FREQUENCY ELECTRONICS INC
Form 10-Q
March 18, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the Quarterly Period ended January 31, 2019

OR

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

For the transition period from __________ to __________

Commission File No. 1-8061

FREQUENCY ELECTRONICS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**11-1986657**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
55 CHARLES LINDBERGH BLVD., MITCHEL FIELD, N.Y.	**11553**
(Address of principal executive offices)	(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller Reporting Company
Emerging growth company	

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of Registrant's Common Stock, par value $1.00 as of March 12, 2019 – 8,729,682

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In thousands except par value)

	January 31, 2019 (UNAUDITED)	April 30, 2018
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 2,418	$ 7,869
Marketable securities	8,442	6,149
Accounts receivable, net of allowance for doubtful accounts of $173 at January 31, 2019 and $181 at April 30, 2018	7,312	4,268
Costs and estimated earnings in excess of billings, net	7,282	5,094
Inventories, net	25,065	26,186
Prepaid income taxes	417	1,459
Prepaid expenses and other	877	1,050
Total current assets	51,813	52,075
Property, plant and equipment, at cost, net of accumulated depreciation and amortization	13,783	14,127
Goodwill and other intangible assets	617	617
Cash surrender value of life insurance and cash held in trust	14,419	13,915
Other assets	3,616	2,850
Total assets	**$ 84,248**	**$ 83,584**
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable - trade	$ 1,120	$ 1,841
Accrued liabilities	3,444	3,416
Total current liabilities	4,564	5,257
Deferred compensation	13,779	13,541
Deferred rent and other liabilities	1,314	1,524

Total liabilities	19,657	20,322
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - $1.00 par value authorized 600 shares, no shares issued	-	-
Common stock - $1.00 par value; authorized 20,000 shares, 9,164 shares issued, 8,955 shares outstanding at January 31, 2019; 8,867 shares outstanding at April 30, 2018	9,164	9,164
Additional paid-in capital	56,696	56,439
Retained earnings (Accumulated deficit)	251	(65)
	66,111	65,538
Common stock reacquired and held in treasury - at cost (209 shares at January 31, 2019 and 297 shares at April 30, 2018)	(960)	(1,361)
Accumulated other comprehensive income	(560)	(915)
Total stockholders' equity	64,591	63,262
Total liabilities and stockholders' equity	**$ 84,248**	**$83,584**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

Nine Months Ended January 31,

(In thousands except per share data)

(Unaudited)

	2019	2018
Condensed Consolidated Statements of Operations		
Revenues	$36,345	$31,932
Cost of revenues	23,953	28,060
Gross margin	12,392	3,872
Selling and administrative expenses	7,838	7,796
Research and development expense	5,094	5,071
Operating loss	(540)	(8,995)
Other income (expense):		
Investment income	242	1,236
Interest expense	(57)	(61)
Other income, net	225	4
Loss before provision (benefit) for income taxes	(130)	(7,816)
Provision for income taxes	38	2,750
Net loss from continuing operations	(168)	(10,566)
Loss from discontinued operations, net of tax	-	(697)
Net loss	$(168)	$(11,263)
Net loss per common share:		
Basic and diluted loss from continued operations	$(0.02)	$(1.20)
Basic and diluted loss from discontinued operations	-	(0.07)
Basic and diluted loss per share	(0.02)	(1.27)
Weighted average shares outstanding:		
Basic	8,899	8,836
Diluted	8,899	8,836
Condensed Consolidated Statements of Comprehensive Income (Loss)		
Net loss	$(168)	$(11,263)
Other comprehensive loss:		
Foreign currency translation adjustment	261	623
Unrealized gain (loss) on marketable securities:		
Change in market value of marketable securities before reclassification, net of tax of $8 in 2018	95	(54)

Reclassification adjustment for realized gains included in net income, net of tax of $355 in 2018	(1)	(688)
Total unrealized gain (loss) on marketable securities, net of tax	94	(742)
Total other comprehensive income (loss)	355	(119)
Comprehensive income (loss)	$187	$(11,382)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

