

FREQUENCY ELECTRONICS INC
Form 10-Q
December 16, 2013

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 October 31, 2013

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, 11553
N.Y. (Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

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the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting
(do not check if a smaller Company
reporting company)

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 December 9, 2013 – 8,531,017

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

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PART I

Item 1. Financial Statements

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Condensed Consolidated Balance SheetsOctober 31, April 30,
2013 2013
(UNAUDITED)

(In thousands except par value)

ASSETS:

Current assets:

| | | |
|---|-----------|-----------|
| Cash and cash equivalents | \$5,062 | \$3,460 |
| Marketable securities | 15,879 | 18,270 |
| Accounts receivable, net of allowance for doubtful accounts of \$298 at October 31, 2013 and \$288 at April 30, 2013 | 11,318 | 7,781 |
| Costs and estimated earnings in excess of billings, net | 5,418 | 8,617 |
| Inventories | 40,667 | 37,521 |
| Deferred income taxes | 3,450 | 3,170 |
| Prepaid expenses and other | 2,202 | 2,197 |
| Total current assets | 83,996 | 81,016 |
| Property, plant and equipment, at cost, less accumulated depreciation and amortization | 9,998 | 8,316 |
| Deferred income taxes | 6,479 | 6,320 |
| Goodwill and other intangible assets | 735 | 781 |
| Cash surrender value of life insurance and cash held in trust | 11,063 | 10,763 |
| Other assets | 1,737 | 1,713 |
| Total assets | \$114,008 | \$108,909 |

LIABILITIES AND STOCKHOLDERS' EQUITY:

Current liabilities:

| | | |
|-------------------------------------|--------|--------|
| Short-term credit obligations | \$- | \$158 |
| Accounts payable - trade | 1,406 | 1,205 |
| Accrued liabilities | 5,399 | 7,964 |
| Total current liabilities | 6,805 | 9,327 |
| Long term debt- noncurrent | 10,100 | 6,000 |
| Deferred compensation | 10,520 | 10,374 |
| Deferred rent and other liabilities | 727 | 756 |
| Total liabilities | 28,152 | 26,457 |

Commitments and contingencies

Stockholders' equity:

| | | |
|---|--------|----------|
| Preferred stock - \$1.00 par value | - | - |
| Common stock - \$1.00 par value, issued 9,164 shares | 9,164 | 9,164 |
| Additional paid-in capital | 52,585 | 51,913 |
| Retained earnings | 22,729 | 20,662 |
| | 84,478 | 81,739 |
| Common stock reacquired and held in treasury - at cost (635 shares at October 31, 2013 and | (2,903 |) (3,200 |

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701 shares at April 30, 2013)

| | | |
|--|------------|------------|
| Accumulated other comprehensive income | 4,281 | 3,913 |
| Total stockholders' equity | 85,856 | 82,452 |
| Total liabilities and stockholders' equity | \$ 114,008 | \$ 108,909 |

See accompanying notes to condensed consolidated financial statements.

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Income and Comprehensive Income
Six Months Ended October 31,
(Unaudited)

| | 2013 | 2012 |
|--|--------------------------------------|----------|
| | (In thousands except per share data) | |
| Condensed Consolidated Statements of Income | | |
| Revenues | \$33,834 | \$34,254 |
| Cost of revenues | 21,336 | 21,541 |
| Gross margin | 12,498 | 12,713 |
| Selling and administrative expenses | 7,045 | 6,996 |
| Research and development expense | 3,226 | 2,618 |
| Operating profit | 2,227 | 3,099 |
| Other income (expense): | | |
| Investment income | 351 | 319 |
| Interest expense | (95 |) (103 |
| Other income (expense), net | 734 | (6 |
| Income before provision for income taxes | 3,217 | 3,309 |
| Provision for income taxes | 1,150 | 1,100 |
| Net income | \$2,067 | \$2,209 |
| Net income per common share | | |
| Basic | \$0.24 | \$0.26 |
| Diluted | \$0.24 | \$0.26 |
| Weighted average shares outstanding | | |
| Basic | 8,505 | 8,390 |
| Diluted | 8,780 | 8,574 |
| Condensed Consolidated Statements of Comprehensive Income | | |
| Net income | \$2,067 | \$2,209 |
| Other comprehensive income : | | |
| Foreign currency translation adjustment | 818 | (145 |
| Change in market value of marketable securities | (730 |) 369 |
| Deferred tax effect of change in marketable securities | 280 | (134 |
| Total other comprehensive income | 368 | 90 |
| Comprehensive income | \$2,435 | \$2,299 |

See accompanying notes to condensed consolidated financial statements.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Income and Comprehensive Income
Three Months Ended October 31,
(Unaudited)

| | 2013 | 2012 |
|--|--------------------------------------|----------|
| | (In thousands except per share data) | |
| Condensed Consolidated Statements of Income | | |
| Revenues | \$17,007 | \$17,569 |
| Cost of revenues | 10,775 | 10,837 |
| Gross margin | 6,232 | 6,732 |
| Selling and administrative expenses | 3,485 | 3,511 |
| Research and development expense | 1,483 | 1,203 |
| Operating profit | 1,264 | 2,018 |
| Other income (expense): | | |
| Investment income | 208 | 152 |
| Interest expense | (36 |) (47 |
| Other income (expense), net | 725 | (12 |
| Income before provision for income taxes | 2,161 | 2,111 |
| Provision for income taxes | 770 | 670 |
| Net income | \$1,391 | \$1,441 |
| Net income per common share | | |
| Basic | \$0.16 | \$0.17 |
| Diluted | \$0.16 | \$0.17 |
| Weighted average shares outstanding | | |
| Basic | 8,520 | 8,402 |
| Diluted | 8,822 | 8,603 |
| Condensed Consolidated Statements of Comprehensive Income | | |
| Net income | \$1,391 | \$1,441 |
| Other comprehensive income: | | |
| Foreign currency translation adjustment | 976 | 449 |
| Change in market value of marketable securities | (266 |) 42 |
| Deferred tax effect of change in marketable securities | 91 | (15 |
| Total other comprehensive income | 801 | 476 |
| Comprehensive income | \$2,192 | \$1,917 |

