
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

(State or other jurisdiction of
incorporation or organization)

11-1986657

(I.R.S. Employer Identification No.)

55 CHARLES LINDBERGH BLVD., MITCHEL FIELD, N.Y.

(Address of principal executive offices)

11553

(Zip Code)

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

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

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

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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.

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)

| | <u>2019</u> | <u>2018</u> |
|--|-------------|-------------|
| 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.

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)

| | <u>2019</u> | <u>2018</u> |
|---|-------------|-------------|
| 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.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
 Condensed Consolidated Statements of Cash Flows
 Nine Months Ended January 31,
 (In thousands)
 (Unaudited)

| | <u>2019</u> | <u>2018</u> |
|---|-----------------|-----------------|
| 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 | <u>\$ 2,418</u> | <u>\$ 6,984</u> |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | <u>\$ 57</u> | <u>\$ 61</u> |
| Income taxes | <u>\$ 2</u> | <u>\$ 325</u> |

See accompanying notes to condensed consolidated financial statements.

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 capital | (Accumulated Deficit) Retained earnings | Treasury stock (at cost) | | Accumulated other comprehensive Income (loss) | Total |
|--|--------------|----------|----------------------------------|--|-----------------------------|------------|--|-----------|
| | Shares | Amount | | | Shares | Amount | | |
| 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 | | | | | | | | |
| Other comprehensive loss, net of tax | | | (81) | | (17,708) | 81 | | - |
| Net income | | | | 122 | | | (95) | 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 | | | | | | | | |
| Other comprehensive income, net of tax | | | (177) | | (38,536) | 177 | | - |
| Net loss | | | | (321) | | | 494 | (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.

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 capital | (Accumulated Deficit) Retained earnings | Treasury stock (at cost) | | Accumulated other comprehensive Income (loss) | Total |
|--|------------------|-----------------|----------------------------------|--|-----------------------------|-------------------|--|------------------|
| | Shares | Amount | | | Shares | Amount | | |
| 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 | <u>9,163,940</u> | <u>\$ 9,164</u> | <u>\$ 56,289</u> | <u>\$ 12,449</u> | <u>310,954</u> | <u>\$ (1,425)</u> | <u>\$ 2,174</u> | <u>\$ 78,651</u> |

See accompanying notes to condensed consolidated financial statements.

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:

| | <u>Nine months</u> | <u>Three months</u> |
|--|---------------------------------|---------------------|
| | <u>(UNAUDITED)</u> | <u>(UNAUDITED)</u> |
| | (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) |

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:

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

** 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:

| | <u>January 31, 2019</u> | <u>April 30, 2018</u> |
|--|-------------------------|-----------------------|
| | (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 | <u>\$ 7,282</u> | <u>\$ 5,094</u> |

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) |

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

| | <u>January 31, 2019</u> | <u>April 30, 2018</u> |
|---|-------------------------|-----------------------|
| 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 | <u>\$ 84,248</u> | <u>\$ 83,584</u> |

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):

| | <u>January 31, 2019</u> | | | |
|-------------------------|-------------------------|-------------------------------|--------------------------------|--------------------------|
| | <u>Cost</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Fair Market Value</u> |
| Fixed income securities | \$ 8,473 | \$ 42 | \$ (73) | \$ 8,442 |

| | <u>April 30, 2018</u> | | | |
|-------------------------|-----------------------|-------------------------------|--------------------------------|--------------------------|
| | <u>Cost</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Fair Market Value</u> |
| Fixed income securities | \$ 6,274 | \$ 10 | \$ (135) | \$ 6,149 |

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.

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.

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.

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 |

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):

| | <u>Balance at</u> <u>April 30, 2018</u> | | <u>Adjustments</u> | | <u>Balance at</u> <u>May 1, 2018</u> |
|---|--|----|--------------------|----|---|
| 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.