Three Months Ended January 31,

(In thousands except per share data)

(Unaudited)

	2019	2018
Condensed Consolidated Statements of Operations		
Revenues	$13,193	$10,572
Cost of revenues	9,093	13,424
Gross margin (loss)	4,100	(2,852)
Selling and administrative expenses	2,657	2,749
Research and development expense	1,837	1,708
Operating loss	(394)	(7,309)
Other expense:		
Investment income	52	68
Interest expense	(23)	(19)
Other income, net	104	1
Loss before provision for income taxes	(261)	(7,259)
Provision for income taxes	60	2,848
Net loss from continuing operations	(321)	(10,107)
Loss from discontinued operations, net of tax	-	(289)
Net loss	$(321)	$(10,396)
Net loss per common share:		
Basic (loss) income from continued operations	$(0.04)	$(1.15)
Basic loss from discontinued operations	-	(0.03)
Basic (loss) income per share	(0.04)	(1.18)
Weighted average shares outstanding:		
Basic	8,928	8,846
Diluted	8,928	8,846
Condensed Consolidated Statements of Comprehensive Income (Loss)		
Net loss	$(321)	$(10,396)
Other comprehensive income:		
Foreign currency translation adjustment	343	48
Unrealized (loss) gain on marketable securities:		
Change in market value of marketable securities before reclassification, net of tax of $39 in 2018	150	(76)

Reclassification adjustment for realized gains included in net income	1	-
Total unrealized gain (loss) on marketable securities, net of tax	151	(76)
Total other comprehensive income (loss)	494	(28)
Comprehensive income (loss)	$173	$(10,424)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

Nine Months Ended January 31,

(In thousands)

(Unaudited)

	2019	2018
Cash flows from operating activities:		
Net loss from continuing operations	$(168)	$(10,566)
Net loss from discontinued operations	-	(697)
Net loss	(168)	(11,263)
Non-cash charges to earnings	3,303	8,285
Net changes in operating assets and liabilities	(4,420)	5,771
Cash provided by operating activities – continuing operations	(1,285)	2,793
Cash provided by operating activities – discontinued operations	-	1,217
Net cash (used in) provided by operating activities	(1,285)	4,010
Cash flows from investing activities:		
Proceeds on redemption of marketable securities	987	6,477
Purchase of marketable securities	(3,200)	(4,961)
Purchase of fixed assets and other assets	(2,175)	(1,032)
Cash (used in) provided by investing activities – continuing operations	(4,388)	484
Cash used in investing activities – discontinued operations	-	(44)
Net (used in) cash provided by investing activities	(4,388)	440
Cash flows from financing activities:		
Tax benefit from exercise of stock-based compensation	-	1
Net cash provided by financing activities	-	1
Net (decrease) increase in cash and cash equivalents before effect of exchange rate changes	(5,673)	4,451
Effect of exchange rate changes on cash and cash equivalents	222	738
Net (decrease) increase in cash and cash equivalents	(5,451)	5,189
Cash and cash equivalents at beginning of period	7,869	2,738
Cash and cash equivalents at end of period	2,418	7,927
Less cash and equivalents of discontinued operations at end of period	-	943
Cash and cash equivalents of continuing operations at end of period	$2,418	$6,984

Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$57	$61
Income taxes	$2	$325

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Changes in Stockholders' Equity

Nine Months Ended January 31,

(In thousands except per share data)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional paid in capital	(Accumulated Deficit) Retained earnings	Treasury stock (at cost) Shares	Treasury stock (at cost) Amount	Accumulated other comprehensive Income (loss)	Total
Balance at April 30, 2018	9,163,940	$9,164	$56,439	$ (65)	297,083	$(1,361)	$ (915)	$63,262
Opening adjustment for adoption of ASU 2014-09				484				484
Adjusted balance at May 1, 2018	9,163,940	9,164	56,439	419	297,083	(1,361)	(915)	63,746
Contribution of stock to 401(k) plan			50		(14,339)	66		116
Stock-based compensation expense			121					121
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price								
Other comprehensive income, net of tax							(44)	(44)
Net income				31				31
Balance at July 31, 2018	9,163,940	$9,164	$56,610	$ 450	282,744	$(1,295)	$ (959)	$63,970
Contribution of stock to 401(k) plan			58		(10,089)	46		104
Stock-based compensation expense			123					123
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price			(81)		(17,708)	81		-
Other comprehensive loss, net of tax							(95)	(95)

