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# EDITED TRANSCRIPT

ANEN.O^B14 - Q4 2002 Anaren Microwave Earnings Conference Call

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## OVERVIEW:

Anaren Microwave Inc., reported net sales for 4Q02 of \$21.5m, up 37% from 4Q01. Operating income for the quarter was \$361,000. Excluding the results of Anaren Europe, Anaren would have had net 4Q sales of \$18.4m and operating income of \$1.6m. Q&A focus - Celeritek, Anaren Europe, Space and Defense Group, financials, and guidance.



## CORPORATE PARTICIPANTS

### Operator

**Larry Sala** *Anaren Microwave - President and CEO*

**Joe Porcello** *Anaren Microwave - VP of Finance*

## CONFERENCE CALL PARTICIPANTS

### Analyst

**Unknown Speaker**

## PRESENTATION

### Operator

Good day, everyone and welcome to the Anaren fourth quarter earnings release. Today's call is being recorded. At this time for introductions and opening remarks, I would like to turn the call over to Mr. Larry Sala, President and Chief Executive Officer of Anaren Microwave, Incorporated. Please go ahead, sir.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Thank you. Good afternoon, and thank you for participating in the Anaren Microwave, Incorporated, fiscal fourth quarter 2002 conference call. I'm Larry Sala, President and CEO, and I'm joined today by Joe Porcello, Vice President of Finance. First I must provide a brief update relative to Celeritek. I will then provide an overview of the results of the fourth quarter and the June 30, 2002, after which Joe Porcello will give financial highlights. We'll then take your questions.

The statements contained in this conference call which are not historical information are forward-looking statements. These statements involve risks and uncertainties that could cause actual results to differ materially from those discussed. You're encouraged to review Anaren's fourth quarter press release and Anaren's Form 10-K for the fiscal year ended June 30th, 2002 and the exhibits to those reports filed with the Securities and Exchange Commission to learn more about the various risks and uncertainties facing Anaren's business and the potential impact in Anaren's net sales and earnings. Anaren disclaims any intent and obligation to update any forward looking statements.

With respect to Celeritek, we attended Celeritek annual shareholders meeting last Friday, and at our request later met with Celeritek CEO and CFO. The meeting took place at the offices of the Celeritek legal counsel. At the outset of the meeting Mr. Hussein [phonetic] informed us that Celeritek has decided to pursue the standalone strategy. Celeritek's outside counsel subsequently informed us that there were several reasons why Celeritek was rejecting Anaren's request to conduct due diligence.

Yesterday we were informed by Celeritek counsel that Celeritek continues to prefer a standalone strategy but offered Anaren the opportunity to meet with Celeritek's board of directors and if they were willing to enter into a standstill agreement, they would consider allowing Anaren to perform certain due diligence investigations.

Anaren's management continues to believe in the merits of the combination between Celeritek and Anaren and the potential benefits to shareholders, customers, and employees of each company. Due to the disappointing response from Celeritek, Anaren has to consider all of the alternatives available to it and may pursue one or two of the possible actions as outlined in our schedule 13B.

Net sales announced - on to results for the quarter. Net sales for the quarter were \$21.5 million up 37 percent from the fourth quarter last year and up 8 percent sequentially from the third quarter fiscal 2002.



Operating income for the quarter was \$361,000 compared to operating income of \$112,000 for the fourth quarter of last year to \$551,000 to the third quarter of fiscal 2002. Excluding the results of Anaren Europe, formally the [inaudible] company and Amitron which we acquired in fiscal 2002 Anaren would have had a net fourth quarter sales of \$18.4 million and operating income of \$1.6 million.

Net income for the fourth quarter was \$2 million for nine cents per diluted share compared to \$1.2 million or five cents per diluted share of the fourth quarter of last year and \$1 million or four cents per diluted share for the third quarter of 2002.

In the fourth quarter we recognize income tax credits and export tax benefits of \$850,000. Excluding the impact of the income tax benefit, net income for the quarter was \$1.2 million or five cents per diluted share. The revenue growth in the fourth quarter was driven by wireless group. Wireless group net sales for the quarter were \$15 million, up 12 percent sequentially from the third quarter. Eliminating the impact of the acquisitions of Anaren Europe and Amitron wireless group net sales increased 10 percent sequentially from the third quarter.

The growth and wireless group net sales was a result of increased market share of components at several leading infrastructure manufacturers and improved sales at our Europe Anaren subsidiary. Anaren Europe is currently producing prototypes for qualifications by four leading wireless infrastructure manufacturers, demonstrating the successful integration of Anaren Europe technology into our global sales force.