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

| | <u>As Reported</u> | <u>Adjustments</u> | <u>Balances Without Adoption of ASU 2014-09</u> |
|---|--------------------|--------------------|---|
| 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 | 15 (d) | 3,601 |
| Total assets | 84,248 | 1,221 | 83,027 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Accrued liabilities | \$ 3,444 | 39 (e) | 3,405 |
| Total current liabilities | 4,564 | 39 | 4,525 |
| Deferred rent and other liabilities | 1,314 | 12 (f) | 1,302 |
| Total liabilities | 19,657 | 51 | 19,606 |
| Retained Earnings (Accumulated deficit) | 251 | 1,170 (g) | (919) |
| Total stockholders' equity | 64,591 | 1,170 | 63,421 |
| Total liabilities and stockholders' equity | 84,248 | 1,221 | 83,027 |

Notes:

- (a) Cumulative adjustment to unbilled accounts receivable for additional revenue recognized for which amounts have not been invoiced due to adoption of ASU 2019-09.
- (b) Cumulative adjustment for additional allocated inventory costs related to additional revenue recognized due to adoption of ASU 2019-09.
- (c) Cumulative adjustment for short-term capitalization of sales commissions, net of amortized amounts, due to adoption of ASC 340-40.
- (d) Cumulative adjustment for long-term capitalization of sales commissions, net of amortized amounts, due to adoption of ASC 340-40.
- (e) Cumulative adjustment to record short-term liability of sales commissions, net of amounts paid, due to adoption of ASC 340-40.
- (f) Cumulative 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 for ASU 2019-09 and ASC 340-40 using the modified-retrospective method as an adjustment to the balance of Retained earnings (Accumulated deficit).

Condensed Consolidated Statement of Operations

| Nine Months Ended January 31, 2019: | <u>As Reported</u> | <u>Adjustments</u> | <u>Balances Without Adoption of ASU 2014-09</u> |
|--|--------------------|--------------------|---|
| Revenues | \$ 36,345 | \$ 2,861 | \$ 33,484 |
| Cost of revenues | 23,953 | 2,186 | 21,767 |
| Gross profit | 12,392 | 677 | 11,715 |
| Selling and administrative expenses | 7,838 | (10) (a) | 7,848 |
| Operating loss | (540) | 686 | (1,226) |
| Loss before provision for income taxes | (130) | 686 | (816) |
| Net loss | (168) | 686 | (854) |

Note:

- (a) Additional expense related the amortization of sales commissions due to the adoptions of ASC 340-40.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

| Three Months Ended January 31, 2019: | As Reported | Adjustments | Balances Without Adoption of ASU 2014-09 |
|---|--------------------|--------------------|---|
| Revenues | \$ 13,193 | \$ 809 | \$ 12,384 |
| Cost of revenues | 9,093 | 1,121 | 7,972 |
| Gross profit | 4,100 | (312) | 4,412 |
| Selling and administrative expenses | 2,657 | (10) (a) | 2,667 |
| Operating loss | (394) | (302) | (92) |
| (Loss) income before provision for income taxes | (261) | (302) | 41 |
| Net loss | (321) | (302) | (19) |

Note:

(a) Additional expense related the amortization of sales commissions due to the adoptions of ASC 340-40.

NOTE K – CREDIT FACILITY

As of January 30, 2019, the Company had available credit at variable terms based on its securities holdings under an advisory arrangement, under which no borrowings have been made.

NOTE L – VALUATION ALLOWANCE ON DEFERRED TAX ASSETS

Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, which will result in taxable or deductible amounts in the future. In evaluating our ability to recover deferred tax assets in the jurisdiction from which they arise, we consider all positive and negative evidence, including the reversal of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. Based on the weighting of all evidence, both positive and negative, most notably the three year cumulative loss, we established a full valuation allowance against our U.S. deferred tax assets during the quarter ended April 30, 2018. If these estimates and assumptions change in the future, the Company may be required to adjust its existing valuation allowance resulting in changes to deferred income tax expense. The Company evaluates the likelihood of realizing its deferred tax assets quarterly.

On December 22, 2017, the legislation commonly known as the Tax Cuts and Jobs Act (the “TCJA” or the “Tax Act”) was enacted into law. In response to the TCJA, the U.S. Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the tax effects of TCJA. The purpose of SAB 118 was to address any uncertainty in applying ASC Topic 740, *Income Taxes* in the reporting period in which the TCJA was enacted. SAB 118 addresses situations where the accounting is incomplete for certain income tax effects of the TCJA upon issuance of a company’s financial statements for the reporting period which include the enactment date. SAB 118 allows for a provisional amount to be recorded if it is a reasonable estimate of the impact of the TCJA. Additionally, SAB 118 allows for a measurement period to finalize the impacts of the TCJA, not to extend beyond one year from the date of enactment.