Net income				122				122
Balance at October 31, 2018	9,163,940	$ 9,164	$ 56,710	$ 572	254,947	$ (1,168)	$ (1,054)	$ 64,224
Contribution of stock to 401(k) plan			35		(5,829)	27		62
Stock-based compensation expense			128		(1,100)	4		132
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price			(177)		(38,536)	177		-
Other comprehensive income, net of tax							494	494
Net loss				(321)				(321)
Balance at January 31, 2019	9,163,940	$ 9,164	$ 56,696	$ 251	209,482	$ (960)	$ (560)	$ 64,591

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Changes in Stockholders' Equity

Nine Months Ended January 31,

(In thousands except per share data)

(Unaudited)

	Common Stock		Additional paid in	(Accumulated Deficit) Retained	Treasury stock (at cost)		Accumulated other comprehensive	
	Shares	Amount	capital	earnings	Shares	Amount	Income (loss)	Total
Balance at April 30, 2017	9,163,940	$ 9,164	$ 55,767	$ 23,712	347,422	$ (1,592)	$ 2,281	$ 89,332
Contribution of stock to 401(k) plan			68		(13,740)	63		131
Stock-based compensation expense			153		(100)	1		154
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price			(3)		(744)	3		-
Other comprehensive loss, net of tax							(340)	(340)
Net income				614				614
Balance at July 31, 2017	9,163,940	$ 9,164	$ 55,985	$ 24,326	332,838	$ (1,525)	$ 1,941	$ 89,891
Contribution of stock to 401(k) plan			57		(11,530)	53		110
Stock-based compensation expense			97					97
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price								
Other comprehensive income, net of tax							261	261
Net loss				(1,481)				(1,481)
Balance at October 31, 2017	9,163,940	$ 9,164	$ 56,139	$ 22,845	321,308	$ (1,472)	$ 2,202	$ 88,878

Contribution of stock to 401(k) plan			36		(7,487)	34		70
Stock-based compensation expense			115		(2,750)	12		127
Exercise of stock options and stock appreciation rights - net of shares tendered for exercise price			(1)		(117)	1		-
Other comprehensive loss, net of tax							(28)	(28)
Net loss				(10,396)				(10,396)
Balance at January 31, 2018	9,163,940	$ 9,164	$ 56,289	$ 12,449	310,954	$ (1,425)	$ 2,174	$ 78,651

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE A – CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management of Frequency Electronics, Inc. (the “Company”), the accompanying unaudited condensed consolidated interim financial statements reflect all adjustments (which include only normal recurring adjustments) necessary to present fairly, in all material respects, the consolidated financial position of the Company as of January 31, 2019 and the results of its operations and cash flows for the nine and three months ended January 31, 2019 and January 31, 2018. The April 30, 2018 condensed consolidated balance sheet was derived from audited financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (‘U.S. GAAP”) have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended April 30, 2018, filed on July 30, 2018, and the financial statements and notes thereto. The results of operations for such interim periods are not necessarily indicative of the operating results for the full fiscal year.

NOTE B – DISCONTINUED OPERATIONS

In April 2017, the Company decided to sell Gillam and determined that the assets and liabilities of this reportable segment met the discontinued operations criteria as defined in U. S. GAAP in the quarter ended April 30, 2017. On April 26, 2018, the Company sold Gillam to a European entity in a stock purchase agreement for $1.0 million in cash, which was received on April 27, 2018, and a note payable in three years for an additional $1.0 million. The loss recorded due to the sale of Gillam was approximately $359,000, which represented the carrying amount of the investment on FEI-NY’s books less the retained earnings and remaining Gillam equity value reduced by the cash received and the value of the note receivable which is recorded in the caption other assets in the accompanying Condensed Consolidated Balance Sheets. As such Gillam’s results have been classified as discontinued operations in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for fiscal 2018.