See accompanying notes to condensed consolidated financial statements.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
Six Months Ended October 31,
(Unaudited)

| | 2013 | 2012 |
|---|----------------|----------|
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$2,067 | \$2,209 |
| Non-cash charges to earnings | 2,800 | 2,611 |
| Gain on sale of equipment | (736) | - |
| Net changes in operating assets and liabilities | (6,634) | (5,801) |
| Net cash used in operating activities | (2,503) | (981) |
| Cash flows from investing activities: | | |
| Proceeds on redemption of marketable securities | 1,767 | 2,006 |
| Purchase of marketable securities | (67) | (947) |
| Purchase of fixed assets and other assets | (2,786) | (612) |
| Net cash (used in) provided by investing activities | (1,086) | 447 |
| Cash flows from financing activities: | | |
| Proceeds from credit line borrowings | 4,100 | 4,000 |
| Payment of short-term credit obligations | - | (1,500) |
| Tax benefit from exercise of stock-based compensation | 157 | - |
| Proceeds from exercise of stock options | - | 20 |
| Payment of lease obligations | (15) | (231) |
| Net cash provided by financing activities | 4,242 | 2,289 |
| Net increase in cash and cash equivalents before effect of exchange rate changes | 653 | 1,755 |
| Effect of exchange rate changes on cash and cash equivalents | 949 | 441 |
| Net increase in cash and cash equivalents | 1,602 | 2,196 |
| Cash and cash equivalents at beginning of period | 3,460 | 4,782 |
| Cash and cash equivalents at end of period | \$5,062 | \$6,978 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | \$87 | \$94 |
| Income Taxes | \$1,260 | \$1,275 |

See accompanying notes to condensed consolidated financial statements.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE A - 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 October 31, 2013 and the results of its operations and cash flows for the six and three months ended October 31, 2013 and 2012. The April 30, 2013 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 have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended April 30, 2013. The results of operations for such interim periods are not necessarily indicative of the operating results for the full fiscal year.

NOTE B - EARNINGS PER SHARE

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

| | Six months Periods ended October 31, | | Three months | |
|--------------------------------------|---|-----------|--------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Weighted average shares outstanding: | | | | |
| Basic | 8,504,810 | 8,389,942 | 8,519,718 | 8,401,636 |
| Effect of dilutive securities | 275,578 | 183,594 | 302,061 | 201,385 |
| Diluted | 8,780,388 | 8,573,536 | 8,821,779 | 8,603,021 |

The computation of diluted earnings per share excludes those options and stock appreciation rights (“SARS”) with an exercise price in excess of the average market price of the Company’s common shares during the periods presented. The inclusion of such options and SARS in the computation of earnings per share would have been antidilutive. The number of excluded options and SARS were

| | Six months Periods ended October 31, | | Three months | |
|---------------------------------------|---|---------|--------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| Outstanding options and SARS excluded | 290,375 | 733,375 | 272,375 | 733,375 |

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

At October 31, 2013 and April 30, 2013, costs and estimated earnings in excess of billings, net, consist of the following:

| October 31, 2013 (In thousands) | April 30, 2013 |
|---------------------------------------|----------------|
|---------------------------------------|----------------|

| | | |
|--|----------|-----------|
| Costs and estimated earnings in excess of billings | \$ 9,331 | \$ 10,228 |
| Billings in excess of costs and estimated earnings | (3,913) | (1,611) |
| Net asset | \$ 5,418 | \$ 8,617 |

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 six and three months ended October 31, 2013, revenue recognized under percentage of completion contracts was approximately \$19.5 million and \$9.8 million, respectively. During the six and three months ended October 31, 2012, such revenue was approximately \$17.0 million and \$8.4 million, respectively.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE D – TREASURY STOCK TRANSACTIONS

During the six month period ended October 31, 2013, the Company made a contribution of 22,291 shares 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. During the same period, the Company issued 43,572 shares from treasury upon the exercise of stock options and SARs by certain officers and employees of the Company.

NOTE E - INVENTORIES

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

| | October 31, 2013 (In thousands) | April 30, 2013 |
|-----------------------------------|---------------------------------------|----------------|
| Raw Materials and Component Parts | \$ 23,617 | \$ 21,066 |
| Work in Progress | 13,805 | 13,665 |
| Finished Goods | 3,245 | 2,790 |
| | \$ 40,667 | \$ 37,521 |

As of October 31, 2013 and April 30, 2013, approximately \$32.1 million and \$29.9 million, respectively, of total inventory is located in the United States, approximately \$7.8 million and \$6.9 million, respectively, is located in Belgium and \$0.7 million and \$0.7 million, respectively, is located in China.