As of the period ended April 30, 2018, the Company’s accounting for certain elements of the TCJA was incomplete. The Company recorded a provisional noncash charge to income tax expense of \$5.3 million related to the revaluation of our deferred tax assets at the lower federal corporate tax rate of 21%. During the quarter ended January 31, 2019, the Company finalized the accounting for the tax effects of TCJA with no material changes to the provisional estimate recorded in prior periods.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995:

The statements in this quarterly report on Form 10-Q regarding future earnings and operations and other statements relating to the future constitute "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1933 or the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "believe," "may," "will," "could," "should," "would," "anticipate," "estimate," "expect," "project," "intend," "objective," "seek," "strive," "might," "likely result," "build," "grow," "plan," "goal," "expand," "position," or similar words, or the negatives of these words, or similar terminology, identify forward-looking statements. All statements by the Company that address activities, events or developments that the Company expects or anticipates will occur in the future, including all statements by the Company regarding its expected financial position, revenues, cash flows and other operating results, business position, legal proceedings or similar matters, are forward-looking statements. These statements are based on assumptions that the Company believes are reasonable, but are subject to a wide range of risks and uncertainties, and a number of factors could cause the Company's actual results to differ materially from those expressed in the forward-looking statements referred to above. Factors that would cause or contribute to such differences include, but are not limited to, continued acceptance of the Company's products in the marketplace, competitive factors, new products and technological changes, product prices and raw material costs, dependence upon third-party vendors, competitive developments, changes in manufacturing and transportation costs, changes in contractual terms, the availability of capital, and other risks detailed in the Company's periodic report filings with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which relate only to events as of the date on which the statements are made and which reflect management's analysis, judgments, belief, or expectation only as of such date. Any and all of the forward-looking statements contained in this Form 10-Q and any other public statements by the Company or its management may turn out to be incorrect. The Company expressly disclaims any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 30, 2018, filed on July 30, 2018. The Company believes its most critical accounting policies to be the recognition of revenue and costs on production contracts, income taxes, and the valuation of inventory. Each of these areas requires the Company to make use of reasoned estimates including estimating the cost to complete a contract, the realizable value of its inventory and the market value of its products. Changes in estimates can have a material impact on the Company's financial position and results of operations. The Company's significant accounting policies did not change during the nine and three months ended January 31, 2019, except for those impacted by the newly adopted accounting standard below.

Revenue Recognition

Revenue is recognized when a performance obligation is satisfied, when the expected goods or services are transferred to the customer, in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. A performance obligation is a distinct product or service that is transferred to the customer's control 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 either as (i) units with specifications and frequencies that can be used by multiple customers (POT) or (ii) units with specific specifications and frequencies that are used by a specific customer or for government end use (POC).

In prior years, a significant portion of our business that was not being accounted for as POC was from contracts where the end customer is the U.S. Government. These production-type contracts under which revenue was previously recorded as POT are currently being recognized as POC following adoption of ASU 2014-09 as noted in Note J to the condensed consolidated financial statements in Part I, Item I of this form 10-Q. As a result, the Company will begin recognizing revenue earlier under these contracts.

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 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 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.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

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.

Costs and Expenses

Contract costs include all direct material costs, direct labor costs, manufacturing overhead and other direct costs related to contract performance. Selling, general and administrative costs are expensed as incurred, except as otherwise noted in Note J above in relation to the adoption of ASU 2014-09.

Inventory

In accordance with industry practice, inventoried costs contain amounts relating to contracts and programs with long production cycles, a portion of which will not be realized within one year. Inventory write-downs are established for slow-moving, obsolete items and costs incurred on programs for which production-level orders cannot be determined as probable. Such write-downs are based upon management's experience and expectations for future business. Any changes arising from revised expectations are reflected in cost of sales in the period the revision is made.