Summarized operating results for the Gillam discontinued operations, for the nine and three months ended January 31, 2018, were as follows:

	Nine months	**Three months**
	(UNAUDITED)	(UNAUDITED)
	(In thousands except par value)	
Revenues	$3,018	$ 1,063
Cost of Revenues	2,089	699
Gross Margin	929	364
Selling and administrative expenses	1,285	582
Research and development expenses	334	66
Operating Loss	(690)	(284)
Other income (expense):		
Investment (loss) income		
Other income (expense), net	(7)	(4)
Loss before provision for income taxes	(697)	(288)
Provision for income taxes	-	1
Net Loss	$(697)	$ (289)

9

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE C – EARNINGS PER SHARE

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

	Nine months		**Three months**	
	Periods ended January 31,			
	2019	**2018**	**2019**	**2018**
Weighted average shares outstanding:				
Basic	8,899,110	8,835,685	8,927,710	8,846,083
Effect of dilutive securities	**	**	**	**
Diluted	8,899,110	8,835,685	8,927,710	8,846,083

** For the nine and three month periods ended January 31, 2019, dilutive securities are excluded since the inclusion of such shares would be antidilutive due to the net loss for the periods. The exercisable shares excluded as of January 31, 2019 are 1,207,750 options. The effect of dilutive securities for the periods would have been 204,071 options and 289,322 options, for the nine and three month periods ended January 31, 2019, respectively. For the nine and three month periods ended January 31, 2018, dilutive securities are excluded since the inclusion of such shares would be antidilutive due to the net loss for the periods. The exercisable shares excluded as of January 31, 2018 are 1,260,250 options. The effect of dilutive securities for the periods would have been 131,638 options and 136,424 options for the nine and three month periods ended January 31, 2018, respectively.

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

At January 31, 2019 and April 30, 2018, costs and estimated earnings in excess of billings, net, consisted of the following:

	January 31, 2019	**April 30, 2018**

	(In thousands)	
Costs and estimated earnings in excess of billings	$8,962	$5,266
Billings in excess of costs and estimated earnings	(1,680)	(172)
Net asset	$7,282	$5,094

Such amounts represent revenue recognized on long-term contracts that had not been billed at the balance sheet dates or represent a liability for amounts billed in excess of the revenue recognized. Amounts are billed to customers pursuant to contract terms, whereas the related revenue is recognized on the percentage of completion basis at the measurement date. In general, the recorded amounts will be billed and collected or revenue recognized within twelve months of the balance sheet date. Revenue on these long-term contracts is accounted for on the percentage of completion basis. During the nine and three months ended January 31, 2019, revenue recognized under percentage of completion contracts was approximately $33.3 million and $12.9 million, respectively. During the nine and three months ended January 31, 2018, revenue recognized under percentage of completion contracts was approximately $13.7 million and $2.8 million, respectively. If contract losses are anticipated, costs and estimated earnings in excess of billings are reduced for the full amount of such losses when they are determinable.

NOTE E – TREASURY STOCK TRANSACTIONS

During the nine and three months period ended January 31, 2019, the Company made contributions of 30,257 shares and 5,829 shares, respectively, of its common stock held in treasury to the Company's profit sharing plan and trust under Section 401(k) of the Internal Revenue Code. Such contributions are in accordance with the Company's discretionary match of employee voluntary contributions to this plan.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE F – INVENTORIES

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

	January 31, 2019	**April 30, 2018**
	(In thousands)	
Raw Materials and Component Parts	$13,135	$16,206
Work in Progress	8,884	8,216
Finished Goods	3,046	1,764
	$25,065	$26,186

As of January 31, 2019 and April 30, 2018, approximately $24.2 million and $25.2 million, respectively, of total inventory was located in the United States and $0.9 million and $1.0 million, respectively, was located in China.