Wireless group customer concentration for the quarter as a percentage of wireless group net sales was PowerWave to 21 percent, Ericsson at 18 percent, Motorola at 8 percent, and Nortel at 5 percent. During the quarter we continued to make excellent progress on our new product initiative development and we continue to develop products that will increase our contact in wireless infrastructure applications as well as 802.11 wireless networking and access point and client application.

During the quarter we sampled products through [inaudible] manufacturers for 802.11 application. We believe our price and performance is very competitive with alternative products and technologies. We anticipate introducing more than ten new component products before the end of the calendar year.

For the space and defense group net sales for the fourth quarter were \$6.5 million down 1 percent or from net sales of \$6.6 million for the fourth quarter of last year. Space and defense group new orders for the quarter were \$4.9 million including an order for antenna distribution networks, a military satellite program. The initial order is for just over \$1 million for the development phase in this program. The total opportunity on this program for Anaren over the next four years is in excess of \$10 million. This is the first significant military satellite win for the company, greatly expanding the addressable markets for our space technology. Space and defense backlog at June 30th, 2002, was approximately \$33.5 million.

During the quarter we also continued to establishing our operating presence in China. Our facility is now complete and we anticipate initiating production there during the second quarter of fiscal 2003. Joe Porcello will now review the financial highlights.

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#### **Joe Porcello - Anaren Microwave - VP of Finance**

The financial highlights of the fourth quarter income statement and balance sheet of June 30, 2002 are as follows. Gross profit margin for the fourth quarter, fiscal 2002, was 29 percent. This was a 3.1 percentage point decrease from gross margins of 31.2 percent in the third quarter of fiscal 2002 and a 7.5 percentage point decrease in gross margins of 36.5 percent in the fourth quarter of fiscal 2001.

The declining gross margins in the third to fourth quarter of fiscal 2002 resulted from a change of shipment product mix. The fourth quarter mix included large volumes of lower margin Ferrites products compared to the third quarter. Excluding the Anaren Europe and Amitron acquisitions, gross margins were 35.6 percent for the fourth quarter of 2002 compared to 39.2 percent in the third quarter and margins of 36.5 percent in fourth quarter of last year.

Investment and research and development as a percent of net sales was 8.2 percent in the fourth quarter of 2002 compared to 8.9 percent of revenue in the third quarter of fiscal 2002 and 8.7 percent of the fourth quarter last year. Research and development expenditures have risen [inaudible] over the past year due to a reemphasis by the company on developing new standard component products for the wireless market. This

effort has culminated in a number of new circuit product introductions over the past six months. We anticipate R and D spending will continue at this higher rate over the next fiscal year as we continue our new product development effort.

Income from operations was 1.7 percent of revenue in the fourth quarter compared to 2.8 percent of revenue in the third quarter of fiscal 2002 and 7 cents percent of revenue in the fourth quarter of fiscal 2001.

Operating margins declined over the third quarter due to the change in sales mix in the fourth quarter with the higher shipment levels from the lower margin Ferrites products. We presently did not expect a significant improvement in operating income over 2002 levels without additional increase in sales volumes and the returns to normal production levels at our Anaren Europe subsidiary.

Income before taxes for extraordinary item was 5.7 percent of revenue for the fourth quarter. This compares with the loss before taxes for extraordinary item of 6.4 percent of revenue in the third quarter of fiscal 2002 and income before taxes of 11 percent of revenue for the fourth quarter of 2001. The improvement over third quarter was attributable to an increase in other income Anaren Europe resulting from the extinguishment of the long term capitalized lease liability due to the fire loss. This amounted to approximately \$200,000.

During the fourth quarter of 2002 the company finalized an analysis of certain available research credits and export tax benefits. As a result of this analysis the company received expected research credit covering the last two fiscal years and export tax benefits relating to 2002 foreign sales activities of \$850,000 or four cents per share diluted in the fourth quarter.

Prior to recognizing the tax benefits, the tax expense for the quarter was \$70,000, three-tenths of a percent of net sales and an effective tax rate of 5.7 percent. This compares to tax expense of \$542,000 or 3.4 percent of net sales for the fourth quarter of the prior year.

Going forward, the company's effective tax rate will be impacted by the local tax credit, nontaxable interest income, export tax benefits, and income loss generated by the company's foreign subsidiary. Based on anticipated results for fiscal 2003, we expect the company to effect a tax rate between 23 and 25 percent.