Marketable Securities

All of the Company's investments in marketable securities are Level 1 securities which trade on public markets and have current prices that are readily available. In general, investments in fixed income securities are only in the commercial paper of financially sound corporations or the bonds of U.S. Government agencies. Although the value of such investments may fluctuate significantly based on economic factors, the Company's own financial strength enables it to wait for the securities to either recover their value or to mature such that any interim unrealized gains or losses are deemed to be temporary.

RESULTS OF OPERATIONS

The table below sets forth for the nine and three months ended January 31, 2019 and 2018, respectively, the percentage of consolidated revenues represented by certain items in the Company's consolidated statements of operations or notes to the condensed consolidated financial statements:

| | <u>Nine months</u> | | <u>Three months</u> | |
|---|----------------------------------|-------------|---------------------|-------------|
| | <u>Periods ended January 31,</u> | | | |
| | <u>2019</u> | <u>2018</u> | <u>2019</u> | <u>2018</u> |
| Revenues | | | | |
| FEI-NY | 77.2% | 69.5% | 73.9% | 61.0% |
| FEI-Zyfer | 24.1 | 38.8 | 27.6 | 42.7 |
| Less intersegment revenues | (1.3) | (8.3) | (1.5) | (3.7) |
| | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenues | 65.9 | 87.9 | 68.9 | 127.0 |
| Gross margin | 34.1 | 12.1 | 31.1 | (27.0) |
| Selling and administrative expenses | 21.6 | 24.4 | 20.1 | 26.0 |
| Research and development expenses | 14.0 | 15.9 | 13.9 | 16.2 |
| Operating loss | (1.5) | (28.2) | (2.9) | (69.2) |
| Other income, net | 1.1 | 3.7 | 1.0 | 0.5 |
| Provision for income taxes | 0.1 | 8.6 | 0.5 | 27.0 |
| Loss from continued operations | (0.5) | (33.1) | (2.4) | (95.7) |
| Loss from discontinued operations, net assets | (0) | (2.2) | (0) | (2.7) |
| Net loss | (0.5)% | (35.3)% | (2.4)% | (98.4)% |

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Revenues

(in thousands)

| Segment | Nine months | | | | Three months | | | |
|-----------------------|---------------------------|------------------|-----------------|--------------|------------------|------------------|-----------------|--------------|
| | Periods ended January 31, | | | | | | | |
| | 2019 | 2018 | Change | | 2019 | 2018 | Change | |
| FEI-NY | \$ 28,076 | \$ 22,184 | \$ 5,892 | 26.6% | \$ 9,754 | \$ 6,444 | \$ 3,310 | 51.4% |
| FEI-Zyfer | 8,746 | 12,378 | (3,632) | (29.3) | 3,644 | 4,514 | (870) | (19.3) |
| Intersegment revenues | (477) | (2,630) | 2,153 | (81.9) | (205) | (386) | 181 | (46.9) |
| | <u>\$ 36,345</u> | <u>\$ 31,932</u> | <u>\$ 4,413</u> | <u>13.8%</u> | <u>\$ 13,193</u> | <u>\$ 10,572</u> | <u>\$ 2,621</u> | <u>24.8%</u> |

For the nine months ended January 31, 2019, revenues from commercial and U.S. Government satellite programs increased approximately \$5.8 million over the same period of fiscal year 2018, and accounted for approximately 48% of consolidated revenues compared to approximately 36% during this same period in fiscal 2018. Revenues on these contracts are recognized primarily under the POC method. Revenues from the satellite market are recorded in the FEI-NY segment. Revenues from non-space U.S. Government/Department of Defense (“DOD”) customers, which are recorded in both the FEI-NY and FEI-Zyfer segments, increased \$3.1 million over the same period of fiscal 2018, and accounted for approximately 47% of consolidated revenues compared to approximately 44% during this same period in fiscal 2018. Other commercial and industrial revenues for the nine months ended January 31, 2019 accounted for approximately 5% of consolidated revenues compared to 20% in the prior year. Changes in revenue for the current year are partially due to implementation of ASU 2014-09 (see Note J). Intersegment revenues are eliminated in consolidation.