NOTE F – SEGMENT INFORMATION

The Company operates under three 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- communication 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.
- (2) Gillam-FEI - operates out of Belgium and France and primarily sells wireline synchronization and network management systems in non-U.S. markets. All sales from Gillam-FEI to the United States are to other segments of the Company.
- (3) FEI-Zyfer – operates out of California and its products incorporate Global Positioning System (GPS) technologies into systems and subsystems for secure communications, both government and commercial, and other locator applications. This segment also provides sales and support for the Company's wireline telecommunications family of products, including US5G, which are sold in the United States market.

The FEI-NY segment also includes the operations of the Company's wholly-owned subsidiaries, FEI-Elcom Tech ("FEI-Elcom") and FEI-Asia. FEI-Asia functions primarily as a manufacturing facility for the Company's commercial product subsidiaries with minimal sales to outside customers. FEI-Elcom, in addition to its own product line, provides

design and technical support for the FEI-NY segment's satellite business.

The Company's chief executive officer 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.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

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

| | Six months Periods ended October 31, | | Three months | |
|----------------------------|---|-----------|--------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues: | | | | |
| FEI-NY | \$ 26,039 | \$ 24,135 | \$ 12,865 | \$ 12,287 |
| Gillam-FEI | 4,568 | 4,518 | 1,873 | 2,610 |
| FEI-Zyfer | 4,352 | 6,688 | 2,363 | 3,331 |
| less intersegment revenues | (1,125) | (1,087) | (94) | (659) |
| Consolidated revenues | \$ 33,834 | \$ 34,254 | \$ 17,007 | \$ 17,569 |

| | Six months Periods ended October 31, | | Three months | |
|-------------------------------|---|----------|--------------|----------|
| | 2013 | 2012 | 2013 | 2012 |
| Operating profit (loss): | | | | |
| FEI-NY | \$ 2,740 | \$ 2,973 | \$ 1,564 | \$ 1,851 |
| Gillam-FEI | (36) | 24 | (92) | 140 |
| FEI-Zyfer | (275) | 297 | (76) | 157 |
| Corporate | (202) | (195) | (132) | (130) |
| Consolidated operating profit | \$ 2,227 | \$ 3,099 | \$ 1,264 | \$ 2,018 |

| | October 31, 2013 | April 30, 2013 |
|---|---------------------|-------------------|
| Identifiable assets: | | |
| FEI-NY (approximately \$3 million in China) | \$58,972 | \$55,508 |
| Gillam-FEI (all in Belgium or France) | 18,874 | 18,071 |
| FEI-Zyfer | 10,934 | 10,418 |
| less intersegment balances | (19,016) | (18,903) |
| Corporate | 44,244 | 43,815 |
| Consolidated identifiable assets | \$114,008 | \$108,909 |

NOTE G – 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 six months ended October 31, 2013 and 2012, the Company acquired product from Morion in the aggregate amount of approximately \$98,000 and \$18,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately \$652,000 and \$96,000, respectively. (See discussion of revenues recognized under the license agreement in the paragraph below.) During the three months ended October 31,

2013 and 2012, the Company acquired product from Morion in the aggregate amount of approximately \$68,000 and \$6,000, respectively, and the Company sold product and training services to Morion in the aggregate amount of approximately \$510,000 and \$66,000, respectively. At October 31, 2013, approximately \$11,000 was payable to Morion and accounts receivable from Morion was approximately \$343,000, including \$225,000 for the equipment, component parts and training activities under the license agreement described below.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

On October 22, 2012, the Company entered into an agreement with respect to its licensing of rubidium oscillator production technology to Morion. The agreement requires the Company to supply production equipment and parts and to provide training to Morion employees to enable Morion to achieve certain levels of volume production of rubidium oscillators. Morion will pay the Company approximately \$2.7 million for the license, the equipment, parts and training, plus 5% royalties on third party sales. For a 5-year period following an initial production run, the Company commits to purchase from Morion a minimum of approximately \$400,000 worth of rubidium oscillators per year although Morion is not obligated to sell that amount to the Company. In November 2012, Morion paid the Company a \$925,000 deposit under the agreement which amount had been recorded on the Company's balance sheet as deferred revenue. In October 2013, after amending the original document to clarify certain billing events, the Company invoiced Morion for the equipment, certain component parts for the production of rubidium oscillators, training of certain Morion employees and transfer of the production technology and license to Morion. Accordingly, during the six and three-month periods ended October 31, 2013, the Company recorded revenues of \$400,000 for the technology transfer, training and sale of parts and recognized a gain of approximately \$736,000 upon the sale of fully-depreciated equipment. The \$925,000 deposit previously recorded as deferred revenue is included in these revenues and gain. Additional revenues under the agreement will be recorded after the Company provides further on-site training for Morion personnel, delivers more component parts and obtains relief from certain U.S. Government limitations relating to the sales of items to be manufactured under the license. The United States Department of State has approved the technology transfer called for under the agreement.