In connection with purchase of Anaren Europe in October 2001, we reported a \$3.4 billion extraordinary gain in the second quarter of fiscal 2002 to recognize the negative goodwill resulting from the transaction. During the fourth quarter Anaren Europe had an operating loss of approximately \$1 million, the same as the third quarter's operating loss and an improvement over the second quarter operating loss of \$2.4 million.

Net income as a percent of revenue was 9.4 percent for the fourth quarter including 4 percent attributable to the fourth quarter tax credit and benefits. This compares to 7.6 percent for the fourth quarter of fiscal 2001 and 5 percent for the third quarter of fiscal 2002.

Diluted earnings per share for the fourth quarter of fiscal 2002 were nine cents including four cents for the tax credit invested. This compares to five cents per dilute share in the fourth quarter [inaudible] year and four cents per diluted share in the third quarter of fiscal 2002.

Cash, cash equivalents and investments were \$125 million June 30th, 2002, down 7.2 million from June 30, 2001 due mainly to \$12.1 million of cash being used to purchase Amitron and Anaren Europe in the first half of fiscal 2002. Cash generated by operations was approximately \$17 million in fiscal 2002.

The company also had a stock buyback authorization which authorizes the repurchase of up to approximately 2 million shares of the company's outstanding stock. The company intends to repurchase shares from time to time by means of open market purchases and privately negotiated transactions at prevailing market prices. The number of shares purchased, if any, will be dependent upon market conditions. No shares were repurchased under this authorization during the fourth quarter of 2002.

Accounts receivable were \$13.1 million at June 30th, 2002, including \$2 million at Amitron and Anaren Europe, up \$1.6 million from June 30, 2001. The accounts receivable levels without Amitron and Anaren Europe fell approximately 3.3 percent during the year. Day of sales outstanding at June 30, 2002 were 56 days compared to 67 days at June 30th, 2001. We continue to expect day sales outstanding to fluctuate between 55 and 75 days as we go forward, depending on current sales level, customer mix and business conditions.

Inventories at June 30th, 2002, were \$20.1 million compared to \$18.6 million June 30th, 2001. The inventory increase was due to the addition of Amitron and Anaren Europe at approximately \$2.1 million in inventory together at June 30th, 2002. Inventory levels without the acquisitions declined approximately 3.2 percent during fiscal 2002.

Capital equipment placed in surface in fiscal 2002 amounted to approximately 9.7 million. \$5.8 million of these additions represented new equipment purchased by Anaren Europe between October 2001 and June 2002 to replace the fixed assets that were destroyed in the July fire. The remaining additions were for the Ferrites production in our [inaudible] facility, automated production equipment for our for our power [phonetic] subsidiary, and new multilayer ceramic manufacturing equipment at Amitron. The accounts payable June 30th, 2002 were \$5 million up \$2 million from June 30th, 2001. The acquisition of Amitron and Anaren Europe amounted to \$1.4 million in the increase of June 30, 2002 and the remaining \$600,000 rise resulted from the current prices and higher business level.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Thanks, Joe. I'd just like to make a quick correction that Joe referenced to the purchase of Anaren Europe and the extraordinary gain which we recorded was \$3.4 million not \$3.4 billion, obviously. As in previous quarters, visibility from our wireless customers remains very limited. Given the current level of market visibility of projecting net sales to be in the range of \$19 to \$21 million and diluted earnings per share to be in the range of two to four cents for the first quarter of fiscal 2003. We will now take questions. 00:31:26

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## QUESTIONS AND ANSWERS

### Operator

Thank you. Today's electronic question and answer session will be held electronically. If you would like to ask a question, please press the star key followed by the digit one on your touch tone phone. Once again, please press the star key followed by the one to ask a question. We'll take our first question today from Mr. Mark McKechnie.

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### Analyst

Thanks, good afternoon, Joe and Larry.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Good day.

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### Analyst

3 billion, huh? The 802.11 products, can you tell us a bit more on those, first what they are and then also when you expect to start seeing some revenue there?

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

Yeah, I guess at the current time we're trying to assess a little bit the functionality of the product over the supply, but I think suffice it to say it's a relatively simple function [inaudible] product of our supplying to the front end of 802.11 applications and sell for price points probably below 25 cents and offer sensitivity improvement over current technology approaches.



