unaudited pro forma financial information in the table below for the fiscal year ended July 31, 2016 is presented as if Comtech's acquisition of TCS had occurred on August 1, 2014, and combines Comtech's historical statement of operations for the fiscal year ended July 31, 2016 (which includes TCS' results of operations since the acquisition date of February 23, 2016) with TCS' historical statement of operations for the trailing five months ended December 31, 2015 and TCS' historical statement of operations for the stub period beginning January 1, 2016 and ended February 23, 2016. TCS' historical statement of operations for the trailing five months ended December 31, 2015 was derived by taking TCS' historical results of operations for the calendar year ended December 31, 2015 and deducting TCS' historical results of operations for the seven months ended July 31, 2015.

	(Unaudited) For the Fiscal Year Ended July 31, 2016
Net sales	$611,241,000
Net loss	(30,750,000)
Basic net loss per share	(1.81)
Diluted net loss per share	(1.81)

The pro forma financial information is not indicative of the results of operations that would have been achieved if the acquisition and cash paid had taken place as of August 1, 2014. The pro forma financial information includes adjustments for:

- The elimination of historical sales between Comtech and TCS of $8,601,000.
- The reduction to capitalized software amortization of $2,566,000, related to the difference between the historical value and the estimated fair value of TCS' capitalized software.
- The elimination of acquisition plan expenses of $36,212,000, due to the assumption that all of the acquisition plan expenses were incurred on August 1, 2014.
- The incremental amortization expense of $7,113,000, associated with the increase in acquired other intangible assets.
- The increase in interest expense of $2,339,000, due to the assumed August 1, 2014 repayment of TCS' legacy debt and related new borrowings under our Secured Credit Facility which was utilized to partially fund the TCS acquisition.
- The reduction to interest income of $577,000, due to the assumed cash payments relating to the TCS acquisition.
- The related adjustment to the provision for income taxes, based on Comtech's effective tax rate for the period.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(3) Accounts Receivable

Accounts receivable consist of the following at July 31, 2018 and 2017:

	2018	2017
Billed receivables from commercial and international customers	$83,411,000	71,404,000
Unbilled receivables from commercial and international customers	19,731,000	24,668,000
Billed receivables from the U.S. government and its agencies	26,251,000	18,497,000
Unbilled receivables from the U.S government and its agencies	19,807,000	11,693,000
Total accounts receivable	149,200,000	126,262,000
Less allowance for doubtful accounts	1,761,000	1,300,000
Accounts receivable, net	$147,439,000	124,962,000

Unbilled receivables relate to contracts-in-progress for which revenue has been recognized but we have not yet billed the customer for work performed. We had $134,000 and $118,000 of retainage included in unbilled receivables at July 31, 2018 and 2017, respectively, and management estimates that substantially all of the unbilled receivables at July 31, 2018 will be billed and collected within one year. Of the unbilled receivables from commercial and international customers at July 31, 2018 and 2017, approximately $1,558,000 and $2,995,000, respectively, relates to a large over-the-horizon microwave system contract with our large U.S. prime contractor customer (all of which related to our North African country end-customer).

As of July 31, 2018, the U.S. government (and its agencies) and Verizon Communications Inc. (through various divisions and, collectively, "Verizon") represented 30.9% and 10.1%, respectively, of total accounts receivable. As of July 31, 2017, except for the U.S. government (and its agencies), which represented 23.9% of total accounts receivable, there were no other customers which accounted for greater than 10.0% of total accounts receivable.

(4) Inventories

Inventories consist of the following at July 31, 2018 and 2017:

	2018	2017
Raw materials and components	$53,649,000	50,569,000
Work-in-process and finished goods	38,854,000	26,053,000
Total inventories	92,503,000	76,622,000
Less reserve for excess and obsolete inventories	17,427,000	16,019,000
Inventories, net	$75,076,000	60,603,000

At July 31, 2018 and 2017, the amount of inventory directly related to long-term contracts (including contracts-in-progress) was $1,249,000 and $2,148,000, respectively.

At July 31, 2018 and 2017, $1,310,000 and $1,718,000, respectively, of the inventory balance above related to contracts from third party commercial customers who outsource their manufacturing to us.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(5) Property, Plant and Equipment

Property, plant and equipment consist of the following at July 31, 2018 and 2017:

	2018	2017
Machinery and equipment	$154,556,000	146,459,000
Leasehold improvements	13,807,000	13,624,000
	168,363,000	160,083,000
Less accumulated depreciation and amortization	139,376,000	127,236,000
Property, plant and equipment, net	$28,987,000	32,847,000

Depreciation and amortization expense on property, plant and equipment amounted to $13,655,000, $14,354,000 and $9,830,000 for the fiscal years ended July 31, 2018, 2017 and 2016, respectively.

(6) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following at July 31, 2018 and 2017:

	2018	2017
Accrued wages and benefits	$23,936,000	19,622,000
Accrued legal costs	6,179,000	8,402,000
Accrued warranty obligations	11,738,000	17,617,000
Accrued contract costs	10,016,000	8,644,000
Accrued commissions and royalties	4,654,000	3,600,000
Other	8,511,000	10,725,000
Accrued expenses and other current liabilities	$65,034,000	68,610,000

Accrued wages and benefits as of July 31, 2018 include $2,963,000 of accrued remittance of employees' statutory tax withholdings related to the net settlement of fully-vested share units, as discussed in more detail in Note (11) - "Stock-Based Compensation." There was no comparable amount as of July 31, 2017.

Accrued legal costs as of July 31, 2018 and 2017 include $3,372,000 and $4,120,000, respectively, related to estimated costs associated with certain TCS intellectual property matters. The accrued potential settlement costs do not reflect the final amounts we may actually pay. Ongoing legal costs associated with defending legacy TCS intellectual property matters and the ultimate resolution could vary and have a material adverse effect on our future consolidated results of operations, financial position or cash flows. TCS intellectual property matters are discussed in more detail in Note (14)(b) - "Commitments and Contingencies - Legal Proceedings and Other Matters."

Accrued contract costs represent direct and indirect costs on contracts as well as estimates of amounts owed for invoices not yet received from vendors or reflected in accounts payable.

Accrued warranty obligations relate to estimated liabilities for warranty coverage that we provide to our customers. We generally provide warranty coverage for some of our products for a period of at least one year from the date of delivery. We record a liability for estimated warranty expense based on historical claims, product failure rates, a consideration of contractual obligations, future costs to resolve software issues and other factors. Some of our product warranties are provided under long-term contracts, the costs of which are incorporated into our estimates of total contract costs.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Changes in our accrued warranty obligations during the fiscal years ended July 31, 2018 and 2017 were as follows:

	2018	2017
Balance at beginning of year	$17,617,000	15,362,000
Provision for warranty obligations	5,055,000	5,394,000
Adjustment to TCS pre-acquisition contingent liability	—	4,200,000
Charges incurred	(8,244,000)	(7,339,000)
Warranty settlement and reclass (see below)	(2,690,000)	—
Balance at end of year	$11,738,000	17,617,000

Our current accrued warranty obligations at July 31, 2018 and 2017 include $4,650,000 and $9,909,000, respectively, of warranty obligations for a small product line that we refer to as the TCS 911 call handling software solution. This solution was licensed to customers prior to our acquisition of TCS. During the fiscal year ended July 31, 2018, we entered into a full and final warranty settlement with AT&T, the largest customer/distributor of this product line, pursuant to which we issued thirty-six credits to AT&T of $153,000 which AT&T can apply on a monthly basis to purchases of solutions from us, beginning October 2017 through September 2020. As of July 31, 2018, the total present value of these monthly credits is $3,616,000, of which $1,586,000 is included in our current accrued warranty obligations and $2,030,000 is reflected in other liabilities (non-current) on our Consolidated Balance Sheet. In connection with this favorable settlement, during the fiscal year ended July 31, 2018, we recorded a benefit to cost of sales of $660,000.

(7) Radyne Acquisition-Related Restructuring Plan

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

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

Our total non-cancelable lease obligations were based on the actual lease term which runs from November 1, 2008 through October 31, 2018. We estimated sublease income based on the terms of a fully executed sublease agreement that expired on October 31, 2015. In accordance with grandfathered accounting standards that were not incorporated into the FASB’s ASC, we recorded these costs, at fair value, as assumed liabilities as of August 1, 2008, with a corresponding increase to goodwill.