NOTE H – FAIR VALUE OF FINANCIAL INSTRUMENTS

The cost, gross unrealized gains, gross unrealized losses and fair market value of available-for-sale securities at October 31, 2013 and April 30, 2013 are as follows (in thousands):

| | October 31, 2013 | | | |
|-------------------------|------------------|------------------------------|-------------------------------|-------------------------|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Market Value |
| Fixed income securities | \$8,935 | \$161 | \$(36) | \$9,060 |
| Equity securities | 6,179 | 949 | (309) | 6,819 |
| | \$15,114 | \$1,110 | \$(345) | \$15,879 |
| | April 30, 2013 | | | |
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Market Value |
| Fixed income securities | \$10,285 | \$297 | \$0 | \$10,582 |
| Equity securities | 6,490 | 1,266 | (68) | 7,688 |
| | \$16,775 | \$1,563 | \$(68) | \$18,270 |

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 |
| October 31, 2013 | | | | | | |
| Fixed Income Securities | \$ 446 | \$ (36) | \$ - | \$ - | \$ 446 | \$ (36) |
| Equity Securities | 1,464 | (86) | 357 | (223) | 1,821 | (309) |
| | \$ 1,910 | \$ (122) | \$ 357 | \$ (223) | \$ 2,267 | \$ (345) |
| April 30, 2013 | | | | | | |
| Fixed Income Securities | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Equity Securities | - | - | 512 | (68) | 512 | (68) |
| | \$ - | \$ - | \$ 512 | \$ (68) | \$ 512 | \$ (68) |

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 October 31, 2013 are 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 six months ended October 31, 2013 and 2012, the Company sold or redeemed available-for-sale securities in the amounts of \$1.8 million and \$2.0 million, respectively, realizing a gain of approximately \$74,000 in the fiscal year 2014 period and no gain in the fiscal year 2013 period.

Maturities of fixed income securities classified as available-for-sale at October 31, 2013 are as follows, at cost (in thousands):

| | |
|--|---------|
| Current | \$4,009 |
| Due after one year through five years | 4,124 |
| Due after five years through ten years | 802 |
| | \$8,935 |

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 three levels of the fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2

Inputs to the valuation methodology include:

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- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

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.

NOTE I - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2012, the FASB issued ASU No. 2012-02, Intangibles – Goodwill and Other (Topic 350): Test Indefinite-Lived Intangible Assets for Impairment. Under the requirements of ASU 2012-02 an entity has the option to assess qualitative factors when testing indefinite-lived intangible assets annually to determine whether it is more likely than not that the asset is not impaired. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test or resume performing the qualitative assessment in any subsequent period. If, after assessing the totality of events and circumstances, an entity concludes that it is more likely than not that the indefinite-lived intangible asset is impaired, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Subtopic 350-30. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company will adopt ASU 2012-02 for its fiscal year 2014 which began on May 1, 2013. The Company is unable to determine the impact of such adoption until it performs the annual test for impairment in the fourth quarter of the current fiscal year.

In February 2013, the FASB issued Accounting Standard Update No. 2013-02, Other Comprehensive Income. The amendment requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. This ASU is effective for periods beginning after December 15, 2012. The Company has adopted ASU 2013-02 but does not expect it to have a material effect on its financial statements.

NOTE J – CREDIT FACILITY

On June 6, 2013, the Company obtained a credit facility (the "Facility") from JPMorgan Chase Bank, N.A. ("JPMorgan") pursuant to a credit agreement (the "Credit Agreement") between the Company and JPMorgan. The maximum aggregate amount of the Facility is \$25.0 million, of which the Company immediately borrowed \$7.2 million, using the proceeds to repay the outstanding balance under the \$9.3 million line of credit with another financial institution which formerly managed a substantial portion of the Company's investment portfolio. As a result of this refinancing of short-term credit with a long-term obligation, as of April 30, 2013, the Company reclassified the \$6.0 million balance payable under the replaced line of credit to long-term debt. Proceeds from the Facility will be used for working capital and to finance acquisitions. During the six-month period ended October 31, 2013, the Company borrowed an additional \$2.9 million under the Facility. The additional borrowings were used for working capital and to finance the acquisition of certain fixed assets.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
(Unaudited)

The Company may make borrowings under the Facility from either Tranche A or Tranche B or a combination of both, not to exceed \$25.0 million. Pursuant to the Credit Agreement, the amount of Tranche A borrowings may not exceed the value of the Pledged Investments (as defined in the Credit Agreement). The amount of Tranche B borrowings may not exceed the lesser of (i) \$15.0 million and (ii) the Borrowing Base (as defined in the Credit Agreement). Current outstanding borrowings under the Facility are all under Tranche A. The Facility is fully guaranteed by certain of the Company's subsidiaries and is secured by, among other things, a pledge of substantially all personal property of the Company and certain of the Company's subsidiaries.

Borrowings under the Facility are evidenced by a line of credit note (the "Note") and bear interest, payable monthly, at a rate equal to the LIBOR Rate, as determined from time to time by JPMorgan pursuant to the terms of the Note, plus a margin of 0.75% for Tranche A borrowings and 1.75% for Tranche B borrowings. The principal balance on the Note, along with any accrued and unpaid interest, is due and payable no later than June 5, 2018, which is the maturity date of the Facility. In addition, the Company is required to pay JPMorgan fees equal to 0.1% per annum on any unused portion of the Facility.

The Credit Agreement contains a number of affirmative and negative covenants, including limitations on the incurrence of additional debt, liens on property, acquisitions, loans and guarantees, mergers, consolidations, liquidations and dissolutions, asset sales, and distributions and other payments in respect of the Company's capital stock. The Credit Agreement also contains certain events of default customary for credit facilities of this type, including nonpayment of principal or interest when due, material incorrectness of representations and warranties when made, breach of covenants, bankruptcy and insolvency, unstayed material judgment beyond specified periods, and acceleration or payment default of other material indebtedness. The Credit Agreement requires the Company to maintain, as of the end of each fiscal quarter, a funded debt to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) ratio and, if there are any borrowings under Tranche B, an interest charge coverage ratio. The calculation of both ratios is defined in the Credit Agreement. For the period ended October 31, 2013, the Company met the required covenants for its borrowings under Tranche A.