As far as time frame for generating revenue, that's a difficult one for the forecast. We would expect, you know, historically when we introduce a product to our customers there's a design in time, there's a reproduction time and then there's a launch and we start seeing revenues and that's historically been nine to twelve months. This is a newer market for us. We believe has potential to move a little more rapidly, but we have no history to be able to give you an absolute time frame.

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**Analyst**

Okay. Thanks on that. The second question is on, then, [inaudible] take a little hit there and I guess I understand what's happening there with 5M, but can you - and I guess that was also from a higher mix of Ferrites.

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

Higher mix of Ferrites.

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**Analyst**

How was - is your strategy similar in defense and wireless or -

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**Larry Sala** - *Anaren Microwave - President and CEO*

Actually the market base in defense right now are as good as the normal wireless margins here, yes.

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**Analyst**

So they're a bit higher. So what dragged you down was the 5M cost and just to refresh, when do you stop seeing the impact from 5M? When, you know, is that something that runs out two years from now or something?

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**Larry Sala** - *Anaren Microwave - President and CEO*

Well, it's just dependent upon our ability to generate incremental business at our wireless infrastructure customers. We reported that we are prototyping now for the four leading infrastructure manufacturers. Any one of those opportunities would be appreciable revenue stream relative to 5M or enter into Europe, current revenue rate.

We're also moving some of our internal productions to Anaren Europe from external sources that we currently use which will help some. From the time line standpoint we're hoping that we have some mitigation of the losses at Anaren Europe by the first of the calendar year. We do not expect to see, you know, significant impact from the new business development activities until the later part of the fiscal year.

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**Analyst**

Okay. And one final question, then I'll hop. You mentioned visibility, still kind of spotty a bit, six to eight weeks or so back booking?



**Larry Sala** - *Anaren Microwave - President and CEO*

Our booking hasn't changed appreciably, but the volatility has probably increased some over the past two months to three months. We still have yet to see standards in time from our customers. We haven't seen people greatly moving out or shortly in the meantime, but the volatility and predictability over the last couple of months has increased.

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**Analyst**

Now, you still getting normal forecasts for December or are you getting forecasting that far out yet?

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**Larry Sala** - *Anaren Microwave - President and CEO*

We're not really seeing demand that far out. We only see [inaudible] forecast out in the next, you know, few weeks or so.

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**Analyst**

Got you. And then I've looked at your guidance for next quarter, but on the south line, kind of flat, you know, plus or minus a bit. Is that going to bring in some incremental market share gains as well?

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

We're fairly confident that we continue to at least maintain or gain market share and expand our customers institution a bit. Always one of the more challenging quarters for us, [inaudible] quarter, quarter in which [inaudible], and, you know, we continue to see relatively steady customer concentration the last quarter. We haven't seen any big change in our customer base and don't anticipate any significant change in our customer distribution, but same in general trying to be a bit softer this quarter than last.

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**Analyst**

Great. Thanks. Okay. Great.

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**Operator**

Thank you. Our next question we'll go to Rich Valera with Needham and Company.

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**Analyst**

Good afternoon, Joe and Larry. Larry, on the Celeritek, can you describe what the standstill agreement consists of and do you plan to sign that? And then go forward with the due diligence that they've offered you at this point.

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**Larry Sala** - *Anaren Microwave - President and CEO*

You know, I have limited ability to comment. I would say first, there were really no terms provided yet for any standstill agreement, just a general concept. Really can't comment at all on any specifics to what that agreement might entail. This is all fairly recent news to us and so we - I can't comment on any decisions that have been made yet on the way we'll go forward.



I guess our concern is that we feel we're getting somewhat of significantly conflicting messages where management has been very clear in their position of maintaining a standstill, standalone strategy while counsel has offered us some other options. Our concern is, again, continuing to drag out time and not make appreciable progress here. So we'll continue to evaluate it and we'll continue to disclose decisions as we make them.

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**Analyst**

Okay. And on the - it looks like combined 5M and Amitron were around \$3 million. Can you give us the split of how that broke out?

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

Amitron is about \$1.8 million of that split.

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**Analyst**

Okay. So can you feel - you saw a little pickup in Amitron from one of the medical customers that you're expecting to come back, or do you expect more of a contribution from them at some point?

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

Fairly consistent out of Amitron. They have broader market diversity than the rest of our business with more like 50 percent of the business being medical applications and those few customers and the rest of the business pretty easily split between wireless and defense applications, so they're fairly steady and we'd expect that to continue as far as we can see.

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**Analyst**

Going forward. But their break even is around \$3 million per quarter, so they're sort of running it, you know, a little more than half break even or is it better than that?