As of July 31, 2018, the amount of the acquisition-related restructuring reserve is as follows:

	Cumulative Activity Through July 31,

	2018
Present value of estimated facility exit costs at August 1, 2008	$2,100,000
Cash payments made	(12,211,000)
Cash payments received	8,600,000
Accreted interest recorded	1,917,000
Liability recorded as of period end as accrued expenses and other current liabilities in the Consolidated Balance Sheet	$406,000

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

As of July 31, 2017, the present value of the estimated facility exit costs was $1,941,000. During the fiscal year ended July 31, 2018, we made cash payments of $1,623,000. Interest accreted for the fiscal years ended July 31, 2018, 2017 and 2016 was $88,000, $189,000 and $278,000, respectively, and is included in interest expense for each respective fiscal period.

TCS
In connection with our February 23, 2016 acquisition of TCS, we continue to implement a tactical shift in strategy in our Government Solutions segment and have initiated certain cost reduction actions. To-date, we have incurred an immaterial amount of severance and retention costs related to our shift in strategy.

(8) Secured Credit Facility

On February 23, 2016, in connection with our acquisition of TCS, we entered into a $400,000,000 secured credit facility (the "Secured Credit Facility") with a syndicate of lenders. The Secured Credit Facility, as amended June 6, 2017 (the "June 2017 Amendment"), comprises a senior secured term loan A facility of $250,000,000 (the "Term Loan Facility") and a secured revolving loan facility of up to $150,000,000, including a $25,000,000 letter of credit sublimit (the "Revolving Loan Facility") and, together, with the Term Loan Facility, matures on February 23, 2021. The proceeds of these borrowings were primarily used to finance our acquisition of TCS, including the repayment of certain existing indebtedness of TCS. The Term Loan Facility requires quarterly repayments. During the fiscal years ended July 31, 2018 and 2017, we repaid $18,960,000 and $33,567,000, respectively, principal amount of borrowings under the Term Loan Facility. The repayments in the fiscal year ended July 31, 2017 include a payment of $22,500,000 made in connection with the June 2017 amendment to reduce the balloon or final payment of the Term Loan Facility, which is discussed further below. Under the Revolving Loan Facility, we had outstanding balances ranging from $34,904,000 to $66,804,000 during the fiscal year ended July 31, 2018.

As of July 31, 2018 and 2017, net amounts outstanding under our Secured Credit Facility were as follows:

	2018	2017
Term Loan Facility	$120,121,000	139,080,000
Less unamortized deferred financing costs related to Term Loan Facility	3,427,000	4,763,000
Term Loan Facility, net	116,694,000	134,317,000
Revolving Loan Facility	48,604,000	57,405,000
Amount outstanding under Secured Credit Facility, net	165,298,000	191,722,000
Less current portion of long-term debt	17,211,000	15,494,000
Non-current portion of long-term debt	$148,087,000	176,228,000

Interest expense, including amortization of deferred financing costs, recorded during the fiscal years ended July 31, 2018, 2017 and 2016 related to the Secured Credit Facility was $9,614,000, $11,106,000 and $6,933,000, respectively, and reflects a blended interest rate of approximately 5.40%, 4.90% and 5.00% in fiscal 2018, 2017 and 2016, respectively.

At July 31, 2018, we had $3,166,000 of standby letters of credit outstanding under our Secured Credit Facility, as amended, related to our guarantees of future performance on certain customer contracts and no outstanding commercial letters of credit.

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COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

The Revolving Loan Facility is primarily used for working capital and other general corporate purposes of the Company and its subsidiaries, including the issuance of letters of credit. Borrowings under the Secured Credit Facility, pursuant to terms defined in the Secured Credit Facility, shall be either (i) Alternate Base Rate ("ABR") borrowings, which bear interest from the applicable borrowing date at a rate per annum equal to (x) the greatest of (a) the Prime Rate in effect on such day, (b) the Federal Funds Effective Rate in effect on such day plus 0.50% per annum and (c) the Adjusted LIBO Rate on such day (or, if such day is not a business day, the immediately preceding business day) plus 1.00% per annum (provided that if the LIBO Rate is less than 1.00%, then the LIBO Rate shall be deemed to be 1.00%), plus (y) the Applicable Rate, or (ii) Eurodollar borrowings, which bear interest from the applicable borrowing date at a rate per annum equal to (x) the Adjusted LIBO Rate for such interest period (provided that if the LIBO Rate is less than 1.00%, then the LIBO Rate shall be deemed to be 1.00%) plus (y) the Applicable Rate. The Applicable Rate is determined based on a pricing grid that is dependent upon our leverage ratio as of the end of each fiscal quarter. The Secured Credit Facility contains customary representations, warranties and affirmative covenants and customary negative covenants, subject to negotiated exceptions, on (i) liens, (ii) investments, (iii) indebtedness, (iv) significant corporate changes, including mergers and acquisitions, (v) dispositions, (vi) restricted payments, including stockholder dividends, and (vii) certain other restrictive agreements. The Secured Credit Facility also contains certain financial covenants and customary events of default (subject to grace periods, as appropriate), such as payment defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency, the occurrence of a defined change in control and the failure to observe the negative covenants and other covenants related to the operation of our business.

We believe the June 2017 Amendment provides increased operating and acquisition flexibility and simplifies the calculations of our financial covenants. In particular, the June 2017 Amendment provides, among other things, that the:

(i) Consolidated EBITDA definition more closely aligns with our Adjusted EBITDA metric by eliminating favorable adjustments to operating income related to settlements of TCS intellectual property matters;

(ii) Leverage Ratio is calculated on a "gross" basis using the quotient of Total Indebtedness (excluding unamortized deferred financing costs) divided by our trailing twelve month ("TTM") Consolidated EBITDA. The prior Leverage Ratio was calculated on a "net" basis but did not include a reduction for any cash or cash equivalents above $50,000,000;

(iii) Fixed Charge Coverage Ratio includes a deduction for all cash dividends, regardless of the amount of our cash and cash equivalents and the related allowable Quarterly Dividend Amount, as defined, now aligns with our current quarterly dividend target of $0.10 per common share;

(iv) Balloon or final payment of the Term Loan Facility, (which is not due until February 23, 2021), was reduced by $22,500,000 through increased borrowings from the Revolving Loan Facility, (which does not expire until February 23, 2021); and

(v) Leverage Ratios will be adjusted, in certain conditions, to provide for additional flexibility for us to make acquisitions.

In connection with the June 2017 Amendment, there were no changes to: (i) the committed borrowing capacity; (ii) the maturity date; or (iii) interest rates payable (except that the interest rate pricing grid is now based on the new

Leverage Ratio). Also, the June 2017 Amendment did not result in an extinguishment for accounting purposes (as such term is defined in ASC 470 "Debt"); instead, the June 2017 Amendment was accounted for as a debt modification. As a result, deferred financing costs (including incremental fees for the June 2017 Amendment) will continue to be amortized over the remaining maturity term of the Secured Credit Facility.

As of July 31, 2018, our Leverage Ratio was 2.19x TTM Consolidated EBITDA compared to the maximum allowable Leverage Ratio of 3.00x TTM Consolidated EBITDA. Our Fixed Charge Coverage Ratio as of July 31, 2018 was 2.33x compared to the minimum required Fixed Charge Coverage Ratio of 1.25x. Given our expected future business performance, we anticipate maintaining compliance with the terms and financial covenants in our Secured Credit Facility, as amended, for the foreseeable future.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

The obligations under the Secured Credit Facility, as amended, are guaranteed by certain of our domestic subsidiaries (the "Subsidiary Guarantors"). As collateral security for amounts outstanding under our Secured Credit Facility, as amended, and the guarantees thereof, we and our Subsidiary Guarantors have granted to an administrative agent, for the benefit of the lenders, a lien on, and first priority security interest in, substantially all of our tangible and intangible assets.