For the three months ended January 31, 2019 revenues from commercial and U.S. Government satellite programs increased approximately \$3.5 million over the same period of fiscal year 2018, and accounted for approximately 45% of consolidated revenues compared to approximately 23% during this same period in fiscal 2018. Revenues from non-space U.S. Government/DOD customers, which are recorded in both the FEI-NY and FEI-Zyfer segments, increased \$0.4 million over the same period of fiscal 2018, and accounted for approximately 50% of consolidated revenues compared to approximately 59% during this same period in fiscal 2018. Other commercial and industrial revenues for the three months ended January 31, 2019 accounted for approximately 5% of consolidated revenues compared to 18% during this same period in the prior year. Intersegment revenues are eliminated in consolidation.

Gross Margin

(in thousands)

| | Nine months | | | | Three months | | | |
|---------|---------------------------|----------|----------|--------|--------------|------------|----------|----------|
| | Periods ended January 31, | | | | | | | |
| | 2019 | 2018 | Change | | 2019 | 2018 | Change | |
| GM Rate | \$ 12,392 | \$ 3,872 | \$ 8,520 | 220.0% | \$ 4,100 | \$ (2,852) | \$ 6,952 | (243.8)% |
| | 34.1% | 12.1% | | | 31.1% | (27.0)% | | |

For the nine and three month period ended January 31, 2019, gross margin and GM Rate increased over the same period in fiscal 2018. The prior year’s gross margin and GM Rate was affected by a \$5.0 million inventory write-down, lower revenues, increased repair costs and unabsorbed manufacturing overhead costs.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Selling and Administrative Expenses

(in thousands)

| Nine months | | | | Three months | | | |
|---------------------------|----------|--------|------|--------------|----------|---------|--------|
| Periods ended January 31, | | | | | | | |
| 2019 | 2018 | Change | | 2019 | 2018 | Change | |
| \$ 7,838 | \$ 7,796 | \$ 42 | 0.5% | \$ 2,657 | \$ 2,749 | \$ (92) | (3.3)% |

For the nine months ended January 31, 2019 and 2018, selling and administrative (“SG&A”) expenses were approximately 22% and 24%, respectively, of consolidated revenues. For the three months periods ended January 31, 2019 and 2018, SG&A expenses were approximately 20% and 26% respectively, of consolidated revenues. The dollar value of SG&A expenses were comparable for both the nine and three months ended January 31, 2019 and 2018; however, the percentage decreased due to the increase in revenue during the fiscal 2019 year.

Research and Development Expense

(in thousands)

| Nine months | | | | Three months | | | |
|---------------------------|----------|--------|------|--------------|----------|--------|------|
| Periods ended January 31, | | | | | | | |
| 2019 | 2018 | Change | | 2019 | 2018 | Change | |
| \$ 5,094 | \$ 5,071 | \$ 23 | 0.5% | \$ 1,837 | \$ 1,708 | \$ 129 | 7.6% |

Research and development (“R&D”) expenditures represent investments intended to keep the Company’s products at the leading edge of time and frequency technology and enhance future competitiveness. The R&D rate for the nine month period ending January 31, 2019 was 14% of sales compared to 16% of sales for the same period of the previous fiscal year. The R&D rate for the three month period ending January 31, 2019 was 14% of sales compared to 16% of sales for the same period of the previous fiscal year. The Company expects the total level of activity related to R&D to continue at a similar rate through the balance of the current year and beyond to address new large opportunities in secure communications, command and control applications, next generation satellite payload products and additional DOD and commercial applications.

Operating Loss

(in thousands)

| Nine months | | | | Three months | | | |
|---------------------------|------------|----------|---------|--------------|------------|----------|---------|
| Periods ended January 31, | | | | | | | |
| 2019 | 2018 | Change | | 2019 | 2018 | Change | |
| \$ (540) | \$ (8,995) | \$ 8,455 | (94.0)% | \$ (394) | \$ (7,309) | \$ 6,915 | (94.6)% |

The Company’s results for the nine and three month periods ending January 31, 2019 reflect improvements in revenues, gross margin and GM Rate and cost containment. These improvements have resulted in reduced operating loss in the nine and three months ending January 31, 2019, as compared to the same period of the preceding fiscal year. Additionally, in fiscal 2018 the Company reported approximately \$8.3 million of non-cash charges to earnings.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Other Income