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

No, we believe their break even is - it's more like the two, six range.

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**Analyst**

Okay. And you mentioned a little bit about the product that you're developing at 5M. Can you give under the circumstances any idea on the either the applications or the sort of dollar content implications of these new products for each either a PA or base station, depending where they go.

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**Larry Sala** - *Anaren Microwave - President and CEO*

On 5M we're basically seizing currently one of the high power amplifier circuit board opportunities. BWB which our transistors would fit within a power amplifier. 5M has what we believe are some unique technology to metal back microwave circuit boards providing better thermal performance and cost and competing technology.



We typically, I would say, see opportunities in the range of, say, \$30 to maybe \$75 dollars of content per PA is a typical range of opportunities we see. So if you look at standard production raises, it's a fairly high dollar content opportunity for us relative to entering Europe's current revenue rate.

So given typical amplifier run rates are thousands to tens of thousands, the dollar opportunity there with any one win, with any one customers is fairly appreciable and oftentimes - let me qualify that. Our customer are multiple source, and at least two sources is very common. So we are very, I guess, positive in the results to date of willingness of customers to give us an opportunity to get qualified. It leads us to believe we're price competitive with our initial quotations. That's definitely an opportunity for us to participate and gain share in this market. We believe it's going to be another two quarters before we can say we're getting program win as a result of the activity today, so I would say so far relatively we're - it's coming along.

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**Analyst**

One final question sort of leads into what you were saying. Assuming market demand levels remain where they were for the next several quarters, let's say out through the end of your June fiscal year, your June '03 fiscal year, when do you start seeing growth from some of the new product, any activities that you have going on that are above and beyond that are just core run rate business?

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**Larry Sala** - *Anaren Microwave - President and CEO*

We're hoping, you know, with the introduction of products that we made last February, our normal expectations would be seeing an impact from those in the second half of this current fiscal year. And as well, as hopefully some improvement in revenue rate entering Europe of the second half of this fiscal year. So we still are fairly confident that the design ends that we've been working on and the qualification and work that we're doing now, some of those products it's really in the second half of this current fiscal 2003 that we would expect to start seeing results from those products introductions and that business development activity.

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**Analyst**

Great. Thank you, guys.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Yes.

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**Operator**

Thank you, and our next question from call from Dale Pfau with CIBC world markets.

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**Analyst**

Good afternoon.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Hey Dale.



**Joe Porcello** - Anaren Microwave - VP of Finance

Hey Dale.

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**Analyst**

Could you tell us how you're doing with the drill line products? Also I wonder how you're doing with your new products, the isolator, Xinger product [inaudible].

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**Larry Sala** - Anaren Microwave - President and CEO

From a generalized standpoint we continue to capture new design waves, and in fact we currently are moving into final phase of prototyping and initial production on a couple of new adrenaLine design waves. From a revenue standpoint, though, we did see a drop off sequentially from the prior quarter or from prior run rates we're expecting to see it drop off due to some of a slow down in the 3G activity that we've seen for the last couple of quarters. We saw this past quarter and the prior, [inaudible] products given by 3G and we expect to see that decline for the next couple of quarters.

But seeing some new design wins so from an acceptance of the product and the marketplace and design activity, we think it continues to be a strong contending product for us.

In terms of the Xinger circulator with the initial product we introduced we continue to see some design in activity. We're trying to introduce over the course of the next couple of months 8 and 900 megahertz versions of that product to have a complete product offering to cover all frequency band. We're also trying to introduce a product that's to cover lower power, lower cost application. So we expect to continue to progress there.

As far as actual contributions, current revenues, we're not really seeing any measurable contribution to our current revenues from our Xinger products. We still think that's probably a quarter or two away, Dale, before we could really get specific about dollars being generated by a product line.

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**Analyst**

And then, Joe, if you said it I missed it in my handwriting, the percentage of revenue that was directly contributable to defense?

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**Joe Porcello** - Anaren Microwave - VP of Finance

To defense?

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**Larry Sala** - Anaren Microwave - President and CEO

Space, Dale, or -

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**Analyst**

Just defense. It could be the space satellite for the defense department, that's fine, but not commercial space.



**Larry Sala** - *Anaren Microwave - President and CEO*

It was about a 50/50 split, Dale, last quarter between commercial and space. Defense about 3 1/2 of the 6 1/2 million. We really didn't have any defense based contribution. The space work that we did was commercial last quarter. So about 3 million commercial space, about 3 1/2 defense.