NOTE G – SEGMENT INFORMATION

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

(1) FEI-NY – operates out of New York and its operations consist principally of precision time and frequency control products used in three principal markets: satellites (both commercial and U.S. Government-funded); terrestrial cellular telephone or other ground-based telecommunication stations; and other components and systems for the U.S. military. The FEI-NY segment also includes the operations of the Company's wholly-owned subsidiaries, FEI-Elcom and FEI-Asia. FEI-Asia functions as a manufacturing facility for the FEI-NY segment with historically minimal sales to outside customers. In fiscal 2015 and 2016, they had higher sales to outside customers, producing product for third parties as a contract manufacturer. FEI-Elcom, in addition to its own product line, provides design and technical support the FEI-NY segment's satellite business.

(2) FEI-Zyfer – operates out of California and its products incorporate timing synchronization and distribution technologies into systems and subsystems for secure communications, both government and commercial.

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

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

	Nine months		**Three months**	
	Periods ended January 31,			
	2019	**2018**	**2019**	**2018**
Revenues:				
FEI-NY	$28,076	$22,184	$9,754	$6,444
FEI-Zyfer	8,746	12,378	3,644	4,514
less intersegment revenues	(477)	(2,630)	(205)	(386)
Consolidated revenues	$36,345	$31,932	$13,193	$10,572
Operating loss:				
FEI-NY	$(1,745)	$(11,312)	$(939)	$(8,554)
FEI-Zyfer	1,305	2,629	847	1,354
Corporate	(100)	(312)	(302)	(109)
Consolidated operating loss	$(540)	$(8,995)	$(394)	$(7,309)

11

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	January 31, 2019	April 30, 2018
Identifiable assets:		
FEI-NY (approximately $1.4 and $1.7 million, respectively in China)	$56,969	$55,181
FEI-Zyfer	9,998	8,168
less intersegment balances	(11,577)	(11,888)
Corporate	28,858	32,123
Consolidated identifiable assets	$84,248	$83,584

NOTE H – INVESTMENT IN MORION, INC.

The Company has an investment in Morion, Inc. ("Morion"), a privately-held Russian company, which manufactures high precision quartz resonators and crystal oscillators. The Company's investment consists of 4.6% of Morion's outstanding shares, accordingly, the Company accounts for its investment in Morion on the cost basis. This investment is included in other assets in the accompanying balance sheets. During the nine months ended January 31, 2019 and 2018, the Company acquired product from Morion in the aggregate amount of approximately $291,000 and $279,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately $2,000 and $192,000, respectively, included in revenues in the statement of operations as part of the FEI-NY segment. During the three months ended January 31, 2019 and 2018, the Company acquired product from Morion in the aggregate amount of approximately $145,000 and $108,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately $9,000 for the same period in 2018, included in revenues in the statement of operations as part of the FEI-NY segment. At January 31, 2019 there was no payable nor receivable related to Morion. During the nine months ended January 31, 2019 and 2018, the Company received a dividend from Morion in the amount of approximately $105,000 and $85,000, respectively, included in other income, net in the statement of operations as part of the FEI-NY segment.

Morion operates as a subsidiary of Gazprombank, a state-owned Russian bank. On July 16, 2014, after the Company's investment in Morion, Gazprombank became subject to the U. S. Department of Treasury's prohibition against U. S. persons from providing it with new financing.