Capitalized terms used but not defined herein have the meanings set forth for such terms in the Secured Credit Facility, dated as of February 23, 2016, and the First Amendment of the Secured Credit Facility, dated as of June 6, 2017, both of which have been documented and filed with the SEC.

(9) Capital Lease and Other Obligations

We lease certain equipment under capital leases. As of July 31, 2018 and 2017, the net book value of the leased assets which collateralize the capital lease and other obligations was $2,547,000 and $5,419,000, respectively, and consisted primarily of machinery and equipment. Depreciation of leased assets is included in depreciation expense.

As of July 31, 2018, our capital lease and other obligations reflect a blended interest rate of approximately 6.10%. Our capital leases generally contain provisions whereby we can purchase the equipment at the end of the lease for a one dollar buyout.

Future minimum payments under capital lease and other obligations consisted of the following at July 31, 2018:

Fiscal 2019	$1,972,000
Fiscal 2020	780,000
Fiscal 2021 and beyond	—
Total minimum lease payments	2,752,000
Less: amounts representing interest	151,000
Present value of net minimum lease payments	2,601,000
Current portion of capital lease and other obligations	1,836,000
Non-current portion of capital lease and other obligations	$765,000

(10) Income Taxes

On December 22, 2017, H.R.1, also known as the Tax Cuts and Jobs Act ("Tax Reform"), was enacted in the U.S. Tax Reform significantly lowered the amount of our current and future income tax expense primarily due to the reduction in the U.S. statutory income tax rate from 35.0% to 21.0%. This provision went into effect on January 1, 2018 and required us to remeasure our deferred tax assets and liabilities. In fiscal 2019 and beyond, Tax Reform will result in the loss of our ability to take the domestic production activities deduction, which has been repealed, and is also likely to result in lower tax deductions for certain executive compensation expenses.

For fiscal 2018, we were subject to a 35.0% statutory income tax rate with respect to the period August 1, 2017 through December 31, 2017 and a 21.0% statutory income tax rate with respect to the period January 1, 2018 through July 31, 2018, or a blended statutory income tax rate for fiscal 2018 of approximately 27.0%. As such, our effective tax rate for accounting purposes in fiscal 2018, excluding discrete items, was 27.0%. We expect to fully benefit from the lower statutory income tax rate in fiscal 2019 and thereafter.

During fiscal 2018, we recorded a net discrete tax benefit of $11,792,000 which, as a result of Tax Reform, primarily related to the remeasurement of deferred tax liabilities associated with non-deductible amortization related to intangible assets. The remeasurement was recorded pursuant to ASC 740 "Income Taxes" and SEC Staff Accounting

Bulletin ("SAB") 118, using estimates based on reasonable and supportable assumptions and available information as of the reporting date. As such, the remeasurement of deferred taxes is an estimate and will be finalized after we file our federal and state income tax returns for fiscal 2018. The estimated impact recorded in fiscal 2018 will change if the timing of the deferred tax impacts shift between fiscal 2018 and fiscal 2019 and beyond. In addition, it is possible that the Internal Revenue Service ("IRS") will issue clarifying or interpretive guidance related to Tax Reform, which may ultimately result in a change to our estimated income tax.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Income (loss) before (benefit from) provision for income taxes consists of the following:

	Fiscal Years Ended July 31,		
	2018	2017	2016
U.S.	$22,243,000	23,732,000	(7,666,000)
Foreign	2,383,000	1,749,000	(526,000)
	$24,626,000	25,481,000	(8,192,000)

The (benefit from) provision for income taxes included in the accompanying Consolidated Statements of Operations consists of the following:

	Fiscal Years Ended July 31,		
	2018	2017	2016
Federal – current	$367,000	(441,000)	2,297,000
Federal – deferred	(7,499,000)	8,399,000	(2,930,000)
State and local – current	440,000	608,000	408,000
State and local – deferred	1,115,000	659,000	(310,000)
Foreign – current	429,000	413,000	81,000
Foreign – deferred	5,000	16,000	—
(Benefit from) provision for income taxes	$(5,143,000)	9,654,000	(454,000)

The (benefit from) provision for income taxes differed from the amounts computed by applying the U.S. Federal income tax rate as a result of the following:

	Fiscal Years Ended July 31,					
	2018		2017		2016	
	Amount	Rate	Amount	Rate	Amount	Rate
Computed "expected" tax expense (benefit)	$6,615,000	27.0 %	8,919,000	35.0 %	(2,867,000)	35.0 %
Increase (reduction) in income taxes resulting from:						
State and local income taxes, net of federal benefit	1,193,000	4.8	1,257,000	4.9	23,000	(0.3)
Stock-based compensation	(1,112,000)	(4.5)	78,000	0.3	68,000	(0.8)
Research and experimentation credits	(678,000)	(2.8)	(919,000)	(3.6)	(1,106,000)	13.5
Acquisition-related tax contingencies	—	—	—	—	1,962,000	(24.0)
Nondeductible transaction costs	—	—	—	—	1,279,000	(15.6)
Tax Reform remeasurement of deferred taxes	(11,317,000)	(46.0)	—	—	—	—
Foreign income taxes	(221,000)	(0.9)	(151,000)	(0.6)	289,000	(3.5)
Other	377,000	1.4	470,000	1.9	(102,000)	1.2
(Benefit from) provision for income taxes	$(5,143,000)	(21.0)%	9,654,000	37.9 %	(454,000)	5.5 %

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at July 31, 2018 and 2017 are presented below:

	2018	2017
Deferred tax assets:		
Inventory and warranty reserves	$5,089,000	7,854,000
Compensation and commissions	3,511,000	3,807,000
Federal, state and foreign research and experimentation credits	18,816,000	16,286,000
Federal alternative minimum tax credit	3,243,000	2,652,000
Stock-based compensation	5,092,000	7,767,000
Acquisition-related contingent liabilities	2,477,000	4,687,000
Federal and state net operating losses	7,349,000	19,880,000
Other	4,672,000	8,764,000
Less valuation allowance	(11,854,000)	(8,633,000)
Total deferred tax assets	38,395,000	63,064,000
Deferred tax liabilities:		
Plant and equipment	(1,155,000)	(1,309,000)
Intangibles	(48,167,000)	(79,061,000)
Total deferred tax liabilities	(49,322,000)	(80,370,000)
Net deferred tax liabilities	$(10,927,000)	(17,306,000)

We provide for income taxes under the provisions of FASB ASC 740 "Income Taxes." FASB ASC 740 requires an asset and liability based approach in accounting for income taxes. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of them will not be realized. If management determines that it is more likely than not that some or all of its deferred tax assets will not be realized, a valuation allowance will be recorded against such deferred tax assets.

At July 31, 2018, we had $19,069,000 of U.S. federal net operating loss carryforwards reflected in deferred tax assets. Of the total loss carryforwards, $18,422,000 were generated by TCS in the tax period from January 1, 2016 to February 23, 2016 and will begin to expire in 2035. $183,000 is the remaining net operating loss carryforwards acquired in an acquisition by TCS in 2001 and will expire in 2021 if unused at that time. The remaining U.S. federal net operating loss carryforwards generated in fiscal year 2016 of $464,000 will expire in 2036.

At July 31, 2018, we had federal alternative minimum tax credit carryforwards of $3,243,000, which are available to offset future regular federal taxes. We have federal research and experimentation credits of $10,948,000 that will begin to expire in 2019. The timing and manner in which we may utilize net operating loss carryforwards and tax credits in future tax years will be limited by the amounts and timing of future taxable income and by the application of the ownership change rules under Section 382 and 383 of the Internal Revenue Code.

We have state net operating loss carryforwards available of $3,345,000 which expire through 2037, utilization of which will be limited in a manner similar to the federal net operating loss carryforwards. We believe that it is more likely than not that the benefit from certain state net operating loss carryforwards will not be realized. In recognition of this risk, we have provided a valuation allowance of $3,138,000 on the deferred tax assets relating to these state net operating loss carryforwards. We have state research and experimentation credit carryforwards of $6,982,000 expiring through 2037. We believe that it is more likely than not that the benefit from certain state research and experimentation credits will not be realized. In recognition of this risk, we have provided a valuation allowance of $6,771,000 on the deferred tax assets relating to these state credits.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

At July 31, 2018 and 2017, our foreign deferred tax assets relating to research and experimentation credits have been offset by a valuation allowance as they may not be utilized in a future period. Our foreign earnings and profits are insignificant and, as such, we have not recorded any deferred tax liability on unremitted foreign earnings.