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**Analyst**

And then just a little bit on trends out there, the fact that you're holding guidance kind of flat in a tough quarter and the quarter came in okay. Are you seeing - and of course you talked about your customers not giving you a whole lot of visibility. Are you seeing some customers move up, others move down? Are you seeing any significant shifts out there? Because it is kind of interesting that we're seeing most of the infrastructure guys under some pressure of one form or another.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Yeah, as I said, I think to a prior question, we haven't seen a dramatic shift, you know, over the last couple of quarters. Obviously over the last year we've seen appreciable drop off in our business at Motorola. We've gone from it being a 40 percent customer of our wireless at its peak to being more like a 10 percent customer the last couple of quarters. That all seems to be continuing. We haven't seen a big shift in demand or anyone picking up or losing share.

So, you know, it's just a general across the board forecast, seems to be softening here. As I said, for us, you know, you have it with your [phonetic] businesses, it's cyclical, but this is always one of the more challenging quarters for us.

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**Analyst**

Are there bright spots out there, are you picking up shares of power amplifier guys and are they holding on? What - if you had to, say, where are things looking the best, where do you feel best?

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**Larry Sala** - *Anaren Microwave - President and CEO*

I guess some of the areas we feel best is the interest and acceptance of some of the new products that we introduced. We are continuing, we think, to pick up market shares, some of our complement products and mainly amplifier applications, and we are still seeing some customer assembly opportunities that are appreciable, with OEMs that we have not traditionally done a lot of custom business with.

So it's not as though - we're not seeing development activity from an engineering standpoint, we're actually still very heavily loaded in both new components development activity and custom assembly, be it backplanes, standard custom and combining components or AdrenaLine products. In all of those areas we have, you know, what we think are credible, appreciable, opportunities that we're applying resources to. So from the engineering activity side we're quite positive, but we're, you know, continue to be concerned that we'll see production follow through in these opportunities.

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**Analyst**

And one final question. That sort of relates to the some Celeritek issue. You've been primarily a passive company and always had an interest to move in the active direction. Is that a definitive direction or will you do specific applications on the passive side to round out your product family, and how aggressive do you expect to be on bringing active devices into the fold?

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**Larry Sala** - *Anaren Microwave - President and CEO*

Well, I guess we've increased our activity on the partnering side and we'll be introducing over the next couple of quarters more that into our product line and doing that initially here through partnerships and moving products developed by ours. As we continue to pursue market opportunities and assess our ability to gain market share in this partnership type of arrangement, that will really be the bigger driver in our decision to either get more or less aggressive in trying to actually make acquisitions and control the active technology ourselves.

But to date, we feel quite frankly that there is great benefit to combining our passive capability with an active technology. So we're continuing down both paths and trying to move forward as diligently and as credibly as we can.

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**Analyst**

Great. Thanks, guys.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Thanks.

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**Operator**

Thank you. Once again, if you would like to ask a question, please press star one on your touch tone phone now. Our next question we'll go to Arindam Basu with Morgan Stanley.

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**Analyst**

How are you?

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**Larry Sala** - *Anaren Microwave - President and CEO*

Great.

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**Analyst**

Larry, you were commenting on some custom apps that the OEMs are able to garner some interest and acceptance. So is this what's referred to in the - when you talk about the initial qualification as wireless OEMs out of 5M?

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**Larry Sala** - *Anaren Microwave - President and CEO*

No, I'm talking totally separate from 5M entering Europe. We're now calling it [inaudible]. That's a separate entity. It's solely focused around color amplifier, microwave, printed circuit assemblies, so that's an entity unto itself and something new for us and unique to 5M. So that's separate and that's what we're referring to in that press release.

It was more responding to sales, specifically about generally where we see other bright spots and in that regard referring to our traditional capabilities and custom assemblies like backplanes, like custom splitting and combining components that we sell and AdrenaLine products which are often customized for our customers.

And in all of those products as well we're seeing a relatively reasonable amount of demand and design activity that we're trying to service, and each one of those opportunities are, you know, appreciable opportunities on the surface. You know, our customers always come to us with relatively significant demand forecasts and so, you know, our concern, though, is whether the production quantities will actually follow, but from an engineering demand standpoint we're seeing a pretty positive outlook right now.

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**Analyst**

Okay. And then out of Anaren Europe, the prototypes that were described, you said they were from amplifier and microwave assemblies. Can you give us some idea of platforms or technology?

