COMTECH TELECOMMUNICATIONS CORP /DE/
Form 10-Q
March 08, 2007

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

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended January 31, 2007

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-7928

(Exact name of registrant as specified in its charter)

Delaware	**11-2139466**
(State or other jurisdiction of incorporation /organization)	(I.R.S. Employer Identification Number)
68 South Service Road, Suite 230, Melville, NY	**11747**
(Address of principal executive offices)	(Zip Code)

(631) 962-7000

(Registrant s telephone number, including area code)

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.
x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of March 2, 2007, the number of outstanding shares of Common Stock, par value $.10 per share, of the registrant was 23,152,760 shares.

COMTECH TELECOMMUNICATIONS CORP.
INDEX

PART I
FINANCIAL INFORMATION
COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

Item 1.	January 31, 2007	July 31, 2006
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 266,214,000	251,587,000
Restricted cash		1,003,000
Accounts receivable, net	68,700,000	70,047,000
Inventories, net	73,816,000	61,043,000
Prepaid expenses and other current assets	5,676,000	7,178,000
Deferred tax asset current	8,205,000	7,591,000
Total current assets	422,611,000	398,449,000
Property, plant and equipment, net	26,060,000	24,732,000
Goodwill	24,387,000	22,244,000
Intangibles with finite lives, net	6,276,000	6,855,000
Deferred financing costs, net	2,176,000	2,449,000
Other assets, net	431,000	537,000
Total assets	$ 481,941,000	455,266,000
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 19,553,000	28,337,000
Accrued expenses and other current liabilities	38,126,000	41,230,000
Customer advances and deposits	9,147,000	3,544,000
Deferred service revenue	4,906,000	9,896,000
Current installments of other obligations	129,000	154,000
Interest payable	1,050,000	1,050,000
Income taxes payable	5,585,000	5,252,000
Total current liabilities	78,496,000	89,463,000
Convertible senior notes	105,000,000	105,000,000
Other obligations, less current installments	177,000	243,000
Deferred tax liability non-current	6,592,000	6,318,000
Total liabilities	190,265,000	201,024,000
Commitments and contingencies (See Note 14)		
Stockholders equity:		
Preferred stock, par value $.10 per share; shares authorized and unissued 2,000,000		
Common stock, par value $.10 per share; authorized 100,000,000 shares, issued 23,348,622 shares and 23,052,593 shares at January 31, 2007 and July 31, 2006, respectively	2,335,000	2,305,000
Additional paid-in capital	147,893,000	139,487,000
Retained earnings	141,633,000	112,635,000

	291,861,000	254,427,000
Less:		
Treasury stock (210,937 shares)	(185,000)	(185,000)
Total stockholders equity	291,676,000	254,242,000
Total liabilities and stockholders equity	$ 481,941,000	455,266,000

See accompanying notes to condensed consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended January 31,		Six months ended January 31,	
	2007	2006	2007	2006
Net sales	$ 111,383,000	95,741,000	208,453,000	202,308,000
Cost of sales	61,533,000	54,650,000	119,228,000	121,013,000
Gross profit	49,850,000	41,091,000	89,225,000	81,295,000
Expenses:				
Selling, general and administrative	18,257,000	15,809,000	34,844,000	31,857,000
Research and development	7,616,000	6,007,000	14,773,000	12,756,000
Amortization of intangibles	679,000	603,000	1,328,000	1,199,000
	26,552,000	22,419,000	50,945,000	45,812,000
Operating income	23,298,000	18,672,000	38,280,000	35,483,000
Other expense (income):				
Interest expense	672,000	672,000	1,367,000	1,346,000
Interest income	(3,315,000)	(2,172,000)	(6,490,000)	(3,947,000)
Income before provision for income taxes	25,941,000	20,172,000	43,403,000	38,084,000
Provision for income taxes	7,770,000	6,868,000	14,405,000	13,316,000
Net income	$ 18,171,000	13,304,000	28,998,000	24,768,000
Net income per share:				
Basic	$ 0.79	0.59	1.26	1.09
Diluted	$ 0.68	0.50	1.09	0.94
Weighted average number of common shares outstanding basic	23,095,000	22,741,000	23,022,000	22,694,000
Weighted average number of common and common equivalent shares outstanding assuming dilution diluted	27,491,000	27,354,000	27,440,000	27,367,000

