

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF PENNSYLVANIA

KEVIN MONTOYA, Individually and on
Behalf of All Others Similarly Situated,

Plaintiff,

vs.

HERLEY INDUSTRIES, INC., LEE N.
BLATT, MYRON LEVY, ANELLO C.
GAREFINO, JOHN M. KELLEY and
THOMAS V. GILBOY,

Defendants.

) Civ. Action No.

)
) CLASS ACTION COMPLAINT FOR
) VIOLATIONS OF FEDERAL SECURITIES
) LAWS

) DEMAND FOR JURY TRIAL

Plaintiff has alleged the following based upon the investigation of plaintiff's counsel, which included a review of United States Securities and Exchange Commission ("SEC") filings by Herley Industries, Inc. ("Herley" or the "Company"), as well as regulatory filings and reports, securities analysts' reports and advisories about the Company, press releases and other public statements issued by the Company, and media reports about the Company, and plaintiff believes that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

NATURE OF THE ACTION

1. This is a federal class action on behalf of purchasers of the publicly traded securities of Herley between October 1, 2001 to June 14, 2006, inclusive (the "Class Period"), seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act").

JURISDICTION AND VENUE

2. The claims asserted herein arise under and pursuant §§10(b) and 20(a) of the Exchange Act [15 U.S.C. §§78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. §240.10b-5].

3. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §1331 and §27 of the Exchange Act.

4. Venue is proper in this District pursuant to §27 of the Exchange Act and 28 U.S.C. §1391(b). Many of the acts charged herein, including the preparation and dissemination of materially false and misleading information, occurred in substantial part in this District.

5. In connection with the acts alleged in this complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

PARTIES

6. Plaintiff Kevin Montoya, as set forth in the accompanying certification and incorporated by reference herein, purchased the publicly traded securities of Herley at artificially inflated prices during the Class Period and has been damaged thereby.

7. Defendant Herley is incorporated in Delaware and maintains its headquarters at 101 North Pointe Boulevard, Lancaster, PA 17601. The Company engages in the research, engineering, development, and manufacture of microwave radio frequency, and millimeter wave components and subsystems for defense and commercial customers worldwide.

8. (a) Defendant Lee N. Blatt (“Blatt”) was, at all relevant times, Chairman of Herley’s Board of Directors and the Company’s Co-Founder.

(b) Defendant Myron Levy (“Levy”) is, and was at all relevant times, Herley’s Chief Executive Officer (“CEO”).

(c) Defendant Anello C. Garefino (“Garefino”) is, and was at all relevant times, Herley’s Chief Financial Officer and Vice President of Finance.

(d) John M. Kelley (“Kelley”) has been a senior officer of Herley since 2000 and has been the Company’s President since August 2003.

(e) Thomas V. Gilboy (“Gilboy”) was Herley’s Vice President and Chief Financial Officer from September 2004 to September 2005.

(f) Defendants Blatt, Levy, Garefino, Kelley and Gilboy are referred to herein as the “Individual Defendants.”

9. During the Class Period, the Individual Defendants, as senior executive officers and/or directors of Herley, were privy to confidential and proprietary information concerning Herley, its operations, finances, financial condition and present and future business prospects. The Individual Defendants also had access to material adverse non-public information concerning

Herley, as discussed in detail below. Because of their positions with Herley, the Individual Defendants had access to non-public information about its business, finances, products, markets and present and future business prospects via access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and/or board of directors meetings and committees thereof and via reports and other information provided to them in connection therewith. Because of their possession of such information, the Individual Defendants knew or recklessly disregarded that the adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

10. The Individual Defendants are liable as direct participants in the wrongs complained of herein. In addition, the Individual Defendants, by reason of their status as senior executive officers and/or directors, were “controlling persons” within the meaning of §20(a) of the Exchange Act and had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of Herley’s business.

11. The Individual Defendants, because of their positions with the Company, controlled and/or possessed the authority to control the contents of its reports, press releases and presentations to securities analysts and through them, to the investing public. The Individual Defendants were provided with copies of the Company’s reports and press releases alleged herein to be misleading, prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Thus, the Individual Defendants had the opportunity to commit the fraudulent acts alleged herein.