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**Larry Sala - Anaren Microwave - President and CEO**

It's pretty much across the board. I said that it's the product line that in any given application typically are looking at \$30 to \$75 of content in a power amplifier and it's really not for us an issue of any particular technology. I would say the one inherent difference in the selling process at Anaren Europe and that product line versus anything else that we sell is there is a much higher opportunity to get design into an existing opportunity as Anaren Europe and that technology as there is with any of our other products.

So somebody asked if we were actively pursuing our additional sorts in an ongoing production opportunity and others are new development that have to go through their development cycle before they reach some production stage. So there's some more earlier opportunities to get production going with Anaren Europe's product line because they can be designed into current production opportunities.

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**Analyst**

Okay. And then you talked about the 802.11 a bit before. Obviously with this market you're reluctant to talk about contribution in fiscal '03, but can you give us a sense in your long term planning even if you want to get near fiscal '04 what your gut feel is on revenue contributions from 802.11 amps from longer term.

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**Larry Sala - Anaren Microwave - President and CEO**

You know, I don't think we're really prepared to give that guidance right now. I think by next quarter we'll be in a better position to start to articulate exactly what we think our contribution can be from that market. By next quarter we'll hopefully have publicly introduced a few specific products which will allow us to talk about the price point and potential volumes on that we see. We're just not ready to be able to articulate right now.

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**Analyst**

Okay. And you commented your sample the [inaudible] manufacturers and you're going to have ten new components before the end of the year. Are each of the manufacturers looking at multiple products? Are those more custom kind of configuration based on the way the system is laid out? Probably just to clarify, when I say ten products I'm speaking to ten products for wireless applications, be it wireless infrastructure or other Xinger products for base stations and amplifier applications as well as several products for 802.11 applications.

So I'm talking about ten products across the wireless markets that we're trying to address. But for the 802.11 application, we're talking about a family of, you know, maybe three to six products currently to provide the features and performance aspects of different customers are looking for, so we're hoping to have a reasonable level of standardization in our product line, but there are some variations that we're providing to better serve the given, you know, features of certain chips that manufacturers over another.

So it's more of a Xinger type of product, I guess, in general, that we try to standardize. We try to standardize footprints and performance as much as we can so that we can produce in volume standard products.

**Analyst**

Okay. And then last question, on the space and defense side your operating margins and space and defense have GAAPed up steady each of the last four quarters. I want to get a sense for that in the June quarter and also talk about the new contract that a fixed cost or excuse me, fixed price account where you'd be able to go in with the lower cost structure and garner the types of operating margin they have been able to generate in that business over the last several quarters.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Joe can talk to the historical margin of the quarter. Just from the specific contract, I'll take that piece of it. Everything we do is a six-part contract, and this one is as well. We have bid and won to date the development portion of this fixed price account contract and if we're successful there, we're given an opportunity to bid on production by - on this contract which I said will bring a total opportunity to us of \$10 million.

We try across our business to achieve the - historically what we believe is our business model, 40 percent gross margin, 20 percent operating margin. This is a government contract. We're audited. We often struggle to get that 20 percent kind of operating margin from the government but we'll, you know, try our best to get a reasonable margin and the difficult part is more actually executing to the margin that we negotiate but this is no different than any other military job that we would pursue.

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

Historically over the last couple of years we've had a lot of commercial business running through the space and defense group over there. We've been able to obtain some very good margins and we've also slimmed the group down quite a bit. The volume of business is we're enjoying a little deficiency. We haven't had to buy a lot of equipment in that area and we've been fortunate that we've been able to execute contracts. Going forward, as Larry said, some of these will be newer business, so maybe we'll see a little fall-off in margins there, but we still have a very highly productive group of people back there right now.

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**Larry Sala** - *Anaren Microwave - President and CEO*

And we expect the revenue rate in that group to sustain or grow somewhat this year over last. See, we're hoping to do that as efficiently as we can, trying to control our cost get a little more revenue.

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**Analyst**

Thanks very much, guys. Appreciate it.

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**Operator**

Thanks. Our next question will come from Mike Walke [phonetic] with RBC Capital Markets.

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**Analyst**

This is Cliff Maldinado [phonetic] for Mike Walke [phonetic]. I just wanted to get an update on the China progress, see if you're going to initiate function for this quarter.

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**Larry Sala** - Anaren Microwave - President and CEO

We're expecting to indicate production late this quarter. We hope to be in full-scale production by next quarter, everything is moving along to pace. Our general manager has been in place since the first of July. We have made several hires. We have our sales manager in place over there. And we're starting to move equipment, production equipment over there as well.