See accompanying notes to condensed consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended January 31,	
	2007	2006
Cash flows from operating activities:		
Net income	$ 28,998,000	24,768,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	3,558,000	2,875,000
Amortization of intangible assets with finite lives	1,328,000	1,199,000
Amortization of stock-based compensation	3,347,000	2,834,000
Amortization of deferred financing costs	273,000	273,000
(Gain) loss on disposal of property, plant and equipment	(2,000)	16,000
Provision for allowance for doubtful accounts	18,000	99,000
Provision for excess and obsolete inventory	1,549,000	987,000
Excess income tax benefit from stock option exercises	(1,855,000)	(1,154,000)
Deferred income tax (benefit) expense	(340,000)	650,000
Changes in assets and liabilities, net of effects of acquisition:		
Restricted cash securing letter of credit obligations	1,003,000	31,000
Accounts receivable	1,329,000	(20,036,000)
Inventories	(14,004,000)	(9,743,000)
Prepaid expenses and other current assets	1,502,000	(1,459,000)
Other assets	106,000	(38,000)
Accounts payable	(8,784,000)	(1,626,000)
Accrued expenses and other current liabilities	(3,717,000)	1,493,000
Customer advances and deposits	5,603,000	(189,000)
Deferred service revenue	(4,990,000)	2,035,000
Income taxes payable	2,292,000	3,310,000
Net cash provided by operating activities	17,214,000	6,325,000
Cash flows from investing activities:		
Purchases of property, plant and equipment	(4,870,000)	(4,643,000)
Purchases of other intangibles with finite lives		(197,000)
Payments for business acquisition	(2,614,000)	
Net cash used in investing activities	(7,484,000)	(4,840,000)
Cash flows from financing activities:		
Principal payments on other obligations	(91,000)	(115,000)
Excess income tax benefit from stock option exercises	1,855,000	1,154,000
Proceeds from exercises of stock options	2,770,000	1,425,000
Proceeds from issuance of employee stock purchase plan shares	363,000	315,000
Net cash provided by financing activities	4,897,000	2,779,000
Net increase in cash and cash equivalents	14,627,000	4,264,000
Cash and cash equivalents at beginning of period	251,587,000	214,413,000
Cash and cash equivalents at end of period	$ 266,214,000	218,677,000

Supplemental cash flow disclosures:		
Cash paid during the period for:		
Interest	$ 1,073,000	1,073,000
Income taxes	$ 12,055,000	9,447,000
Noncash investing activities:		
Accrued business acquisition payments (See Note 5)	$ 613,000	

See accompanying notes to condensed consolidated financial statements.

COMTECH TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) *General*

The accompanying condensed consolidated financial statements of Comtech Telecommunications Corp. and Subsidiaries (the Company) as of and for the three and six months ended January 31, 2007 and 2006 are unaudited. In the opinion of management, the information furnished reflects all material adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the unaudited interim periods. The results of operations for such periods are not necessarily indicative of the results of operations to be expected for the full fiscal year. For the three and six months ended January 31, 2007 and 2006, comprehensive income was equal to net income.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results may differ from those estimates.

These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the fiscal year ended July 31, 2006 and the notes thereto contained in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC), and all of the Company s other filings with the SEC.

(2) *Reclassifications*

Certain reclassifications have been made to previously reported financial statements to conform to the Company s current financial statement format.

(3) *Stock-Based Compensation*

The Company applies the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, which establishes the accounting for employee stock-based awards. Under the provisions of SFAS No. 123(R), stock-based compensation is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period of the grant). The Company used the modified prospective method upon adopting SFAS No. 123(R).