We must generate $158,700,000 of taxable income in the future to fully utilize our net deferred tax assets as of July 31, 2018. Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets.

At July 31, 2018 and 2017, total unrecognized tax benefits were $9,339,000 and $8,681,000, respectively, including interest of $202,000 and $95,000, respectively. At July 31, 2018, $2,572,000 of our unrecognized tax benefits were recorded as non-current income taxes payable in our Consolidated Balance Sheet. The remaining unrecognized tax benefits of $6,767,000 were presented as an offset to the associated non-current deferred tax assets in our Consolidated Balance Sheet. At July 31, 2017, $2,515,000 of our unrecognized tax benefits were recorded as non-current income taxes payable in our Consolidated Balance Sheet. The remaining unrecognized tax benefit of $6,166,000 was presented as an offset to the associated non-current deferred tax assets in our Consolidated Balance Sheet. Of the total unrecognized tax benefits, $8,563,000 and $7,727,000 at July 31, 2018 and 2017, respectively, net of the reversal of the federal benefit recognized as a deferred tax asset relating to state reserves, would favorably impact our effective tax rate, if recognized. Unrecognized tax benefits result from income tax positions taken or expected to be taken on our income tax returns for which a tax benefit has not been recorded in our financial statements. We do not expect that there will be any significant changes to our total unrecognized tax benefits within the next twelve months.

Our policy is to recognize interest and penalties relating to uncertain tax positions in income tax expense. The following table summarizes the activity related to our unrecognized tax benefits for fiscal years 2018, 2017 and 2016 (excluding interest):

	2018	2017	2016
Balance at beginning of period	$8,586,000	9,108,000	2,728,000
Increase related to current period	645,000	587,000	2,487,000
Increase related to prior periods	49,000	86,000	4,490,000
Expiration of statute of limitations	(81,000)	(404,000)	(580,000)
Decrease related to prior periods	(62,000)	(791,000)	(17,000)
Balance at end of period	$9,137,000	8,586,000	9,108,000

Since November 2017, our federal income tax return for fiscal 2016 has been under audit by the IRS. The audit is ongoing and we are unaware of any proposed adjustments by the IRS. Our federal income tax returns for fiscal 2015 and 2017 are also subject to potential future IRS audit. None of our state income tax returns prior to fiscal 2014 are subject to audit. TCS' federal income tax returns for tax years 2014 and 2015 and the tax period from January 1, 2016 to February 23, 2016 are subject to potential future IRS audit. None of TCS' state income tax returns prior to calendar year 2013 are subject to audit. The results of the IRS tax audit for fiscal 2016, future tax assessments or settlements could have a material adverse effect on our consolidated results of operations and financial condition.

(11) Stock-Based Compensation

Overview

We issue stock-based awards to certain of our employees and our Board of Directors pursuant to our 2000 Stock Incentive Plan, as amended, (the "Plan") and our 2001 Employee Stock Purchase Plan (the "ESPP") and recognize related stock-based compensation in our consolidated financial statements. The Plan provides for the granting to employees and consultants of Comtech (including prospective employees and consultants): (i) incentive and non-qualified stock options, (ii) restricted stock units ("RSUs"), (iii) RSUs with performance measures (which we refer to as "performance shares"), (iv) restricted stock, (v) stock units (reserved for issuance to non-employee directors) and share units (reserved for issuance to employees) (collectively, "share units") and (vi) stock appreciation rights ("SARs"), among other types of awards. Our non-employee directors are eligible to receive non-discretionary grants of stock-based awards, subject to certain limitations.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

On August 1, 2017, we adopted ASU No. 2016-09, which amended several aspects of the accounting for and reporting of our share-based payment transactions, including:

Excess tax benefits and shortfalls - ASU No. 2016-09 requires that all tax effects related to our share-based awards be recognized in the Consolidated Statement of Operations. ASU No. 2016-09 also removes the prior requirement to delay recognition of excess tax benefits until it reduces current taxes payable; instead, we are now required to recognize excess tax benefits as discrete items in the interim period in which they occur, subject to normal valuation allowance considerations. As ASU No. 2016-09 eliminated the concept of accumulated hypothetical tax benefits, excess tax benefits and shortfalls are no longer recognized in stockholders' equity. As a result, ASU No. 2016-09 is expected to result in future volatility of our income tax expense (as the future tax effects of share-based awards will be dependent on the price of our common stock at the time of settlement). Additionally, on a prospective basis, excess income tax benefits from the settlement of share-based awards are presented as a cash inflow from operating activities in our Consolidated Statement of Cash Flows.

Diluted earnings per share - Prior to the adoption of ASU No. 2016-09, in addition to considering the amount an employee must pay upon assumed exercise of stock-based awards and the amount of stock-based compensation cost attributed to future services and not yet recognized, when calculating our diluted earnings per share, the assumed proceeds also included the amount of excess tax benefits, if any, that would have been credited to additional paid-in capital assuming exercise of in-the-money stock-based awards. Effective with our adoption of ASU No. 2016-09, excess tax benefits are to be excluded from the calculation on a prospective basis. As a result, the denominator for our diluted calculations could increase in the future as compared to prior calculations.

Forfeitures - As permitted by ASU No. 2016-09, we elected to continue to estimate forfeitures of share-based awards.

Statutory Tax Withholding Requirements - ASU No. 2016-09 now allows us, when net settling share-based awards, to withhold an amount up to the employees' maximum individual tax rate in the relevant jurisdiction, without resulting in liability classification of the award. To qualify, we must have at least some withholding obligation. This aspect of adopting ASU No. 2016-09 did not have any material impact on us. However, with respect to cash payments that we make to taxing authorities on behalf of employees for such shares withheld, on a retrospective basis, we are required to present such payments as a cash outflow from financing activities in our Consolidated Statements of Cash Flows (as opposed to operating activities).

As of July 31, 2018, the aggregate number of shares of common stock which may be issued, pursuant to the Plan, may not exceed 10,362,500. Stock options granted may not have a term exceeding ten years or, in the case of an incentive stock award granted to a stockholder who owns stock representing more than 10.0% of the voting power, no more than five years. We expect to settle all outstanding awards under the Plan and employee purchases under the ESPP with the issuance of new shares of our common stock.

As of July 31, 2018, we had granted stock-based awards pursuant to the Plan representing the right to purchase and/or acquire an aggregate of 8,166,820 shares (net of 3,926,429 expired and canceled awards), of which an aggregate of 5,679,407 have been exercised or settled.

As of July 31, 2018, the following stock-based awards, by award type, were outstanding:

	July 31, 2018
Stock options	1,668,975
Performance shares	255,275
RSUs and restricted stock	397,412
Share units	165,751
Total	2,487,413

Our ESPP provides for the issuance of up to 800,000 shares of our common stock. Our ESPP is intended to provide our eligible employees the opportunity to acquire our common stock at 85% of fair market value at the date of issuance.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Through July 31, 2018, we have cumulatively issued 743,735 shares of our common stock to participating employees in connection with our ESPP.

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

	Fiscal Years Ended July 31,		
	2018	2017	2016
Cost of sales	$758,000	760,000	296,000
Selling, general and administrative expenses	6,866,000	7,071,000	3,407,000
Research and development expenses	945,000	675,000	414,000
Stock-based compensation expense before income tax benefit	8,569,000	8,506,000	4,117,000
Estimated income tax benefit	(2,005,000)	(3,065,000)	(1,434,000)
Net stock-based compensation expense	$6,564,000	5,441,000	2,683,000

Stock-based compensation for equity-classified awards is measured at the date of grant, based on an estimate of the fair value of the award and is generally expensed over the vesting period of the award. At July 31, 2018, unrecognized stock-based compensation of $6,641,000, net of estimated forfeitures of $742,000, is expected to be recognized over a weighted average period of 2.7 years. Total stock-based compensation capitalized and included in ending inventory at July 31, 2018 and 2017 was $48,000 and $12,000, respectively. There are no liability-classified stock-based awards outstanding as of July 31, 2018 or 2017.