So there's two what we feel are significant opportunities for us. One is the source some material from suppliers in China and in Asia in general. We initiated that activity which we believe will help mitigate some of the costs that we've been incurring over the last couple of quarters and then to initiate manufacturing there. We still plan to have both these activities going by the end of this quarter and by the end of the year, to be calendar year here, to have, you know, a significant production activity ongoing there.

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**Analyst**

Great. And then will it be possible to get the split of the wireless component business versus the higher level backplane percent?

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**Larry Sala** - Anaren Microwave - President and CEO

Yeah, typically, you know, have seen about a 50/50 split between our component activities and custom assemblies. And just to clarify, we would call custom assemblies more than just backplanes. Backplanes have typically done been of the big drivers, but a lot of our AdrenaLine product falls into our custom assembly business, and we have what we call splitting the combining components in our custom - in our custom business. So traditionally it's been more like 50/50. Over the last couple of quarters, it's trended to be more like 70 percent component - 60 percent component activity, 40 custom activity would be accurate.

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**Analyst**

Okay. Great. And then did I mishear the customer mix? Did Lucent drop off and Nortel sequentially come on?

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**Larry Sala** - Anaren Microwave - President and CEO

Yes, that's correct. Nortel was 5 percent of sales. The real reason behind Lucent dropping off, we have this quarter now we disclosed what was Celion [phonetic] as another customer for us now which would have been combined as Lucent in prior quarters for us. So we may have been a little late in making that change.

But if we had combined the two together, Lucent would still be about the same size customer as they've been historically. I think they've typically been about an 8 percent, maybe sometimes 10 percent customer. Lucent by themselves is only about half of that or less typically so they're a 3 to 5 percent customer on their own.

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**Analyst**

I see.

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**Larry Sala** - Anaren Microwave - President and CEO

So they've dropped off and I would expect over the next couple of quarters we'll start reporting Andrew now that we're starting Soller [phonetic] as part of Andrew. No big change in our business. Just the fact that they have sold off that group.



**Analyst**

All right. Okay. That's it for me. Thanks.

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**Larry Sala** - *Anaren Microwave - President and CEO*

Thank you.

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**Operator**

Thank you. And as a final reminder, if you'd like to ask a question, please press star one on your phone now. We'll take our next follow-up question from Mark McKechnie.

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**Analyst**

Hi, Joe. On the tax rate, you said what, 23 to 25 percent for September. Is that going to continue for the whole fiscal year of '03?

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

If the fiscal year falls out as we expect right now, yes.

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**Analyst**

Got you. I mean, if is that a reasonable assumption, you know, for long term fully tax rate or -

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**Joe Porcello** - *Anaren Microwave - VP of Finance*

We've got in terms of research credits, housing, look at the foreign subsidiaries. There's going to be a lot of things. Obviously we have the Chinese subsidiary now. We get a tax holiday over there so we start making some money. Then we get a further tax holiday for I believe about three years once we do start making money where we won't have to pay taxes. So I think the rate we're going to have to take a look at it may be every six months and let you know.

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**Analyst**

Okay. That's fair. And then this China facility, are you seeing expenses from that already or should we -

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**Larry Sala** - *Anaren Microwave - President and CEO*

Yeah, we've had expenses from China since probably the middle of the fourth quarter. We've had our general manager in place over there since July 1. He's been onboard here since maybe the beginning of May. So I think we're going to ramp up employees now. We have three or four at this point over there. We should have probably another six to ten by the end of the first quarter and then maybe production will depend on how we move production over there.

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**Analyst**

Got you. Okay. And the timing of that production, again, you said was -

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**Larry Sala** - Anaren Microwave - President and CEO

We're hoping, like I said, to initiate production in the later part of this quarter and be volume production there by the middle of the second quarter.

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**Analyst**

Of the second quarter. Okay. And your gross margins guidance and the like you're already seeing expenses so you wouldn't expect to see another down tick there in margins.

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**Larry Sala** - Anaren Microwave - President and CEO

No.

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**Joe Porcello** - Anaren Microwave - VP of Finance

No, I don't think so.

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**Analyst**

Thanks, gents.

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**Operator**

And there appear to be no further questions. Mr. Sala, I'll turn it back over to you for any closing comments.

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**Larry Sala** - Anaren Microwave - President and CEO

Thank you very much for your participation, and we look forward to speaking with you again next quarter.

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**Operator**

Thank you. And that does concluded today's conference. We appreciate your participation.

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