NOTE K – INCOME TAXES

In prior fiscal years, the Company reduced the valuation allowance on the deferred tax assets of its U.S. subsidiaries. Consequently, for the six and three months ended October 31, 2013 and 2012, the Company recorded provisions for income taxes based on both current taxes due in the United States as well as the tax provision or benefit to be realized from temporary tax differences. As of October 31, 2013 and April 30, 2013, the remaining deferred tax asset valuation allowance is approximately \$1.9 million and is primarily related to deferred tax assets of the Company's non-U.S.-based 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 pursuant to 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. 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. By making these forward-looking statements, the Company undertakes no obligation to update these statements for revisions or changes after the date of this report.

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, 2013. The Company believes its most critical accounting policies to be the recognition of revenue and costs on production contracts 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 or the market value of its products. Changes in estimates can have a material impact on the Company's financial position and results of operations.

Revenue Recognition

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 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 percentage for a contract is reflected in revenues in the period in which the change is known. Provisions for 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.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

For customer orders in the Company's Gillam-FEI and FEI-Zyfer segments 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, direct labor costs, manufacturing overhead and other direct costs related to contract performance. Selling, general and administrative costs are charged to expense as incurred.

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 price 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.

Foreign Operations and Foreign Currency Adjustments

The Company maintains manufacturing operations in Belgium and the People's Republic of China. The Company is vulnerable to currency risks in these countries. The local currency is the functional currency of each of the Company's non-U.S. subsidiaries. No foreign currency gains or losses are recorded on intercompany transactions since they are effected at current rates of exchange. The results of operations of foreign subsidiaries, when translated into U.S. dollars, reflect the average rates of exchange for the periods presented. The balance sheets of foreign subsidiaries, except for equity accounts which are translated at historical rates, are translated into U.S. dollars at the rates of exchange in effect on the date of the balance sheet. As a result, similar results in local currency can vary upon translation into U.S. dollars if exchange rates fluctuate significantly from one period to the next.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

RESULTS OF OPERATIONS

The table below sets forth for the respective periods of fiscal years 2014 and 2013 (which end on April 30, 2014 and 2013, respectively) the percentage of consolidated revenues represented by certain items in the Company's consolidated statements of operations:

| | Six months | | Three months | |
|-------------------------------------|---------------------------|--------|--------------|--------|
| | Periods ended October 31, | | | |
| | 2013 | 2012 | 2013 | 2012 |
| Revenues | | | | |
| FEI-NY | 76.9 | % 70.5 | % 75.6 | % 69.9 |
| Gillam-FEI | 13.5 | 13.2 | 11.0 | 14.9 |
| FEI-Zyfer | 12.9 | 19.5 | 13.9 | 19.0 |
| Less intersegment revenues | (3.3) | (3.2) | (0.5) | (3.8) |
| | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenues | 63.1 | 62.9 | 63.4 | 61.7 |
| Gross margin | 36.9 | 37.1 | 36.6 | 38.3 |
| Selling and administrative expenses | 20.8 | 20.4 | 20.5 | 20.0 |
| Research and development expenses | 9.5 | 7.6 | 8.7 | 6.8 |
| Operating profit | 6.6 | 9.1 | 7.4 | 11.5 |
| Other income, net | 2.9 | 0.6 | 5.3 | 0.5 |
| Pretax income | 9.5 | 9.7 | 12.7 | 12.0 |
| Provision for income taxes | 3.4 | 3.2 | 4.5 | 3.8 |
| Net income | 6.1 | % 6.5 | % 8.2 | % 8.2 |

Revenues

| Segment | Six months | | | Three months | | | | |
|-----------------------|---------------------------|-----------|-----------|--------------|-----------|-----------|-----------|--------|
| | Periods ended October 31, | | | | | | | |
| | 2013 | 2012 | Change | 2013 | 2012 | Change | | |
| FEI-NY | \$ 26,039 | \$ 24,135 | \$ 1,904 | 8 % | \$ 12,865 | \$ 12,287 | \$ 578 | 5 % |
| Gillam-FEI | 4,568 | 4,518 | 50 | 1 % | 1,873 | 2,610 | (737) | (28 %) |
| FEI-Zyfer | 4,352 | 6,688 | (2,336) | (35 %) | 2,363 | 3,331 | (968) | (29 %) |
| Intersegment revenues | (1,125) | (1,087) | (38) | | (94) | (659) | 565 | |
| | \$ 33,834 | \$ 34,254 | \$ (420) | (1 %) | \$ 17,007 | \$ 17,569 | \$ (562) | (3 %) |

For the six and three months ended October 31, 2013, revenues from commercial and U.S. Government satellite programs accounted for more than 55% of consolidated revenues and increased by approximately 20% over the same periods of fiscal year 2013. Revenues on these contracts are recognized primarily under the percentage of completion method. Revenues from the satellite market are recorded in the FEI-NY segment. Revenues from non-space U.S.