NOTE I – FAIR VALUE OF FINANCIAL INSTRUMENTS

The cost, gross unrealized gains, gross unrealized losses, and fair market value of available-for-sale securities at January 31, 2019 and April 30, 2018, respectively, were as follows (in thousands):

	January 31, 2019			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Fixed income securities	$8,473	$ 42	$ (73)	$ 8,442

	April 30, 2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Fixed income securities	$6,274	$ 10	$ (135)	$ 6,149

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

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

	Less than 12 months		12 Months or more		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
January 31, 2019						
Fixed Income Securities	$1,695	$ (15)	$4,546	$ (58)	$6,241	$ (73)
April 30, 2018						
Fixed Income Securities	$5,334	$ (135)	$-	$ -	$5,334	$ (135)

The Company regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. The Company does not believe that its investments in marketable securities with unrealized losses at January 31, 2019 were other-than-temporary due to market volatility of the security's fair value, analysts' expectations, and the Company's ability to hold the securities for a period of time sufficient to allow for any anticipated recoveries in market value.

During the nine months ended January 31, 2019, the Company sold or redeemed available-for-sale securities of approximately $987,000, realizing gains of approximately $2,000. During the nine months ended January 31, 2018, the Company sold or redeemed available-for-sale securities in the amounts of approximately $6.5 million, realizing gains of approximately $1 million.

Maturities of fixed income securities classified as available-for-sale at January 31, 2019 were as follows, at cost (in thousands):

Current	$1,572
Due after one year through five years	3,997
Due after five years through ten years	2,904
	$8,473

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

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

The Company believes that the fair value of its financial instruments comprising notes receivable approximate the carrying amount.

NOTE J – RECENT ACCOUNTING PRONOUNCEMENTS

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

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”) which replaces the incurred loss impairment methodology in current generally accepted accounting principles (“GAAP”) with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The new guidance is effective for fiscal years beginning after December 15, 2019. The Company is evaluating the effect, if any, the update will have on the financial statements when adopted in fiscal year 2021.

In February 2016, the FASB issued ASU No. 2016-02 *Leases (Topic 842)* (“ASU 2016-02”). The objective of the update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The standard requires a modified retrospective transition approach for existing leases. The amendments of ASU 2016-02 are effective for fiscal years beginning after December 31, 2018 and early adoption is permitted. The Company will adopt this update on May 1, 2019, the effective date of initial application, using a modified retrospective transition approach. The Company will continue to apply ASC-840, including disclosure requirements, in the comparative periods in the year the Company adopts the new guidance. The new standard provides a number of optional practical expedients. The Company expects to elect the package of three practical expedients which permits the Company not to reassess under the new standard the Company’s prior conclusions about lease identification and initial direct costs. The Company does not expect to elect the practical expedients to use hindsight or pertaining to land easements, the latter not being applicable to the Company. The Company expects this standard will have a material effect on our financial statements, with the most significant effects related to: (i) the recognition of new right of use assets and lease liabilities on our balance sheet for primarily real estate operating leases and (ii) providing significant new disclosures regarding lease activities. The Company does not expect a significant change in our leasing activities between now and adoption.

In August 2018, the FASB issued ASU No. 2018-13 *Fair Value Measurement (Topic 820)* (“ASU 2018-13”) which modifies the disclosure requirement on fair value measurements. The new guidance is effective for fiscal years beginning after December 15, 2019. The Company is evaluating the effect, if any, the update will have on the financial statements when adopted in fiscal 2021.

