

FISCAL YEAR 2007 CHAIRMAN'S LETTER TO STOCKHOLDERS

In early Fiscal 2007 we started to manufacture RF signal generators for the first of FEI's new, larger satellite payload contracts. By the end of the fiscal year, we were building these signal generators at a rate more than ten times greater than the Company had ever before achieved. We also began delivering these units for three more new, large satellite payload contracts. At the beginning of the fiscal year we did not anticipate that these demands would be as immediate and as large as they are turning out to be. In response, we took the necessary steps and made exceptional investments to exploit our new and larger opportunities to their fullest extent.

Also in Fiscal 2007, we defined the Company's business in the context of three major areas: Telecommunications Infrastructure, wireless and wireline; Satellite Payloads, commercial and government; and other DOD/US Government programs. Our telecommunications infrastructure business rose to the highest levels in recent years, and we see this business area continuing to grow. As our satellite payload business increases, short-term ups and downs in our telecommunications infrastructure business will have less impact on our overall results than in years past. Other DOD/US Government business was lower this year, but this area continues to offer significant opportunities for revenue enhancement in the future.

We anticipate that FEI will realize significantly higher revenues in the coming fiscal year.

FINANCIAL REPORT

Annual revenues rose to \$56.2 million, compared to \$52.8 million in Fiscal 2006, primarily from a large increase in the last quarter, led by satellite sales. The operating results and net loss of \$257,000 were driven by investing \$9.4 million in R&D, \$3.1 million more than Fiscal 2006, and by higher engineering expenses. These investments were made and expenses incurred in response to the opportunities in our growing satellite business. We believe that the bulk of exceptional spending has been accomplished.

The Company's bookings rose significantly in Fiscal 2007, exceeding the increase in annual revenues, which resulted in backlog growing from \$36 million to above \$44 million at year end. That portion of the Company's backlog relating to commercial satellite payloads more than doubled during the course of the year.

Our increasing business tempo produced a 36% increase in the Company's inventories. This increase was driven by the short lead-time needs of our telecommunications infrastructure customers and by major satellite program requirements on existing contracts. Over 70% of our total inventory is committed to existing programs or is guaranteed by our customers.

Stockholders were paid \$1.7 million in dividends, and stockholders' equity increased to \$70.8 million. The Company ended the year in strong financial condition, with no long term debt and a healthy cash position.

THE YEAR IN REVIEW

The outsourcing trend from large satellite prime contractors that we foresaw last year has been validated by our actual market experience, and we took major steps to exploit these opportunities. We made accelerated investments to expand design, manufacturing, and test capabilities. We added supervisory and technical personnel, and augmented capital equipment. We increased R&D expenditures 50% over the prior year, focusing on enhanced market reach and design for volume production.

Throughout Fiscal 2007 we continued to use the Company's leading edge technology to expand our opportunities in the business areas of Telecommunications Infrastructure and other DOD/US Government programs. Telecommunications infrastructure sales experienced solid growth, almost all of which came from increased market share with wireless OEM's. Revenues for Gillam-FEI, our Belgian developer of wireline synchronization and other network management products, improved from Fiscal 2006. Gillam's new US5Ge wireline synchronization unit was introduced in Europe, and the US5G unit continues in testing by US service providers. FEI-Asia, our wholly-owned subsidiary in Tianjin, China, doubled its workforce during the past fiscal year, and continues to provide the high quality manufacturing support that keeps our telecommunication products cost-competitive. Revenues from DOD/US Government programs were lower, primarily as a result of lower revenues from FEI-Zyfer, our high-precision GPS-aided instrument and systems subsidiary based in California.

Earlier this year, the Russian government designated Morion, our affiliate in St. Petersburg, a strategic industry, which required us to reduce our equity interest. After the close of Fiscal 2007, we sold a portion of our holding to a Russian government majority-owned bank in a cash transaction on favorable terms. Our strong relationship with Morion continues. They are a high quality, cost effective supplier to FEI.

During the third quarter of Fiscal 2007, FEI acquired a 25% interest in ELCOM Technologies, Inc., a private New Jersey based company specializing in advanced RF microwave instruments and components. Their technology is applicable to Satellite Payloads and other DOD/US Government programs.

LOOKING AHEAD TO NEXT YEAR

Revenue growth is our primary focus. We see the higher revenue rate achieved during the last quarter of Fiscal 2007 continuing through early Fiscal 2008, and increasing during the balance of this next fiscal year. We are confident, as higher revenues are achieved, higher margins and profits will follow.

During Fiscal 2008 we expect Satellite Payloads to become the Company's largest major business area. Many of the building blocks that support an increased pace of space business are already in place. We will continue to make investments in new products aimed at capturing an even larger portion of future satellite payloads. These new products are state-of-the-art synthesizers, frequency converters, and receivers, to be added to our new family of RF signal generators. Taken together with our legacy timing systems, these products represent 100% of satellite payloads addressable by FEI, and will more than double the potential revenue per satellite that we realize from the new large satellite contracts already in hand.

Also in Fiscal 2008, we see potential for growth in our Telecommunications Infrastructure business area. FEI has the ideal quartz product for Wi-Max technology and we are supporting major companies in their test networks. We anticipate domestic sales of the US5G wireline synchronization system to begin before the end of the fiscal year. Revenues from DOD/US Government programs are expected to increase as development work continues on low g-sensitivity and other FEI proprietary products in transition from prototype to pilot production and as sales by FEI-Zyfer improve.

As I noted, the Company added an important corporate partner this year in ELCOM Technologies. We will continue our search for added resources to help us take full advantage of the market opportunities we see ahead.

THE FUTURE

The markets for FEI's high precision time and frequency products continue to grow, with the experience from this past year now validating our earlier projections. More detail is included in the pages of this Annual Report which follow. We believe that our markets' growth is based on the demand for more efficient spectrum utilization and increased bandwidth, and for systems that perform with greater stability and dependability. FEI's proprietary quartz technology and new state-of-the-art products for space applications are becoming more critical for telecommunications, satellites and other US Government programs. FEI competes for business with three significant advantages that have been established over many years: our unmatched legacy, leading edge technology, and high technical barriers for competitors to enter these markets.

Dependable product performance based on advanced technology is the foundation of shareholder value at Frequency Electronics. We have added to the outstanding staff of dedicated professionals who keep us in the forefront of the high precision time and frequency industry. Once again we salute the loyalty and skills of our senior staff and employees, and on behalf of the Officers and Directors of Frequency Electronics, I also thank you, our shareholders, for your confidence and support. We are looking forward to reporting our progress to you in the coming years.

JOSEPH P. FRANKLIN
Chairman of the Board