(in thousands)

| | Nine months | | | | Three months | | | |
|-------------------|---------------------------|-----------------|-----------------|----------------|---------------|--------------|--------------|----------------|
| | Periods ended January 31, | | | | | | | |
| | 2019 | 2018 | Change | (2019 vs 2018) | 2019 | 2018 | Change | (2019 vs 2018) |
| Investment income | \$ 242 | \$ 1,236 | \$ (994) | (80.4)% | \$ 52 | \$ 68 | \$ (16) | (23.5)% |
| Interest expense | (57) | (61) | 4 | (6.6)% | (23) | (19) | (4) | 21.1% |
| Other income, net | 225 | 4 | 221 | NM% | 104 | 1 | 103 | NM% |
| | <u>\$ 410</u> | <u>\$ 1,179</u> | <u>\$ (769)</u> | <u>(65.2)%</u> | <u>\$ 133</u> | <u>\$ 50</u> | <u>\$ 83</u> | <u>166.0%</u> |

Investment income is derived primarily from the Company's holdings of marketable securities. Earnings on securities may vary based on fluctuating interest rates, dividend payout levels, and the timing of purchases, sales, redemptions or maturities of securities. Investment income in fiscal 2018 included gains of approximately \$1.0 million from divesting all of the Company's holdings in equity securities. Other income in fiscal 2019 included the proceeds from a life insurance policy of a retired employee.

Income Tax Provision (Benefit)

(in thousands)

| | Nine months | | | | Three months | | | |
|--|---------------------------|----------|------------|----------------|--------------|----------|------------|----------------|
| | Periods ended January 31, | | | | | | | |
| | 2019 | 2018 | Change | (2019 vs 2018) | 2019 | 2018 | Change | (2019 vs 2018) |
| Effective tax rate on pre-tax book income: | \$ 38 | \$ 2,750 | \$ (2,712) | (99)% | \$ 60 | \$ 2,848 | \$ (2,788) | (98)% |
| | (29.2)% | (35.2)% | | | (23.1)% | (39.2)% | | |

For the nine months ended January 31, 2019, the Company recorded an income tax expense of \$37,700, which included a discrete income tax provision of \$163,800. The calculation of the overall income tax provision for the nine months ended January 31, 2019 primarily consisted of foreign taxes and a discrete income tax provision related to the accrual of interest for unrecognized tax benefits and the expiration of a foreign net operating loss carryforward. For the nine months ended January 31, 2018, the Company recorded an income tax expense of \$2.7 million, which included a discrete income tax provision of \$5.0 million primarily related to the enactment of the TCJA.

For the three months ended January 31, 2019, the Company recorded an income tax expense of \$60,200, which included a discrete income tax provision of \$127,100. The calculation of the overall income tax provision for the three months ended January 31, 2019 primarily consisted of foreign taxes and a discrete income tax provision related to the accrual of interest for unrecognized tax benefits and the expiration of a foreign net operating loss carryforward. For the three months ended January 31, 2018, the Company recorded an income tax provision of \$2.8 million, which included a discrete income tax provision of \$4.9 million.

The effective tax rate for the nine months ended January 31, 2019 is an income tax benefit of 29.2% on a pretax loss of \$130 compared to an income tax provision of 35.2% on a pretax loss of \$7,817 in the comparable prior period. The Company did not recognize an income tax provision on US domestic pretax income in the current period but recognized an income tax provision in the comparable period related to the enactment of the TCJA. The effective rate for the nine months ended January 31, 2019 differs from the U.S. statutory rate of 21% primarily due to the mix of domestic and foreign earnings, a discrete income tax provision related to the accrual of interest for unrecognized tax benefits, the expiration of a foreign net operating loss carryforward, and domestic losses for which the Company is not recognizing an income tax benefit.

The effective tax rate for the three months ended January 31, 2019 is an income tax provision of 23.1% on a pretax loss of \$242 compared to an income tax provision of 39.2% on a pretax loss of \$7,259 in the comparable prior period. The Company did not recognize an income tax provision on US domestic pretax income in the current period but recognized an income tax provision in the comparable period related to the enactment of the TCJA. The effective rate for the three months ended January 31, 2019 differs from the U.S. statutory rate of 21% primarily due to the mix of domestic and foreign earnings, a discrete income tax provision related to the accrual of interest for unrecognized tax benefits and the expiration of a foreign net operating loss carryforward, and domestic losses for which the Company is not recognizing an income tax benefit.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Based on the weighting of all evidence, both positive and negative, most notably the three-year cumulative loss, we established a full valuation allowance against our U.S. deferred tax assets during the quarter ended April 30, 2018. If these estimates and assumptions change in the future, the Company may be required to adjust its existing valuation allowance resulting in changes to deferred income tax expense. The Company evaluates the likelihood of realizing its deferred tax assets quarterly.