Government/DOD customers, which are recorded in both the FEI-NY and FEI-Zyfer segments, accounted for approximately 20% of fiscal year 2014 consolidated revenues. Such revenues decreased by 10% and 36%, respectively, from the same periods of fiscal year 2013. Total revenues from U.S. Government satellite contracts and non-space programs approached 60% of consolidated revenues for the six months ended October 31, 2013 and were

approximately 55% of revenues for the three-month period then ended. Network infrastructure revenues in the fiscal year 2014 periods accounted for approximately 15% of consolidated revenues and declined by approximately 20% and 30%, respectively, from the same periods of fiscal year 2013. Network infrastructure revenues are recorded in all three segments although the largest network infrastructure sales volume is recorded in the Gillam-FEI and FEI-Zyfer segments and accounted for most of the year-over-year decline in FEI-Zyfer's revenues. For the three-month period ended October 31, 2013, Gillam-FEI revenues decreased over the prior year primarily due to lower intersegment sales which are eliminated in consolidation.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

For the six and three months ended October 31, 2012, FEI-NY revenues from commercial and U.S. Government satellite programs increased 10% over the prior year. Revenues from these programs accounted for just under 50% of consolidated sales, approximately the same ratio as the same six-month period of fiscal year 2012. Revenues on these long-term contracts are recognized primarily under the percentage of completion method. Sales from the U.S. Government/DOD business area, which accounted for more than 20% of consolidated revenues, increased almost 20% over fiscal year 2012 revenues due primarily to the FEI-Elcom acquisition. Between sales from FEI-NY (including FEI-Elcom) and FEI-Zyfer, total revenues from U.S. Government satellite and non-space programs exceeded 50% for the six months ended October 31, 2012 and neared 60% for the three month period then ended. Network infrastructure sales, which are recorded in all three segments, grew approximately 15% year over year and accounted for approximately 20% of consolidated revenues, similar to the prior fiscal year.

Based on the Company's current backlog, over three-fourths of which represent satellite payload business, and the potential for additional new orders, revenues for fiscal year 2014 are expected to remain at approximately the same level as the prior year. Satellite payload revenues will continue to be the dominant portion of the Company's business and represents the Company's best growth opportunity.

Gross margin

| | Six months | | | Three months | | | |
|---------|---------------------------|-----------|----------|--------------|----------|----------|----------------|
| | Periods ended October 31, | | | | | | |
| | 2013 | 2012 | Change | 2013 | 2012 | Change | |
| | \$ 12,498 | \$ 12,713 | \$ (215) | (2 %) | \$ 6,232 | \$ 6,732 | \$ (500) (7 %) |
| GM Rate | 36.9 % | 37.1 % | | 36.6 % | 38.3 % | | |

Gross margin for the six and three month periods ended October 31, 2013, decreased due to lower revenues and lower gross margin rates. The gross margin rate is impacted by product mix as well as by unabsorbed overhead costs during fiscal year 2014.

Fiscal year 2013 gross margin increased over the prior fiscal year due to higher consolidated revenues. The fiscal year 2013 gross margin rate was reduced from the fiscal year 2012 rates due to the effect of low sales volume and higher costs incurred on certain customer-funded nonrecurring engineering projects at FEI-Elcom whose results of operations are included in the FEI-NY segment.

The gross margin rates recorded in the fiscal year 2014 and 2013 periods were less than the Company's targeted rate of 40%. As satellite payload sales volume increases and as the product mix changes, the Company anticipates that its gross margin rates for the remainder of fiscal year 2014 will approach its target rate.

Selling and administrative expenses

| | Six months | | | Three months | | | |
|--|---------------------------|----------|--------|--------------|----------|----------|--------------|
| | Periods ended October 31, | | | | | | |
| | 2013 | 2012 | Change | 2013 | 2012 | Change | |
| | \$ 7,045 | \$ 6,996 | \$ 49 | 1 % | \$ 3,485 | \$ 3,511 | \$(26) (1 %) |

For the six and three-month periods ended October 31, 2013 and 2012, selling and administrative expenses varied from 20% to 21% of consolidated revenues which approximates the Company's target for such expenditures. The fluctuation in expenses in the fiscal year 2014 periods compared to the same periods of fiscal year 2013 is due to primarily to variations in stock-based compensation and accruals for incentive compensation plans. For the remainder of fiscal year 2014, the Company expects selling and administrative expenses to be incurred at approximately the same rate.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Research and development expense

| Six months | | | Three months | | | | |
|---------------------------|----------|--------|--------------|----------|----------|--------|------|
| Periods ended October 31, | | | | | | | |
| 2013 | 2012 | Change | 2013 | 2012 | Change | | |
| \$ 3,226 | \$ 2,618 | \$ 608 | 23 % | \$ 1,483 | \$ 1,203 | \$ 280 | 23 % |

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 competitiveness for future revenues. R&D spending for the six and three-month periods ended October 31, 2013, was approximately 10% and 9% of consolidated revenues, respectively, compared to 8% and 7% for the same periods of the prior fiscal year. In the fiscal year 2014 periods, the

Company accelerated its development of new satellite payload microwave receivers/converters from DC to Ka band. Such products are anticipated to be ready for customer evaluation and new contract awards by the third quarter of fiscal year 2014. In the fiscal year 2013 periods, increased R&D spending is due primarily to product development expenditures at FEI-Elcom to improve its own product line.

R&D spending in fiscal year 2014, in addition to the development of new satellite payload products, will also include development and improvement of miniaturized rubidium atomic clocks, development of new GPS-based synchronization products and further enhancement of the capabilities of the Company’s line of low g-sensitivity and ruggedized rubidium oscillators. Included in these efforts are product redesign and process improvements to enhance product manufacturability and reduce production costs. The Company will continue to devote significant resources to develop new products, enhance existing products and implement efficient manufacturing processes. For fiscal year 2014, the Company is targeting to spend under 10% of revenues on internal R&D projects. Internally generated cash and cash reserves are adequate to fund these development efforts.