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

	Fiscal Years Ended July 31,		
	2018	2017	2016
Stock options	$1,089,000	1,400,000	2,353,000
Performance shares	1,013,000	1,607,000	1,374,000
RSUs and restricted stock	1,458,000	829,000	227,000
ESPP	205,000	162,000	163,000
Share units	4,804,000	4,508,000	—
Stock-based compensation expense before income tax benefit	8,569,000	8,506,000	4,117,000
Estimated income tax benefit	(2,005,000)	(3,065,000)	(1,434,000)
Net stock-based compensation expense	$6,564,000	5,441,000	2,683,000

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

The estimated income tax benefit as shown in the above table was computed using income tax rates expected to apply when the awards are settled. Such deferred tax asset was recorded net as part of our non-current deferred tax liability in our Consolidated Balance Sheet as of July 31, 2018 and 2017. The actual income tax benefit recognized for tax reporting is based on the fair market value of our common stock at the time of settlement and can significantly differ from the estimated income tax benefit recorded for financial reporting.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Stock Options

The following table summarizes the Plan's activity:

	Awards (in Shares)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at July 31, 2015	2,119,683	$ 29.33		
Granted	552,806	27.15		
Expired/canceled	(396,610)	28.99		
Exercised	(19,200)	27.24		
Outstanding at July 31, 2016	2,256,679	28.87		
Expired/canceled	(400,804)	30.15		
Outstanding at July 31, 2017	1,855,875	28.60		
Expired/canceled	(72,190)	27.58		
Exercised	(114,710)	27.44		
Outstanding at July 31, 2018	1,668,975	$ 28.72	4.53	$8,198,000
Exercisable at July 31, 2018	1,314,448	$ 28.67	4.07	$6,516,000
Vested and expected to vest at July 31, 2018	1,632,696	$ 28.70	4.48	$8,049,000

Stock options outstanding as of July 31, 2018 have exercise prices ranging from $20.90 - $33.94. The total intrinsic value relating to stock options exercised during the fiscal years ended July 31, 2018 and 2016 was $469,000 and $32,000, respectively. There were no stock options exercised during the fiscal year ended July 31, 2017. Stock options granted during the fiscal year ended July 31, 2016 had exercise prices equal to the fair market value of our common stock on the date of grant, a contractual term of five or ten years and a vesting period of three or five years. There were no stock options granted during the fiscal years ended July 31, 2018 and 2017.

During fiscal 2018, at the election of certain holders of vested stock options, 101,610 stock options were net settled upon exercise. As a result, 8,706 net shares of our common stock were issued during the fiscal year ended July 31, 2018, after reduction of shares retained to satisfy the exercise price and statutory tax withholding requirements.

The estimated per-share weighted average grant-date fair value of stock options granted during fiscal 2016 was $5.50, which was determined using the Black-Scholes option pricing model, and included the following weighted average assumptions:

	Fiscal Year Ended July 31, 2016
Expected dividend yield	4.46 %
Expected volatility	34.44 %
Risk-free interest rate	1.52 %
Expected life (years)	5.15

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

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

Performance Shares, RSUs, Restricted Stock and Share Unit Awards

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

	Awards (in Shares)	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at July 31, 2015	224,165	$ 28.26	
Granted	71,605	27.45	
Settled	(16,439)	26.35	
Forfeited	(62,118)	27.62	
Outstanding at July 31, 2016	217,213	28.32	
Granted	705,241	14.31	
Settled	(61,462)	26.63	
Forfeited	(30,795)	17.13	
Outstanding at July 31, 2017	830,197	16.95	
Granted	473,005	22.45	
Settled	(354,822)	17.66	
Canceled/Forfeited	(129,942)	17.26	
Outstanding at July 31, 2018	818,438	$ 19.78	$27,500,000
Vested at July 31, 2018	207,998	$ 28.88	$6,989,000
Vested and expected to vest at July 31, 2018	785,543	$ 19.92	$26,394,000

The total intrinsic value relating to fully-vested awards settled during the fiscal years ended July 31, 2018, 2017 and 2016 was $10,473,000, $1,039,000 and $660,000 respectively.

Performance shares granted to employees prior to fiscal 2014 generally vest over a 5.3 year period, beginning on the date of grant once pre-established performance goals were attained, and are convertible into shares of our common stock at the time of vesting, on a one-for-one basis for no cash consideration. The performance shares granted to employees since fiscal 2014 principally vest over a three-year performance period, if pre-established performance goals are attained, or as specified pursuant to the Plan and related agreements. As of July 31, 2018, the number of outstanding performance shares included in the above table, and the related compensation expense prior to consideration of estimated pre-vesting forfeitures, assume achievement of the pre-established goals at a target level.

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

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Share units granted prior to July 31, 2017 were vested when issued and are convertible into shares of our common stock, generally at the time of termination, on a one-for-one basis for no cash consideration, or earlier under certain circumstances. Share units granted on or after July 31, 2017 were granted to certain employees in lieu of non-equity incentive compensation and are convertible into shares of our common stock on the one-year anniversary of the respective grant date.

On July 31, 2018, 160,899 fully vested share units were granted to certain employees in lieu of fiscal 2018 non-equity incentive compensation. Also, on July 31, 2018, 247,664 fully vested share units (previously granted in lieu of fiscal 2017 non-equity incentive compensation) were converted into 162,391 shares of our common stock after reduction of shares retained to satisfy employees' statutory tax withholding requirements. Cumulatively, through July 31, 2018, 265,348 share units granted have been settled.

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

Dividend equivalents are subject to forfeiture, similar to the terms of the underlying stock-based awards, and are payable in cash generally at the time of settlement of the underlying shares into our common stock. During fiscal 2018, 2017 and 2016, we accrued $300,000, $273,000 and $155,000, respectively, of dividend equivalents (net of forfeitures) and paid out $141,000, $176,000 and $23,000, respectively. Accrued dividend equivalents were recorded as a reduction to retained earnings. As of July 31, 2018 and 2017, accrued dividend equivalents were $713,000 and $554,000, respectively.

We recorded $1,193,000 of income tax benefit in our Consolidated Statements of Operations for fiscal 2018, which primarily represents net excess income tax benefits from the settlement of stock-based awards. During fiscal 2017 and 2016, net income tax shortfalls from similar items totaled $670,000 and $283,000, pursuant to prior GAAP, were recorded as a reduction to additional paid-in capital.

Subsequent Events

In the first quarter of fiscal 2019, our Board of Directors authorized the issuance of 152,617 stock-based awards of which 46,305 were performance shares, 10,386 were restricted stock and 95,926 were restricted stock units. Total unrecognized compensation expense related to such awards, net of estimated forfeitures and assuming achievement of the pre-established performance goals at a target level, approximated $5,057,000.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(12) Customer and Geographic Information

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

	Fiscal Years Ended July 31,		
	2018	2017	2016
United States			
U.S. government	35.5 %	32.7 %	40.8 %
Domestic	38.9 %	38.9 %	29.2 %
Total United States	74.4 %	71.6 %	70.0 %
International	25.6 %	28.4 %	30.0 %
Total	100.0%	100.0%	100.0%

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

Domestic sales include sales to commercial customers, as well as to U.S. state and local governments. Included in domestic sales are sales to Verizon which represented 10.0% of consolidated net sales for fiscal 2018. Except for the U.S. government, there were no customers that represented more than 10.0% of consolidated net sales during fiscal 2017 and 2016.

International sales for fiscal 2018, 2017 and 2016 (which include sales to U.S. domestic companies for inclusion in products that are sold to international customers) were $145,784,000, $156,483,000 and $123,474,000, respectively.

Except for the U.S., no individual country (including sales to U.S. domestic companies for inclusion in products that are sold to a foreign country) represented more than 10% of consolidated net sales for fiscal 2018, 2017 and 2016.

(13) Segment Information

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

Our Commercial Solutions segment serves commercial customers and smaller government customers, such as state and local governments, that require advanced communication technologies to meet their needs. This segment also serves certain large government customers (including the U.S. government) that have requirements for off-the-shelf commercial equipment. We believe this segment is a leading provider of satellite communications (such as satellite earth station modems and TWTAs), public safety systems (such as NG911 technologies) and enterprise application technologies (such as messaging and trusted location-based technologies).