The Company recognized stock-based compensation for awards issued under the Company s Stock Option Plans and the Company s 2001 Employee Stock Purchase Plan (the ESPP) in the following line items in the Condensed Consolidated Statements of Operations:

	Three months ended January 31,		**Six months ended January 31,**	
	2007	**2006**	**2007**	**2006**
Cost of sales	$ 122,000	105,000	262,000	181,000
Selling, general and administrative expenses	1,188,000	1,238,000	2,609,000	2,323,000
Research and development expenses	227,000	195,000	476,000	330,000
Stock-based compensation expense before income tax benefit	1,537,000	1,538,000	3,347,000	2,834,000
Income tax benefit	(579,000)	(351,000)	(1,074,000)	(625,000)
Net stock-based compensation expense	$ 958,000	1,187,000	2,273,000	2,209,000

Of the total stock-based compensation expense before income tax benefit recognized in the three months ended January 31, 2007 and 2006, $41,000 and $99,000, respectively, related to awards issued pursuant to the ESPP. Of the total stock-based compensation expense before income tax benefit recognized in the six months ended January 31, 2007 and 2006, $83,000 and $138,000, respectively, related to awards issued pursuant to the ESPP. Stock-based compensation that was capitalized and included in ending inventory at January 31, 2007 and July 31, 2006 was $58,000 and $61,000, respectively.

The Company estimates the fair value of stock options using the Black-Scholes option pricing model. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company s stock options granted during the three and six months ended January 31, 2007 and 2006. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the employees who receive equity awards.

The per share weighted average fair value of stock options granted during the three months ended January 31, 2007 and 2006 was $13.79 and $15.79, respectively. The per share weighted average fair value of stock options granted during the six months ended January 31, 2007 and 2006 was $10.68 and $14.23, respectively. In addition to the exercise and grant date prices of the awards, certain weighted average assumptions that were used to estimate the fair value of stock option grants in the respective periods are listed in the table below:

	Three months ended January 31,		**Six months ended January 31,**	
	2007	**2006**	**2007**	**2006**
Expected dividend yield	0%	0%	0%	0%
Expected volatility	45.47%	50.90%	45.47%	51.76%
Risk-free interest rate	4.48%	4.43%	4.89%	4.12%
Expected term (years)	3.63	3.63	3.63	3.63

Options granted during the three and six months ended January 31, 2007 and 2006 had exercise prices equal to the fair market value of the stock on the date of grant, a contractual term of five years and a vesting period of three years. All options granted through July 31, 2005 had exercise prices equal to the fair market value of the stock on the date of grant, a contractual term of ten years and generally a vesting period of five years.

The Company estimates expected volatility by considering the historical volatility of the Company s stock, the implied volatility of publicly traded stock options in the Company s stock and the Company s expectations of volatility for the expected term of stock-based compensation awards. The risk-free interest rate is based on the United States (U.S.) treasury yield curve in effect at the time of grant. The expected option term is the number of years that the Company estimates that options will be outstanding prior to exercise. The expected term of the awards issued after July 31, 2005 was determined using the simplified method prescribed in SEC Staff Accounting Bulletin (SAB) No. 107.

The actual income tax benefit recorded relating to the exercise of stock option awards was $1,959,000 and $1,154,000 for the six months ended January 31, 2007 and 2006, respectively. Of these amounts, $1,855,000 and $1,154,000, respectively, represents excess income tax benefits and has been classified as a financing cash inflow in the Company s Condensed Consolidated Statements of Cash Flows for the six months ended January 31, 2007 and 2006, respectively. The Company settles employee stock option exercises with new shares.

At January 31, 2007, total remaining unrecognized compensation cost related to unvested stock-based awards was $14,895,000, net of estimated forfeitures of $1,498,000. The net cost is expected to be recognized over a weighted average period of 2.2 years.

(4) *Earnings Per Share*

The Company calculates earnings per share (EPS) in accordance with SFAS No. 128, Earnings per Share. Basic EPS is computed based on the weighted average number of shares outstanding. Diluted EPS reflects the dilution from potential common stock issuable pursuant to the exercise of stock options and the conversion of convertible senior notes, if dilutive, outstanding during each period. Stock options to purchase 697,000 and 702,000 shares for the three months ended January 31, 2007 and 2006, respectively, were not included in the EPS calculation because their effect would have been anti-dilutive. Stock options to purchase 1,035,000 and 663,000 shares for the six months ended January 31, 2007 and 2006, respectively, were not included in the EPS calculation because their effect would have been anti-dilutive.