In addition to internal R&D efforts, the Company continues to conduct development activities on customer-funded programs the cost of which appears in cost of revenues.

Operating profit

| Six months | | | Three months | | | | |
|---------------------------|----------|----------|--------------|----------|----------|----------|--------|
| Periods ended October 31, | | | | | | | |
| 2013 | 2012 | Change | 2013 | 2012 | Change | | |
| \$ 2,227 | \$ 3,099 | \$ (872) | (28 %) | \$ 1,264 | \$ 2,018 | \$ (754) | (37 %) |

Accelerated R&D spending in the fiscal year 2014 periods along with flat revenues and decreased gross margin rates as compared to the same periods of fiscal year 2013 resulted in reduced operating profit for the six and three months ended October 31, 2013. Fiscal year 2014’s six- and three-month operating profit was 6.6% and 7.4%, respectively, of consolidated revenues compared to 9.1% and 11.5%, respectively, of consolidated revenues in the same periods of the prior year.

The late fiscal year 2012 addition of FEI-Elcom reduced consolidated operating results for the first half of fiscal year 2013. Revenues increased but were offset by higher operating expenses resulting in lower consolidated operating profit in fiscal year 2013 than in fiscal year 2012.

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The Company anticipates that for the full fiscal year 2014, it will generate an operating profit that exceeds that of fiscal year 2013.

Other income (expense)

| | Six months Periods ended October 31, | | | Three months | | |
|--------------------------------|---|--------|-------------|--------------|--------|-------------|
| | 2013 | 2012 | Change | 2013 | 2012 | Change |
| Investment income | \$ 351 | \$ 319 | \$32 10 % | \$ 208 | \$ 152 | \$56 37 % |
| Interest expense | (95) | (103) | 8 (8 %) | (36) | (47) | 11 (23 %) |
| Other income (expense), net | 734 | (6) | 740 NM | 725 | (12) | 737 NM |
| | \$ 990 | \$ 210 | \$780 371 % | \$ 897 | \$ 93 | \$804 865 % |

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

Investment income is derived primarily from the Company's holdings of marketable securities. Earnings on these securities may vary based on fluctuating interest rates and dividend payout levels and the timing of purchases or sales of securities. During the fiscal year 2014 periods, the Company recorded a gain of approximately \$74,000 on the sale of certain marketable securities. No investment gains or losses were recorded in the fiscal year 2013 periods. During the six and three months ended October 31, 2013, as a result of certain bond redemptions over the preceding quarters, the Company held more low earning cash equivalents than investments earning a higher return in the year-ago period. During the six and three months ended October 31, 2012, investments were held in higher yielding marketable securities than those held during the same periods ended October 31, 2011.

The decrease in interest expense for the six and three months ended October 31, 2013 compared to the same periods of fiscal year 2013 is due to the lower interest rate under the Company's new credit facility from a bank. During the fiscal year 2014 periods, the Company refinanced the \$6 million used to acquire FEI-Elcom during fiscal year 2012 and increased its borrowings by an additional \$4.1 million for working capital and capital equipment acquisitions.

Other income in the fiscal year 2014 periods consists primarily of a \$736,000 gain recognized upon the sale of certain manufacturing equipment to Morion, Inc. under the terms of a license agreement related to the Company's rubidium oscillator production technology. (See Note G to the accompanying condensed financial statements.) During the fiscal year 2013 periods, other income consisted of insignificant non-operating expenses.

Income tax provision

| | Six months | | Three months | | | | | |
|--|------------|----------|-------------------------------------|-----|--------|--------|--------|------|
| | 2013 | 2012 | Periods ended October 31, Change | | 2013 | 2012 | Change | |
| | \$ 1,150 | \$ 1,100 | \$50 | 5 % | \$ 770 | \$ 670 | \$100 | 15 % |

| | | | | | |
|--|--------|--------|--|--------|--------|
| Effective tax rate on pre-tax book income: | 35.7 % | 33.3 % | | 35.6 % | 31.8 % |
|--|--------|--------|--|--------|--------|

The provision for income taxes for the six and three months ended October 31, 2013 increased over the same periods of fiscal year 2013 due to the estimated increased effective tax rate. For the full year, the effective tax rate in fiscal year 2014 is expected to be in the range of 30% to 36% depending on the level of pretax income or loss recorded at the Company's foreign subsidiaries for which no net tax provision or benefit is recognized. As of October 31, 2013 and April 30, 2013, the remaining deferred tax asset valuation allowance is approximately \$1.9 million.

The provision for income taxes for the six and three months ended October 31, 2012 decreased from the same periods of fiscal year 2012 due to decreased pretax income and reduced effective tax rate.

The Company is subject to taxation in several countries as well as the states of New York, New Jersey and California. The statutory federal rates are 34% in the United States and Belgium. The effective rate is impacted by the income or loss of certain of the Company's European and Asian subsidiaries that are currently not taxed. In addition, the Company utilizes the availability of research and development tax credits and the Domestic Production Activity credit in the United States to lower its tax rate. As of April 30, 2013, the Company's European subsidiaries had available net operating loss carryforwards of approximately \$2.7 million, which will offset future taxable income. As a result of the FEI-Elcom acquisition, the Company has a federal net operating loss carryforward of \$6.6 million that may be applied in annually limited amounts to offset future U.S.-sourced taxable income over the next 19

years.