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Our Government Solutions segment serves large government end-users (including those of foreign countries) that require mission-critical technologies and systems. Government solutions products include command and control applications (such as the design, installation and operation of data networks that integrate computing and communications, including both satellite and terrestrial links), ongoing network operation and management support services (including project management and fielding and maintenance solutions related to satellite ground terminals), troposcatter communications (such as digital troposcatter multiplexers, digital over-the-horizon modems, troposcatter systems and frequency converter systems) and RF power and switching technologies (such as solid-state high-power broadband amplifiers, enhanced position location reporting system (commonly known as "EPLRS") amplifier assemblies, identification friend or foe ("IFF") amplifiers and amplifiers used in the counteraction of improvised explosive devices).

Our CODM primarily uses a metric that we refer to as Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA") to measure an operating segment’s performance and to make decisions about resources to be allocated. Our Adjusted EBITDA metric for the Commercial Solutions and Government Solutions segments do not consider any allocation of indirect expenses, including the following: income taxes, interest (income) and other, interest expense, amortization of stock-based compensation, amortization of intangibles, depreciation expense, settlement of intellectual property litigation, acquisition plan expenses or strategic alternatives analysis expenses and other expenses that relate to our Unallocated segment. These items, while periodically affecting our results, may vary significantly from period to period and may have a disproportionate effect in a given period, thereby affecting the comparability of results. Any amounts shown in the Adjusted EBITDA calculation for our Commercial Solutions and Government Solutions segments are directly attributable to those segments. Our Adjusted EBITDA is also used by our management in assessing the Company's operating results. Although closely aligned, the Company's definition of Adjusted EBITDA is different than the Consolidated EBITDA (as such term is defined in our Secured Credit Facility, as amended) utilized for financial covenant calculations and also may differ from the definition of EBITDA or Adjusted EBITDA used by other companies and, therefore, may not be comparable to similarly titled measures used by other companies.

Operating segment information, along with a reconciliation of segment net income (loss) and consolidated net income (loss) to Adjusted EBITDA is presented in the tables below:

	Fiscal Year Ended July 31, 2018			
	Commercial Solutions	Government Solutions	Unallocated	Total
Net sales	$345,076,000	225,513,000	—	$570,589,000
Operating income (loss)	$40,837,000	10,950,000	(16,712,000)	$35,075,000
Net income (loss)	$40,297,000	10,835,000	(21,363,000)	$29,769,000
Provision for (benefit from) income taxes	270,000	—	(5,413,000)	(5,143,000)
Interest (income) and other	151,000	112,000	(9,000)	254,000
Interest expense	119,000	3,000	10,073,000	10,195,000
Amortization of stock-based compensation	—	—	8,569,000	8,569,000
Amortization of intangibles	17,699,000	3,376,000	—	21,075,000
Depreciation	9,479,000	3,088,000	1,088,000	13,655,000
Adjusted EBITDA	$68,015,000	17,414,000	(7,055,000)	$78,374,000

Purchases of property, plant and equipment	$7,151,000	901,000	590,000	$8,642,000
Total assets at July 31, 2018	$610,166,000	195,924,000	39,067,000	$845,157,000

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

	Fiscal Year Ended July 31, 2017			
	Commercial Solutions	Government Solutions	Unallocated	Total
Net sales	$330,867,000	219,501,000	—	$550,368,000
Operating income (loss)	$33,234,000	9,393,000	(5,585,000)	$37,042,000
Net income (loss)	$32,871,000	9,421,000	(26,465,000)	$15,827,000
Provision for income taxes	258,000	—	9,396,000	9,654,000
Interest (income) and other	(108,000)	(34,000)	74,000	(68,000)
Interest expense	213,000	6,000	11,410,000	11,629,000
Amortization of stock-based compensation	—	—	8,506,000	8,506,000
Amortization of intangibles	17,698,000	5,125,000	—	22,823,000
Depreciation	9,938,000	2,938,000	1,478,000	14,354,000
Settlement of intellectual property litigation	—	—	(12,020,000)	(12,020,000)
Adjusted EBITDA	$60,870,000	17,456,000	(7,621,000)	$70,705,000
Purchases of property, plant and equipment	$7,007,000	1,046,000	97,000	$8,150,000
Total assets at July 31, 2017	$606,436,000	185,234,000	40,393,000	$832,063,000

	Fiscal Year Ended July 31, 2016			
	Commercial Solutions	Government Solutions	Unallocated	Total
Net sales	$248,955,000	162,049,000	—	$411,004,000
Operating income (loss)	$23,255,000	23,006,000	(46,837,000)	$(576,000)
Net income (loss)	$22,785,000	23,018,000	(53,541,000)	$(7,738,000)
Provision for (benefit from) income taxes	72,000	—	(526,000)	(454,000)
Interest (income) and other	109,000	(11,000)	(232,000)	(134,000)
Interest expense	289,000	(1,000)	7,462,000	7,750,000
Amortization of stock-based compensation	—	—	4,117,000	4,117,000
Amortization of intangibles	10,592,000	2,823,000	—	13,415,000
Depreciation	7,073,000	2,006,000	751,000	9,830,000
Acquisition plan expenses	—	—	21,276,000	21,276,000
Adjusted EBITDA	$40,920,000	27,835,000	(20,693,000)	$48,062,000
Purchases of property, plant and equipment	$4,614,000	978,000	75,000	$5,667,000
Long-lived assets acquired in connection with the TCS acquisition	367,865,000	82,860,000	4,359,000	455,084,000
Total assets at July 31, 2016	$631,936,000	226,865,000	62,395,000	$921,196,000

Unallocated expenses result from corporate expenses such as executive compensation, accounting, legal and other regulatory compliance related costs and also includes all of our amortization of stock-based compensation. Unallocated expenses reflect favorable adjustments to operating income related to: (i) warranty and sales and use tax settlements in fiscal 2018; and (ii) settlement of certain legacy TCS intellectual property matters in fiscal 2017.

During fiscal 2016, unallocated expenses include acquisition plan expenses, most of which related to the February 23, 2016 acquisition of TCS.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Interest expense in fiscal 2018, 2017 and 2016 includes $9,614,000, $11,106,000 and $6,933,000, respectively, related to our Secured Credit Facility, as amended, and includes the amortization of deferred financing costs. See Note (8) - "Secured Credit Facility" for further discussion of such debt.

Intersegment sales in fiscal 2018, 2017 and 2016 by the Commercial Solutions segment to the Government Solutions segment were $9,630,000, $12,492,000 and $6,266,000, respectively. There were nominal sales by the Government Solutions segment to the Commercial Solutions segment for these fiscal periods. All intersegment sales are eliminated in consolidation and are excluded from the tables above.

Unallocated assets at July 31, 2018 consist principally of cash and cash equivalents, income taxes receivable, corporate property, plant and equipment and deferred financing costs. Substantially all of our long-lived assets are located in the U.S.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(14) Commitments and Contingencies

(a) Operating Leases

At July 31, 2018, future minimum lease payments, net of subleases, under non-cancelable operating lease agreements are as follows:

Fiscal Year:	
2019	$11,246,000
2020	9,884,000
2021	7,866,000
2022	6,577,000
2023	4,950,000
Thereafter	10,760,000
Total	$51,283,000

Lease expense charged to operations was $12,733,000, $13,270,000 and $9,100,000 in fiscal 2018, 2017 and 2016, respectively.

We lease our Melville, New York production facility from a partnership controlled by our President, CEO and Chairman. Lease payments made in fiscal 2018 were $625,000. The current lease provides for our use of the premises as they exist through December 2021 with an option for an additional 10 years. The annual rent of the facility for calendar year 2019 is $645,000 and is subject to customary adjustments. We have a right of first refusal in the event of a sale of the facility.