In accordance with Emerging Issues Task Force (EITF) Issue No. 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share, the Company includes the impact of the assumed conversion of its 2.0% convertible senior notes in calculating diluted EPS.

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

	Three months ended January 31,		Six months ended January 31,	
	2007	**2006**	**2007**	**2006**
Numerator:				
Net income for basic calculation	$ 18,171,000	13,304,000	28,998,000	24,768,000
Effect of dilutive securities:				
Interest expense (net of tax) on convertible senior notes	417,000	408,000	833,000	831,000
Numerator for diluted calculation	$ 18,588,000	13,712,000	29,831,000	25,599,000
Denominator:				
Denominator for basic calculation	23,095,000	22,741,000	23,022,000	22,694,000
Effect of dilutive securities:				
Stock options	1,063,000	1,280,000	1,085,000	1,340,000
Conversion of convertible senior notes	3,333,000	3,333,000	3,333,000	3,333,000
Denominator for diluted calculation	27,491,000	27,354,000	27,440,000	27,367,000

(5) *Acquisition*

In August 2006, the Company acquired certain assets and assumed certain liabilities of Insite Consulting, Inc. (Insite), a logistics application software company, for $3,227,000, including transaction costs of $256,000. To date, the Company has paid $2,614,000 and expects to make guaranteed payments of $613,000 through the first quarter of fiscal 2008. In addition to the guaranteed purchase price, the Company might be required to make certain earn-out payments based on the achievement of future sales targets. The first part of the earn-out cannot exceed $1,350,000 and is limited to a five-year period. The second part of the earn-out, which is for a ten-year period, is unlimited and based on a per unit future sales target primarily relating to new commercial satellite-based mobile data communication markets. Insite has developed the geoOps Enterprise Location Monitoring System, a software-based solution that allows customers to integrate legacy data systems with near-real time logistics and operational data systems. Sales and income relating to the Insite assets acquired would not have been material to the Company s results of operations for the three and six months ended January 31, 2006 and were not material for the three and six months ended January 31, 2007. This operation was combined with the Company s existing business and is part of the mobile data communications segment.

The Insite purchase price was allocated as follows:

		Estimated Useful Lives
Fair value of net tangible assets acquired	$ 335,000	
Adjustments to record intangible assets at fair value:		
Existing technology	447,000	7 years
Other intangibles	302,000	1 to 10 years
Goodwill	2,143,000	Indefinite
	2,892,000	
Aggregate purchase price	$ 3,227,000	

The valuation of existing technology was based primarily on the discounted capitalization of royalty expense saved because the Company now owns the asset. The valuation of other intangibles was primarily based on the value of the discounted cash flows that the related assets could be expected to generate in the future.

(6) *Accounts Receivable*

Accounts receivable consist of the following:

	January 31, 2007	July 31, 2006
Accounts receivable from commercial customers	$ 37,888,000	36,700,000
Unbilled receivables on contracts-in-progress	1,667,000	10,361,000
Amounts receivable from the U.S. government and its agencies	30,118,000	24,362,000
	69,673,000	71,423,000
Less allowance for doubtful accounts	973,000	1,376,000
Accounts receivable, net	$ 68,700,000	70,047,000

There was no retainage included in unbilled receivables at January 31, 2007 or July 31, 2006. In the opinion of management, substantially all of the unbilled balances will be billed and collected within one year. As of January 31, 2007 and July 31, 2006, a prime contractor represented 7.2% and 16.6%, respectively, of accounts receivable, net.

(7) *Inventories*

Inventories consist of the following:

	January 31, 2007	July 31, 2006
Raw materials and components	$ 42,582,000	35,835,000
Work-in-process and finished goods	37,837,000	31,331,000
	80,419,000	67,166,000
Less reserve for excess and obsolete inventories	6,603,000	6,123,000

Inventories, net	$ 73,816,000	61,043,000

Inventories directly related to long-term contracts were $18,147,000 and $8,349,000 at January 31, 2007 and July 31, 2006, respectively. At January 31, 2007 and July 31, 2006, $4,124,000 and $3,406,000, respectively, of the inventory balance above related to a contract from a third party commercial customer to outsource its manufacturing.