Net income

| Six months | | | Three months | | |
|---------------------------|----------|---------------|--------------|----------|--------------|
| Periods ended October 31, | | | | | |
| 2013 | 2012 | Change | 2013 | 2012 | Change |
| \$ 2,067 | \$ 2,209 | \$(142) (6 %) | \$ 1,391 | \$ 1,441 | \$(50) (3 %) |

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FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES

(Continued)

As discussed above, accelerated research and development expenses and reduced gross margins based on flat sales and higher costs, reduced net income for the six and three months ended October 31, 2013 as compared to the same periods of the prior year. Based on recent bookings and its backlog, the Company expects continued growth in satellite revenues and increased profitability over that of the prior fiscal year.

LIQUIDITY AND CAPITAL RESOURCES

The Company's balance sheet continues to reflect a strong working capital position of \$77.2 million at October 31, 2013, compared to working capital of \$71.7 million at April 30, 2013. Included in working capital at October 31, 2013 is \$20.9 million consisting of cash, cash equivalents and marketable securities. The Company's current ratio at October 31, 2013 is 12.3 to 1.

For the six months ended October 31, 2013, the Company used cash from operations in the amount of \$2.5 million compared to the use of cash from operating activities of \$981,000 in the comparable fiscal year 2013 period. The reduced cash flow in the fiscal year 2014 period resulted primarily from increased accounts receivables and increased inventory. For the six-month periods ended October 31, 2013 and 2012, the Company incurred approximately \$2.8 million and \$2.6 million, respectively, of non-cash operating expenses, such as depreciation and amortization and accruals for employee benefit programs. Net income in fiscal year 2014 also included a \$736,000 gain on the sale of equipment and such gain is excluded from operating cash flow. For the balance of fiscal year 2014, as receivables are billed and collected and the pace of purchases of inventory slows, the Company expects to generate positive cash flow from operating activities.

Net cash used in investing activities for the six months ended October 31, 2013, was \$1.1 million compared to \$447,000 provided by such activity for the same period of fiscal year 2013. During the fiscal year 2014 period, marketable securities were sold or redeemed in the amount of \$1.8 million compared to \$2.0 million of such redemptions during the fiscal year 2013 period. Some of these proceeds and other cash were reinvested in additional marketable securities for the periods ended October 31, 2013 and 2012 in the amount of \$67,000 and \$947,000, respectively. In the fiscal periods ended October 31, 2013 and 2012, the Company acquired property, plant and equipment in the amount of approximately \$2.8 million and \$612,000, respectively. The Company may continue to invest cash equivalents in longer-term securities or to convert short-term investments to cash equivalents as dictated by its investment and acquisition strategies. The Company will continue to acquire more efficient equipment to automate its production process. The Company intends to spend between \$3.5 million and \$4.0 million on capital equipment during fiscal year 2014. Internally generated cash or additional borrowings under the Company's credit facility will be used to acquire this level of capital equipment.

Net cash provided by financing activities for the six months ended October 31, 2013 and 2012 was \$4.2 million and \$2.3 million, respectively. During the fiscal year 2014 period, the Company borrowed \$4.1 million under its new credit facility with a bank. In the fiscal year 2013 period, the Company borrowed \$4.0 million under a previous line of credit with a financial institution and also repaid \$1.5 million of such borrowings. Such funds were used for working capital and to finance the acquisition of certain fixed assets. During the fiscal year 2014 and 2013 periods, the Company made payments of \$15,000 and \$231,000, respectively, against capital lease obligations. In addition, during the six months ended October 31, 2012, cash of \$20,000 was received upon exercise of employee stock options.

The Company has been authorized by its Board of Directors to repurchase up to \$5 million worth of shares of its common stock for treasury whenever appropriate opportunities arise but it has neither a formal repurchase plan nor

commitments to purchase additional shares in the future. As of October 31, 2013, the Company has repurchased approximately \$4 million of its common stock out of the \$5 million authorization.

FREQUENCY ELECTRONICS, INC. and SUBSIDIARIES
(Continued)

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 continued profitability. During fiscal year 2014, the Company intends to make a substantial investment of capital and technical resources to develop and acquire new products to meet the needs of the U.S. Government, commercial space and network infrastructure marketplaces and to invest in more efficient product designs and manufacturing procedures. Where possible, the Company will secure partial customer funding for such development efforts but is targeting to spend its own funds at a rate of less than 10% of revenues to achieve its development goals. 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 October 31, 2013, the Company's consolidated backlog is approximately \$57 million compared to \$51 million at April 30, 2013, the end of fiscal year 2013. Approximately 70% of this backlog is expected to be realized in the next twelve months. Included in the backlog at October 31, 2013 is approximately \$3 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. On fixed price contracts, the Company excludes any unfunded portion which, at October 31, 2013, was approximately \$20 million. The Company expects these contracts to become fully funded over time and will add to its backlog at that time.

The Company believes that its liquidity is adequate to meet its operating and investment needs through at least October 31, 2014.

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. 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. Based on their evaluation, the

Company's chief executive officer and chief financial officer have concluded that, as of October 31, 2013, 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 Securities and Exchange Commission rules and forms.

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 six months ended October 31, 2013 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 October 31, 2013 formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Income and Comprehensive Income, (iii) Condensed Consolidated Statements of Cash Flows and (iv) 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: December 16, 2013

By: /s/ Alan Miller
Alan Miller
Chief Financial Officer and
Treasurer
Signing on behalf of the registrant
and
as principal financial officer