(b) Legal Proceedings and Other Matters

Legacy TCS Intellectual Property Matter - Vehicle IP
In December 2009, Vehicle IP, LLC ("Vehicle IP") filed a patent infringement lawsuit in the U.S. District Court for the District of Delaware (the "District Court"), seeking monetary damages, fees and expenses and other relief from, among others, our customer Verizon Wireless ("Verizon"), based on the VZ Navigator product, and TCS is defending Verizon against Vehicle IP. In 2013, the District Court granted the defendants' motion for summary judgment on the basis that the products in question did not infringe plaintiff's patent. Plaintiff appealed that decision and, in 2014, the U.S. Court of Appeals for the Federal Circuit reversed the District Court's claim construction, overturned the District Court's grant of summary judgment of noninfringement, and remanded the case for further proceedings. Fact discovery and expert discovery has closed. Substantive settlement conversations have occurred but, to-date, the parties have been unable to reach a settlement. As discussed in Note (6) - "Accrued Expenses and Other Current Liabilities," we have accrued certain legal and settlement costs related to the Vehicle IP matter. The accrued settlement costs related to this matter do not reflect the final amounts we actually may pay, if any.

On May 30, 2017, we received positive news that the District Court issued a supplemental claim construction order in our favor. As a result, the plaintiff agreed to file a joint status report to the District Court that requested that the District Court cancel the trial date (which was scheduled for July 2017). On July 28, 2017, the parties entered into a stipulation that the defendants' accused products do not infringe Vehicle IP's patent under the District Court's current revised construction of the disputed patent claim term and requested that the District Court therefore enter a judgment of noninfringement. On August 18, 2017, the court entered such a judgment of noninfringement. As expected, following the judgment, Vehicle IP filed a notice of appeal on August 29, 2017. Vehicle IP's opening brief on appeal of the District Court's claim construction was submitted in October 2017. TCS' brief in response was filed on January 19, 2018. Vehicle IP's reply brief was filed on February 23, 2018. Oral argument was held on August 8, 2018 and an appellate ruling may take several months to be issued. If the District Court's current claim construction is ultimately upheld at the appellate level, it is possible that we may not have to go to trial or pay any monetary damages.

Ongoing legal expenses associated with defending this matter and its ultimate resolution could vary and have a material adverse effect on our consolidated results of operations, financial position or cash flows in future periods.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

Other Matters

In October 2014, we disclosed to the U.S. Department of the Treasury, Office of Foreign Assets Control ("OFAC") that we learned during a self-assessment of our export transactions that a shipment of modems sent to a Canadian customer by Comtech EF Data Corp. was incorporated into a communication system, the ultimate end user of which was the Sudan Civil Aviation Authority. The sales value of this equipment was approximately $288,000. At the time of shipment, OFAC regulations prohibited U.S. persons from doing business directly or indirectly with Sudan. In late 2015, OFAC issued an administrative subpoena seeking further information about the disclosed transaction. We have responded to the subpoena, including alerting OFAC to Comtech's repair of three modems for a customer in Lebanon who may have rerouted the modems from Lebanon to Sudan without the required U.S. licensing authorization. Subsequently, in October 2017, U.S. sanctions with respect to Sudan were revoked. Consistent with the revocation of the Sudan Sanction Regulations ("SSR"), shipments to the Sudan Civil Aviation Authority by U.S. persons are now permissible. We are not able to predict when OFAC will complete its review, nor whether it will take any enforcement action against us in light of the recent revocation of the SSR. If OFAC determines that we have violated U.S. trade sanctions, civil and criminal penalties could apply, and we may suffer reputational harm. Even though we take precautions to avoid engaging in transactions that may violate U.S. trade sanctions, those measures may not be effective in every instance.

In May 2018, we were informed by the Office of Export Enforcement ("OEE") of the Department of Commerce ("DoC") that it was forwarding to the DoC's Office of Chief Counsel, the results of its audit of international shipments by Comtech Xicom Technology, Inc. for further review and possible determination of an administrative penalty. We fully cooperated with the OEE in their audit and, based on our self-assessment of the approximately 7,800 individual transactions audited, have determined that six (6) transactions may not have been fully in compliance with the Export Administration Regulations ("EAR"). These six (6) items, for which export licenses were not obtained, were either spares or repaired power amplifier subassembly components valued at less than $100,000 (in aggregate) and were shipped to Brazil, Italy, Russia, Thailand and the United Arab Emirates. The EAR provides an exception to the requirement to obtain an export license for the replacement of a defective or damaged component. During our self-assessment, we determined that we inadvertently did not obtain export licenses for the spares, or had evidence of the return or destruction of the defective or damaged components necessary to authorize our use of the export license exception for the replacements. Since discovering this issue, we have implemented additional controls and procedures and have increased awareness of these specific export requirements throughout the Company to help avoid similar occurrences in the future. Administrative penalties under the EAR can range from a warning letter to a denial of export privileges. Given the lapsed legal status of the Export Administration Act ("EAA") itself, administrative penalties under the EAR are currently determined pursuant to the International Emergency Economic Powers Act ("IEEPA"), which can reach the greater of twice the amount of the transaction that is the basis of the violation or approximately $300,000 per violation. We have not recorded an accrual related to a possible administrative penalty and continue to work cooperatively with the OEE.

In the ordinary course of business, we include indemnification provisions in certain of our customer contracts to indemnify, hold harmless and reimburse such customers for certain losses, including but not limited to losses related to third-party claims of intellectual property infringement arising from the customer's use of our products or services. From time to time, customers seek indemnification under these contractual arrangements and we evaluate such claims as and when they arise. We do not always agree with customers that they are entitled to indemnification and in such cases reject their indemnification claims. However, pending or future claims asserted against us by a party that we agree to indemnify could result in legal costs and damages that could have a material adverse effect on our consolidated results of operations and financial condition.

There are certain other pending and threatened legal actions which arise in the normal course of business. Although the ultimate outcome of litigation is difficult to accurately predict, we believe that the outcome of these other pending and threatened actions will not have a material adverse effect on our consolidated financial condition or results of operations.

(c) Employment Change of Control and Indemnification Agreements

We have an employment agreement with our CEO and President. The employment agreement generally provides for an annual salary and bonus award. We have also entered into change of control agreements with certain of our executive officers and certain key employees. All of these agreements may require payments by us, in certain circumstances, including, but not limited to, a change in control of our Company.

(15) Goodwill

The following table represents goodwill by reportable operating segment as of July 31, 2018 and 2017:

	Commercial Solutions	Government Solutions	Total
Goodwill	$231,440,000	59,193,000	$290,633,000

In accordance with FASB ASC 350 "Intangibles - Goodwill and Other," we perform a goodwill impairment analysis at least annually (in the first quarter of each fiscal year), unless indicators of impairment exist in interim periods. If we fail the quantitative assessment of goodwill impairment ("quantitative assessment"), pursuant to our adoption of FASB ASU No. 2017-04 in fiscal 2017, we would be required to recognize an impairment loss equal to the amount that a reporting unit's carrying value exceeded its fair value; however, any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

On August 1, 2018 (the first day of our fiscal 2019), we performed our annual quantitative assessment using market participant assumptions to determine if the fair value of each of our reporting units with goodwill exceeded its carrying value. In making this assessment, we considered, among other things, expectations of projected net sales and cash flows, assumptions impacting the weighted average cost of capital, trends in trading multiples of comparable companies, changes in our stock price and changes in the carrying values of our reporting units with goodwill. We also considered overall business conditions.

In performing the quantitative assessment, we estimated the fair value of each of our reporting units using a combination of the income and market approaches. The income approach, also known as the discounted cash flow ("DCF") method, utilizes the present value of cash flows to estimate fair value. The future cash flows for our reporting units were projected based on our estimates, at that time, of future revenues, operating income and other factors (such as working capital and capital expenditures). For purposes of conducting our impairment analysis, we assumed revenue growth rates and cash flow projections that are below our actual long-term expectations. The discount rates used in our DCF method were based on a weighted-average cost of capital ("WACC") determined from relevant market comparisons, adjusted upward for specific reporting unit risks (primarily the uncertainty of achieving projected operating cash flows). A terminal value growth rate was applied to the final year of the projected period and reflected our estimate of stable, perpetual growth. We then calculated a present value of the respective cash flows for each reporting unit to arrive at an estimate of fair value under the income approach. Under the market approach, we estimated a fair value based on comparable companies' market multiples of revenues and earnings before interest, taxes, depreciation and amortization and factored in a control premium. Finally, we compared our estimates of fair values to our August 1, 2018 total public market capitalization and assessed implied control premiums based on our common stock price of $33.70 as of August 1, 2018.