(8) *Accrued Expenses*

Accrued expenses and other current liabilities consist of the following:

		January 31, 2007	July 31, 2006
Accrued wages and benefits	$	12,824,000	17,361,000
Accrued commissions		4,897,000	5,745,000
Accrued warranty		10,564,000	10,468,000
Accrued hurricane related costs (See Note 14)		2,240,000	2,240,000
Accrued business acquisition payments (See Note 5)		613,000	
Other		6,988,000	5,416,000
Accrued expenses and other current liabilities	$	38,126,000	41,230,000

The Company provides warranty coverage for most of its products for a period of at least one year from the date of shipment. The Company records a liability for estimated warranty expense based on historical claims, product failure rates and other factors. In the six months ended January 31, 2007, the Company recorded a reduction in its estimated reserve for warranty obligations of $667,000 primarily due to lower than anticipated claims received to date on a large over-the-horizon microwave system contract whose warranty period is nearing expiration. Changes in the Company s product warranty liability during the six months ended January 31, 2007 and 2006 were as follows:

	Six months ended January 31,	
	2007	2006
Balance at beginning of period	$ 10,468,000	7,910,000
Provision for warranty obligations	3,549,000	4,735,000
Reversal of warranty liability	(667,000)	
Charges incurred	(2,786,000)	(1,828,000)
Balance at end of period	$ 10,564,000	10,817,000

(9) *2.0% Convertible Senior Notes*

On January 27, 2004, the Company issued $105,000,000 of its 2.0% convertible senior notes in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from this transaction were $101,179,000 after deducting the initial purchaser s discount and other transaction costs of $3,821,000.

The notes bear interest at an annual rate of 2.0% and, during certain periods, the notes are convertible into shares of the Company s common stock at an initial conversion price of $31.50 per share (a conversion rate of 31.7460 shares per $1,000 original principal amount of notes), subject to adjustment in certain circumstances. The notes may be converted if, during a conversion period on each of at least 20 trading days, the closing sale price of the Company s common stock exceeds 120% of the conversion price in effect. Upon conversion of the notes, in lieu of delivering common stock, the Company may, in its discretion, deliver cash or a combination of cash and common stock. The Company may, at its option, redeem some or all of the notes on or after February 4, 2009. Holders of the notes will have the right to require the Company to repurchase some or all of the outstanding notes on February 1, 2011, February 1, 2014 and February 1, 2019 and upon certain events, including a change in control. If not redeemed by the Company or repaid pursuant to the holders right to require repurchase, the notes mature on February 1, 2024. The notes have substantive conversion features as defined by EITF No. 05-1, Accounting for the Conversion of an Instrument that Becomes Convertible Upon the Issuer s Exercise of a Call Option. Accordingly, the Company will not recognize a gain or loss if it issues common stock upon the conversion and settlement of these notes.

The 2.0% interest is payable in cash, semi-annually, through February 1, 2011. After such date, the 2.0% interest will be accreted into the principal amount of the notes. Also, commencing with the six-month period beginning February 1, 2009, if the average note price for the applicable trading period equals 120% or more of the accreted principal amount of such notes, the Company will pay contingent interest at an annual rate of 0.25%.

The notes are general unsecured obligations of the Company, ranking equally in right of payment with all of its other existing and future unsecured senior indebtedness and senior in right of payment to any of its future subordinated indebtedness. All of Comtech Telecommunications Corp. s (the Parent) wholly-owned subsidiaries have issued full and unconditional guarantees in favor of the holders of the Company s 2.0% convertible senior notes (the Guarantor Subsidiaries), except for the subsidiary that purchased Memotec, Inc. in fiscal 2004 (the Non-Guarantor Subsidiary). These full and unconditional guarantees are joint and several. Other than supporting the operations of its subsidiaries, the Parent has no independent assets or operations and there are currently no significant restrictions on its ability, or the ability of the guarantors, to obtain funds from each other by dividend or loan. Consolidating financial information regarding the Parent, the Guarantor Subsidiaries and the Non-Guarantor Subsidiary can be found in Note 16 to the condensed consolidated financial statements.