On December 22, 2017, the TCJA was enacted into law. In response to the TCJA, the SEC staff issued SAB 118, which provides guidance on accounting for the tax effects of TCJA. The purpose of SAB 118 was to address any uncertainty or diversity of view in applying ASC Topic 740, Income Taxes, in the reporting period in which the TCJA was enacted. SAB 118 addresses situations where the accounting is incomplete for certain income tax effects of the TCJA upon issuance of a company's financial statements for the reporting period which include the enactment date. SAB 118 allows for a provisional amount to be recorded if it is a reasonable estimate of the impact of the TCJA. Additionally, SAB 118 allows for a measurement period to finalize the impacts of the TCJA, not to extend beyond one year from the date of enactment.

As of the period ended April 30, 2018, the Company's accounting for certain elements of the TCJA was incomplete. The Company recorded a provisional noncash charge to income tax expense of \$5.3 million related to the revaluation of our deferred tax assets at the lower federal corporate tax rate of 21%. During the quarter ended January 31, 2019, we finalized the accounting for the tax effects of TCJA with no material changes to the provisional estimate recorded in prior periods.

Discontinued Operations
(in thousands)

| | Nine months | | | Three months | | |
|----------|---------------------------|----------|-----------------|--------------|----------|-----------------|
| | Periods ended January 31, | | | | | |
| | 2019 | 2018 | Change | 2019 | 2018 | Change |
| Net Loss | \$ - | \$ (697) | \$ 697 (100.0)% | \$ - | \$ (289) | \$ 289 (100.0)% |

The above table represents the net loss for the Gillam segment accounted for as discontinued operations as presented in Note B to the condensed consolidated financial statements in Part I, Item 1 of this Form 10-Q. On April 26, 2018, the Company sold Gillam to a European entity, in a stock purchase agreement, for \$1.0 million in cash 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. The calculation of the loss was the carrying amount of the investment on FEI-NY's books less the retained earnings and remaining equity amounts of Gillam reduced by the cash received and the value of the note receivable. As such Gillam's results have been classified as discontinued operations in the accompanying Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income for fiscal 2018.

LIQUIDITY AND CAPITAL RESOURCES

The Company's balance sheet continues to reflect a strong working capital position of \$47.2 million at January 31, 2019 and \$46.8 million at April 30, 2018. Included in working capital at January 31, 2019 and April 30, 2018, is \$10.9 million and \$14.0 million, respectively, consisting of cash, cash equivalents, and marketable securities. The Company's current ratio at January 31, 2019 is 11.4 to 1.

Cash used by continuing operations for the nine months ended January 31, 2019 was \$1.3 million compared to \$2.8 million of cash provided by operations in the comparable fiscal 2018 period. The decreased cash flow in the fiscal 2019 period resulted primarily from an increase in accounts receivable balances, which was offset by a decrease in inventories and accounts payable. For the nine month periods ended January 31, 2019 and 2018, the Company incurred approximately \$3.3 million and \$8.3 million, respectively, of non-cash operating expenses including depreciation and amortization, inventory reserve adjustments, and accruals for employee benefit programs.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Net cash used in investing activities from continuing operations for the nine months ended January 31, 2019 was \$4.4 million compared to cash provided by investing activities of \$0.5 for the nine months ended January 31, 2018. During the fiscal 2019 period, marketable securities were sold or redeemed in the amount of \$1.0 million compared to \$6.5 million of such redemptions during the fiscal 2018 period. In the nine months, ended January 31, 2019, \$3.2 million of marketable securities were purchased compared to \$5.0 million of securities purchased in the same period of 2018. In the nine months ended January 31, 2019 and 2018, the Company acquired property, plant and equipment in the amount of approximately \$2.2 million and \$1.0 million, respectively.