Newly Adopted Accounting Standards

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), as amended, which establishes new guidance for revenue recognition. ASU 2014-09 eliminates most of the existing industry-specific revenue recognition guidance and significantly expands related disclosures. Additionally, it supersedes some cost guidance in Subtopic 605-35, *Revenue Recognition-Construction-Type and Production-Type Contracts*, and creates a new Subtopic 340-40, *Other Assets and Deferred Costs-Contracts with Customers*. The Company determines revenue recognition through the following steps: identification of the contract, or contracts, with the customer; identification of the performance obligations in the contract; determination of the transaction price; allocation of the transaction price to the performance obligations in the contract; and recognize revenue when, or as, the entity satisfies a performance obligation. The core principle of the guidance is that the Company will recognize revenue upon the transfer of the promised goods and services to its customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods and services. The new guidance requires significant additional judgement and estimation (as compared to the previous guidance) that may include, but is not limited to, identifying performance obligations and estimating the amount of variable consideration, if any, to include in the transaction price, and allocation of the transaction price to the performance obligations. The new standard allows for two methods of adoption, either by (i) retrospectively to each prior reporting period presented ("full retrospective method") or (ii) retrospectively with the cumulative effect of initially applying the new guidance recognized at the date of initial application ("modified-retrospective method"). The Company adopted ASU 2014-09 in the first quarter of fiscal 2019 using the modified-retrospective method, which resulted in a cumulative effect increase of $484,000, including the adoption of ASC 340-40 as noted below, as of the date of adoption on May 1, 2018, to retained earnings. The adoption of ASU 2014-09 effected all new and open contracts as of the adoption date.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In connection with the adoption of ASU 2014-09 on May 1, 2018, the Company also adopted the guidance in ASC 340-40, *Other Assets and Deferred Costs - Contracts with Customers* (“ASC 340-40”), with respect to capitalization and amortization of incremental costs of obtaining a contract. The new cost guidance requires the capitalization of all incremental costs incurred to obtain a contract with a customer that it would not have incurred if the contract had not been obtained, provided it expects to recover the costs. The Company expects that sales commissions as a result of obtaining customer contracts are recoverable, and therefore the Company defers and capitalizes them as contract costs. As a result of this new guidance, the Company capitalizes sales commissions for which the expected amortization period is greater than one year. The Company classifies the unamortized portion of deferred commissions as current or noncurrent assets based upon the timing of when the Company expects to recognize the expense. The current and noncurrent portion of deferred commissions are included in prepaid expenses and other current assets, respectively, in the Company’s Condensed Consolidated Balance Sheet. Adoption of ASC 340-40 resulted in a cumulative effect adjustment of $87,000 to total assets, $109,000 to total liabilities, and a $22,000 reduction to retained earnings, as of the date of adoption, on May 1, 2018.

The Company’s new accounting policies as a result of adopting ASU 2014-09 are discussed below.

Revenue Recognition

Revenue is recognized when a performance obligation is satisfied, which is when the expected goods or services are transferred to the customer, in an amount that reflects the consideration to which the Company expects to receive. A performance obligation is a distinct product or service that is transferred to the customer based on the contract. The transaction price is allocated to each performance obligation and is recognized as revenue upon satisfaction of that performance obligation. The company derives revenue from contracts with customers by units sold with specific specifications and frequencies that are used by a specific customer and contracts where the end user is the government. The Company’s contracts typically include multiple performance obligations which are satisfied either by shipped projects or the completion of milestones as defined in the contract. The transaction price is allocated either (i) based on the sale price of each item shipped or (ii) as defined by the milestones stated in the contract.

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

On production-type orders, revenue is recorded as units are delivered with the related cost of sales recognized on each shipment based upon a percentage of estimated final program costs. Changes in job performance on long-term contracts and production-type orders may result in revisions to costs and income and are recognized in the period in which revisions are determined to be required. Provisions for anticipated losses on customer orders are made in the period in which they become determinable.

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

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In connection with the adoption of ASU 2019-09, there were changes to the timing of the Company's revenue recognition associated with the significant portion of our business that was not being accounted for as percentage of completion in prior years for contracts where the end customer was the U.S. Government. These production-type contracts under which revenue was previously recorded as Passage of Title ("POT") are currently being recognized as POC following adoption of this ASU. As a result, the Company will begin recognizing revenue earlier under these contracts. The Company's products generally carry a one-year warranty, but may vary based on the contract terms.

Significant judgment is used in evaluating the financial information for certain contracts related to the adoption of this ASU to determine an appropriate budget and estimated cost. The Company evaluates this information continuously and bases its judgments on historical experience, design specifications, and expected costs for material and labor.

Practical Expedients

The Company expenses sales commissions as sales and marketing expenses in the period they are incurred if the expected amortization period is one year or less.

The Company expenses costs, other than sales commissions, to obtain a contract in the period for which they are incurred as these amounts would have been incurred even if the contract had not been obtained.