Based on our quantitative evaluation, we determined that our Commercial Solutions and Government Solutions reporting units had estimated fair values in excess of their carrying values of at least 42.5% and 105.5%, respectively, and concluded that our goodwill was not impaired and that neither of our two reporting units was at risk of failing the quantitative assessment. It is possible that, during fiscal 2019 or beyond, business conditions (both in the U.S. and internationally) could deteriorate from the current state, our current or prospective customers could materially postpone, reduce or even forgo purchases of our products and services to a greater extent than we currently anticipate or our common stock price could decline. A significant decline in our customers' spending that is greater than we anticipate or a shift in funding priorities may also have a negative effect on future orders, sales, income and cash flows and we might be required to perform a quantitative assessment during fiscal 2019 or beyond. If assumed net sales and cash flow projections are not achieved in future periods or our common stock price significantly declines from current levels, our Commercial Solutions and Government Solutions reporting units could be at risk of failing the quantitative assessment and goodwill assigned to the respective reporting units could be impaired.

In any event, we are required to perform the next annual goodwill impairment analysis on August 1, 2019 (the start of our fiscal 2020). If our assumptions and related estimates change in the future, or if we change our reporting unit structure or other events and circumstances change (e.g., a sustained decrease in the price of our common stock (considered on both absolute terms and relative to peers)), we may be required to record impairment charges when we perform these tests, or in other future periods. Any impairment charges that we may record in the future could be material to our results of operations and financial condition.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(16) Intangible Assets

Intangible assets with finite lives as of July 31, 2018 and 2017 are as follows:

	July 31, 2018			
	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	21.0	$249,831,000	55,350,000	$194,481,000
Technologies	12.8	82,370,000	54,386,000	27,984,000
Trademarks and other	16.4	28,894,000	10,563,000	18,331,000
Total		$361,095,000	120,299,000	$240,796,000

	July 31, 2017			
	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	20.3	$249,831,000	41,923,000	$207,908,000
Technologies	12.3	82,370,000	48,623,000	33,747,000
Trademarks and other	16.4	28,894,000	8,678,000	20,216,000
Total		$361,095,000	99,224,000	$261,871,000

The weighted average amortization period in the above table excludes fully amortized intangible assets.

Amortization expense for the fiscal years ended July 31, 2018, 2017 and 2016 was $21,075,000, $22,823,000 and $13,415,000, respectively.

The estimated amortization expense consists of the following for the fiscal years ending July 31:

2019	$17,155,000
2020	17,155,000
2021	16,196,000
2022	14,955,000
2023	14,955,000

We review net intangible assets with finite lives for impairment when an event occurs indicating the potential for impairment. No such event has occurred during the fiscal year ended July 31, 2018. We believe that the carrying values of our net intangible assets were recoverable as of July 31, 2018. Any impairment charges that we may record in the future could be material to our results of operations and financial condition.

(17) Stockholders' Equity

Sale of Common Stock

In June 2016, the Company sold 7,145,000 shares of its common stock in a public offering at a price to the public of $14.00 per share, resulting in proceeds to the Company of $95,029,000, net of underwriting discounts and commissions. During the fiscal year ended July 31, 2016, the Company recorded $1,112,000 of total issuance costs related to this common stock offering, $959,000 of which was a reduction to the additional paid-in capital included in the Consolidated Balance Sheet as of July 31, 2016. As of July 31, 2018 and September 26, 2018, an aggregate registered amount of $74,970,000 under the Company's existing shelf registration statement filed with the SEC remains available for sale of various types of securities, including debt.

Stock Repurchase Program
As of July 31, 2018 and September 26, 2018, we were authorized to repurchase up to an additional $8,664,000 of our common stock, pursuant to our current $100,000,000 stock repurchase program. Our stock repurchase program has no time restrictions and repurchases may be made in open-market or privately negotiated transactions and may be made pursuant to SEC Rule 10b5-1 trading plans. There were no repurchases made during the fiscal years ended July 31, 2018 or 2017.

Dividends
Since September 2010, we have paid quarterly dividends pursuant to an annual targeted dividend amount that was established by our Board of Directors. On September 27, 2017, December 6, 2017, March 7, 2018 and June 6, 2018, our Board of Directors declared a dividend of $0.10 per common share, which were paid on November 17, 2017, February 16, 2018, May 18, 2018 and August 17, 2018, respectively. On September 26, 2018, our Board of Directors declared a dividend of $0.10 per common share, payable on November 16, 2018 to stockholders of record at the close of business on October 17, 2018.

Future dividends remain subject to compliance with financial covenants under our Secured Credit Facility, as amended, as well as Board approval.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

(18) Unaudited Quarterly Financial Data

The following is a summary of unaudited quarterly operating results. Our historical results prior to February 23, 2016 do not include TCS; as such, you should not rely on period-to-period comparisons as an indicator of future performance as these comparisons may not be meaningful.

Fiscal 2018	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Net sales	$121,569,000	133,731,000	147,854,000	167,435,000	$570,589,000
Gross profit	47,716,000	50,801,000	62,436,000	62,988,000	223,941,000
Net (loss) income	(1,660,000)	15,761,000	8,210,000	7,458,000	29,769,000
Diluted (loss) income per share	(0.07)	0.66	0.34	0.31	1.24

Fiscal 2017	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Net sales	$135,786,000	139,028,000	127,792,000	147,762,000	$550,368,000
Gross profit	52,108,000	53,204,000	52,461,000	60,412,000	218,185,000
Net (loss) income	(2,489,000)	6,585,000	4,417,000	7,314,000	15,827,000
Diluted (loss) income per share	(0.11)	0.28	0.19	0.31	0.67

Fiscal 2016	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Net sales	$64,117,000	70,323,000	124,187,000	152,377,000	$411,004,000
Gross profit	28,202,000	29,438,000	51,391,000	62,206,000	171,237,000
Net income (loss)	1,439,000	2,476,000	(14,355,000)	2,702,000	(7,738,000)
Diluted income (loss) per share	0.09	0.15	(0.89)	0.14	(0.46) *

* The per share information is computed independently for each quarter and the full year based on the respective weighted average number of common shares outstanding. Therefore, income per share information for the full fiscal year may not equal the total of the quarters within the year.

Schedule II
COMTECH TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES

Valuation and Qualifying Accounts and Reserves

Fiscal Years Ended July 31, 2018, 2017 and 2016

Column A	Column B	Column C Additions				Column D		Column E
Description	Balance at beginning of period	Charged to cost and expenses		Charged to other accounts - describe		Transfers (deductions) - describe		Balance at end of period
Allowance for doubtful accounts receivable:								
Year ended July 31,								
2018	$1,300,000	573,000	(A)	—		(112,000)	(B)	$1,761,000
2017	1,029,000	497,000	(A)	—		(226,000)	(B)	1,300,000
2016	1,206,000	907,000	(A)	—		(1,084,000)	(B)	1,029,000
Inventory reserves:								
Year ended July 31,								
2018	$16,019,000	5,628,000	(C)	—		(4,220,000)	(D)	$17,427,000
2017	16,198,000	2,900,000	(C)	—		(3,079,000)	(D)	16,019,000
2016	16,904,000	2,780,000	(C)	—		(3,486,000)	(D)	16,198,000
Valuation allowance for deferred tax assets:								
Year ended July 31,								
2018	$8,633,000	3,221,000	(E)	—		—		$11,854,000
2017	9,624,000	324,000	(E)	121,000	(F)	(1,436,000)	(F)	8,633,000
2016	4,442,000	524,000	(E)	4,658,000	(F)	—		9,624,000

(A) Provision for doubtful accounts.
(B) Write-off of uncollectible receivables.
(C) Provision for excess and obsolete inventory.
(D) Write-off of inventory.
(E) Change in valuation allowance.
(F) Acquisition related valuation allowance charged to (deducted from) goodwill.

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