No cash was provided by financing activities for the nine months ended January 31, 2019 compared to approximately \$1,000 provided in the nine months ended January 31, 2018.

The Company has been authorized by its Board of Directors to repurchase up to \$5 million worth of shares of its common stock when appropriate opportunities arise. As of January 31, 2019, the Company has repurchased approximately \$4 million of its common stock out of the \$5 million authorization. For the nine months ended January 31, 2019 and 2018, there were no repurchase of shares.

The Company will continue to expend resources to develop, improve and acquire products for space applications, guidance and targeting systems, and communication systems which management believes will result in future growth and profitability. During fiscal 2018, the Company secured partial customer funding for a portion of its R&D efforts. The customer funds received in connection therewith appear in revenues and are not included in R&D expenses. For fiscal 2019, the Company has secured significant additional customer funding for its R&D activities, and will allocate internal funds depending on market conditions and identification of new opportunities as in fiscal year 2018. The Company expects internally generated cash will be adequate to fund these development efforts. The Company may also pursue acquisitions to expand its range of products and may use internally generated cash and external funding in connection with such acquisitions.

As of January 31, 2019, the Company's consolidated funded backlog was approximately \$39 million compared to \$30 million at April 30, 2018, the end of fiscal 2018. Approximately 75% of this backlog is expected to be realized in the next twelve months. Included in the backlog at January 31, 2019 was approximately \$3.1 million under cost-plus-fee contracts which the Company believes represent firm commitments from its customers for which the Company has not received full funding to-date. The Company excludes from backlog any contracts or awards for which it has not received authorization to proceed and on fixed price contracts excludes any unfunded portion. The Company expects these contracts to become fully funded over time and will add them to its backlog at that time.

The Company believes that its liquidity is adequate to meet its operating and investment needs through at least March 16, 2020 and the foreseeable future.

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

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements, other than operating leases, that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Item 4. Controls and Procedures

Disclosure Controls and Procedures. The Company's management, with the participation of the Company's chief executive officer and chief financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on their evaluation, the Company's chief executive officer and chief financial officer have concluded that, as of January 31, 2019, the Company's disclosure controls and procedures were effective to ensure that information relating to the Company, including its consolidated subsidiaries, required to be included in its reports that it filed or submitted under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Changes in Internal Control Over Financial Reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended January 31, 2019 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits

- 31.1 - [Certification by the Chief Executive Officer pursuant to Rule 13a-14\(a\) or 15d-14\(a\) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 31.2 - [Certification by the Chief Financial Officer pursuant to Rule 13a-14\(a\) or 15d-14\(a\) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 32 - [Certifications by the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101- The following materials from the Frequency Electronics, Inc. Quarterly Report on Form 10-Q for the quarter ended January 31, 2019 formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations and Comprehensive Income (Loss), (iii) Condensed Consolidated Statements of Cash Flows, (iv) Condensed Consolidated Statements of Changes in Stockholders' Equity and (v) Notes to Condensed Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FREQUENCY ELECTRONICS, INC.
(Registrant)

Date: March 18, 2019

By: /s/ Steven L. Bernstein
Steven L. Bernstein
Chief Financial Officer
Signing on behalf of the registrant and as principal financial officer

**CERTIFICATION PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Stanton Sloane, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Frequency Electronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Stanton Sloane
Stanton Sloane
Chief Executive Officer

March 18, 2019

**CERTIFICATION PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Steven L. Bernstein, certify that

1. I have reviewed this quarterly report on Form 10-Q of Frequency Electronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Steven L. Bernstein
Steven L. Bernstein
Chief Financial Officer

March 18, 2019

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Certification of CEO

In connection with the Quarterly Report of Frequency Electronics, Inc. (the "Company") on Form 10-Q for the period ended January 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stanton Sloane, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Stanton Sloane
Stanton Sloane
Chief Executive Officer

March 18, 2019

Certification of CFO

In connection with the Quarterly Report of Frequency Electronics, Inc. (the "Company") on Form 10-Q for the period ended January 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven L. Bernstein, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Steven L. Bernstein
Steven L. Bernstein
Chief Financial Officer

March 18, 2019

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This certification accompanies this Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by such Act, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.