The net proceeds of the offering are being used for working capital and general corporate purposes and potentially may be used for future acquisitions of businesses or technologies or repurchases of the Company s common stock. The Company filed a registration statement with the SEC, which has become effective, for the resale of the notes and the shares of common stock issuable upon conversion of the notes.

(10) *Stock Option Plans and Employee Stock Purchase Plan*

The Company has stock option and employee stock purchase plans as follows:

1993 Incentive Stock Option Plan The 1993 Incentive Stock Option Plan, as amended, provided for the granting to key employees and officers of incentive and non-qualified stock options to purchase up to 2,345,625 shares of the Company s common stock at prices generally not less than the fair market value at the date of grant with the exception of anyone who, prior to the grant, owns more than 10% of the voting power, in which case the exercise price cannot be less than 110% of the fair market value. In addition, it provided formula grants to non-employee members of the Company s Board of Directors. The term of the options could be no more than ten years. However, for incentive stock options granted to any employee who, prior to the granting of the option, owns stock representing more than 10% of the voting power, the option term could be no more than five years. As of January 31, 2007, the Company had granted stock options representing the right to purchase an aggregate of 2,016,218 shares (net of 428,441 canceled options) at prices ranging between $0.67 - $5.31 per share, of which 151,962 are outstanding at January 31, 2007. To date, 1,864,256 shares have been exercised. Outstanding awards have been transferred to the 2000 Stock Incentive Plan. The terms applicable to these awards prior to the transfer continue to apply. The plan was terminated by the Company s Board of Directors in December 1999 due to the approval by the shareholders of the 2000 Stock Incentive Plan.

2000 Stock Incentive Plan The 2000 Stock Incentive Plan, as amended, provides for the granting to all employees and consultants of the Company (including prospective employees and consultants) non-qualified stock options, stock appreciation rights, restricted stock, performance shares, performance units and other stock-based awards. In addition, employees of the Company are eligible to be granted incentive stock options. Non-employee directors of the Company are eligible to receive non-discretionary grants of non-qualified stock options subject to certain limitations. The aggregate number of shares of common stock which may be issued may not exceed 5,737,500 plus the shares that were transferred to the Plan relating to outstanding awards that were previously granted, or available for grant, under the 1982 Incentive Stock Option Plan and the 1993 Incentive Stock Option Plan. The Stock Option Committee of the Company s Board of Directors, consistent with the terms of the Plan, will determine the types of awards to be granted, the terms and conditions of each award and the number of shares of common stock to be covered by each award. Grants of incentive and non-qualified stock options may not have a term exceeding ten years or no more than five years in the case of an incentive stock option granted to a stockholder who owns stock representing more than 10% of the voting power. As of January 31, 2007, the Company had granted stock options representing the right to purchase an aggregate of 4,818,760 shares (net of 540,540 canceled options) at prices ranging between $3.13 - $41.51, of which 2,960,645 are outstanding at January 31, 2007. As of January 31, 2007, 1,858,115 stock options have been exercised. All options granted through January 31, 2007 had exercise prices equal to the fair market value of the common stock on the date of grant. All options granted through July 31, 2005 have a term of ten years. All options granted since August 1, 2005 have a term of five years.

The following table summarizes certain stock option activity during the three and six months ended January 31, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at July 31, 2006	2,919,242	$ 15.99	5.9	$ 34,373,000
Granted	645,100	27.00		
Expired/canceled	(138,025)	9.91		
Exercised	(227,235)	9.42		
Outstanding at October 31, 2006	3,199,082	18.94	5.5	$ 53,671,000
Granted	21,500	35.67		
Expired/canceled	(52,925)	27.06		
Exercised	(55,050)	11.45		
Outstanding at January 31, 2007	3,112,607	$ 19.05	5.2	$ 52,834,000
Exercisable at January 31, 2007	1,002,232	$ 13.40	5.7	$ 22,664,000