Disaggregation of Revenue

Total revenue related to the adoption ASU 2014-09 and recognized over time as POC was approximately $33.3 million of the $36.4 million reported for the nine months ended January 31, 2019, and $12.9 million of the $13.2 million reported for the three months ended January 31, 2019. The amounts by segment and product line were as follows:

	Nine Months Ended January 31, 2019 (In thousands)		
	POC Revenue	POT Revenue	Total Revenue
FEI-NY	$26,611	$ 1,465	$ 28,076
FEI-Zyfer	6,680	2,066	8,746
Intersegment	(25)	(452)	(477)
Revenue	$33,266	$ 3,079	$ 36,345

	Three Months Ended January 31, 2019 (In thousands)		
	POC Revenue	POT Revenue	Total Revenue
FEI-NY	$9,412	$ 342	$ 9,754
FEI-Zyfer	3,447	197	3,644
Intersegment	11	(216)	(205)
Revenue	$12,870	$ 323	$ 13,193

	Periods ended January 31,			
	Nine months		Three months	
	2019	2018	2019	2018
	(In thousands)			
Revenue by Product Line:				
Satellite Revenue	$17,289	$11,448	$5,987	$2,450
Government Non-Space Revenue	17,058	13,928	6,639	6,222
Other Commercial & Industrial Revenue	1,998	6,556	567	1,900
Consolidated revenues	$36,345	$31,932	$13,193	$10,572

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The cumulative effect of changes made to the Condensed Consolidated Balance Sheet as of May 1, 2018 was as follows (in thousands):

	Balance at April 30, 2018	**Adjustments**		**Balance at May 1, 2018**
ASSETS				
Costs and estimated earnings in excess of billings, net	$5,094	$ 1,435	(a)	$6,529
Inventories, net	26,186	(929)	(b)	25,257
Prepaid expenses and other	1,050	77	(c)	1,127
Total current assets	52,075	583		52,658
Other assets	2,850	10	(d)	2,860
Total assets	83,584	593		84,177
LIABILITIES AND STOCKHOLDERS' EQUITY				
Accrued liabilities	$3,416	$ 97	(e)	$3,513
Total current liabilities	5,257	97		5,354
Deferred rent and other liabilities	1,524	12	(f)	1,536
Total liabilities	20,322	109		20,431
(Accumulated deficit) Retained Earnings	(65)	484	(g)	419
Total stockholders' equity	63,262	484		63,746
Total liabilities and stockholders' equity	83,584	593		84,177

Notes:

(a) Adjustment to unbilled accounts receivable for additional revenue recognized for which amounts have not been invoiced due to adoption of ASU 2019-09.

(b) Adjustment for additional allocated inventory costs related to additional revenue recognized due to adoption of ASU 2019-09.

(c) Adjustment for short-term capitalization of sales commissions, net of amortized amounts, due to adoption of ASC 340-40.

(d) Adjustment for long-term capitalization of sales commissions, net of amortized amounts, due to adoption of ASC 340-40.

(e) Adjustment to record short-term liability of sales commissions, net of amounts paid, due to adoption of ASC 340-40.

(f) Adjustment to record long-term liability of sales commissions, net of amounts paid, due to adoption of ASC 340-40.

(g) The cumulative effect of initially adopting ASU 2019-09 and ASC 340-40 using the modified-retrospective method as an adjustment to the beginning balance of (Accumulated deficit) Retained Earnings.

Table of Contents

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The impact of adopting the standard on the Company's consolidated financial statements for the nine and three months ended January 31, 2019 were as follows (in thousands):

Condensed Consolidated Balance Sheet

	As Reported	Adjustments		Balances Without Adoption of ASU 2014-09
ASSETS				
Costs and estimated earnings in excess of billings, net	$ 7,282	$ 4,286	(a)	$ 2,996
Inventories, net	25,065	(3,115	)(b)	28,180
Prepaid expenses and other	877	35	(c)	842
Total current assets	51,813	1,206		50,607
Other assets	3,616			