12. As senior executive officers and/or directors and as controlling persons of a publicly traded company whose common stock was, and is, registered with the SEC pursuant to the Exchange Act, and was, and is, traded on the NASDAQ National Market (“NASDAQ”) and governed by the

federal securities laws, the Individual Defendants had a duty to disseminate promptly accurate and truthful information with respect to Herley's financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings and present and future business prospects, to correct any previously issued statements that had become materially misleading or untrue, so that the market price of Herley's securities would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

13. The Individual Defendants are liable as participants in a fraudulent scheme and course of conduct that operated as a fraud or deceit on purchasers of Herley's publicly traded securities by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Herley's business, operations and management and the intrinsic value of Herley's securities; (ii) enabled the Individual Defendants to sell 273,939 shares of their personally-held Herley stock for gross proceeds in excess of \$4.7 million; (iii) enabled the Company to complete a public offering of its common stock whereby the Company reaped approximately \$69 million in gross proceeds; and (iv) caused plaintiff and members of the Class to purchase Herley's publicly traded securities at artificially inflated prices.

PLAINTIFF'S CLASS ACTION ALLEGATIONS

14. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a class consisting of all those who purchased the publicly-traded securities of Herley between October 1, 2001 to June 14, 2006, inclusive, and who were damaged thereby (the "Class"). Excluded from the Class are defendants, the officers and directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

15. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Herley's stock was actively traded on the NASDAQ. While the exact number of Class members is unknown to plaintiff at this time and can only be ascertained through appropriate discovery, plaintiff believes that there are hundreds or thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Herley or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

16. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law complained of herein.

17. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

18. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the business and operations of Herley;

(c) whether the prices of Herley's publicly traded securities were artificially inflated during the Class Period; and

(d) to what extent the members of the Class have sustained damages and the proper measure of damages.

19. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

SUBSTANTIVE ALLEGATIONS

20. Defendant Herley describes itself as a “leader in the design, development and manufacture of microwave technology solutions for the defense, aerospace and medical industries worldwide.”

21. Herley’s primary customers include: (i) the U.S. Government (including the Department of Defense, NASA and other U.S. Government agencies); (ii) large defense prime contractors (including Northrop Grumman, Lockheed Martin, Raytheon and Boeing); and (iii) international customers (including the Egyptian, German, Japanese and South Korean militaries and suppliers to international militaries). Importantly, the U.S. Government represents approximately 25% of the Company’s revenues.

22. Despite the Company’s strong dependence on revenue from contracts with the U.S. Government, since at least the start of the Class Period, the Company and defendant Blatt engaged in a course of conduct to defraud the U.S. Government. Specifically, the Company and defendant Blatt fabricated manufacturing costs on three contracts with the U.S. Department of Defense in order to reap excessive profits: one contract was for the sale of voltage controlled oscillators which was completed in January 2001 and the other two contracts involved the sale of powerheads to the U.S. Government which were completed in April 2002 and October 2002, respectively. Moreover, the Company and defendant Blatt also submitted a phony “high” bid for a U.S. Government contract so

that the U.S. Government would be led to believe that the “lower” bid submitted by Herley was the cheapest.

23. On June 6, 2006, the Company announced that the U.S. Attorney’s office for the Eastern District in Pennsylvania had indicted the Company and Defendant Blatt on multiple charges in connection with activities resulting in alleged excessive profits by the Company on three contracts with the U.S. Department of Defense.

24. On June 6, 2006, after the market closed, several news agencies began to review the indictment and revealed that the Company, through Defendant Blatt, misrepresented the company’s manufacturing costs and was behind the creation of fake bids to justify the prices charged to the government. Furthermore, it was learned that the indictment included “charges of wire fraud, lying to the government, obstruction, aiding and abetting, and major fraud against the United States.”

25. Then, on June 13, 2006, the Company announced that its operations in Lancaster, Pennsylvania, Woburn, Massachusetts, Chicago, Illinois and Herley’s subsidiary in Farmingdale, New York were suspended from receiving new contract awards from the U.S. Government.

26. In response to these disclosures, as detailed herein, shares of the Company’s stock have declined from \$19.38 per share to a 52-week low of \$9.21 per share, losing more than 50% of their value.

27. Prior to these disclosures, the Company was able to complete a public offering of its common stock whereby Herley reaped approximately \$69 million in gross proceeds and the Individual Defendants were able to sell 273,939 shares of their personally-held Herley stock for gross proceeds in excess of \$4.7 million.

Materially False and Misleading Statements Made During the Class Period

28. The Class Period begins on October 1, 2001. On that date, the Company issued a press release announcing its financial results for the fiscal fourth quarter and year end of 2001, the

period ended July 29, 2001. For the quarter, Herley reported revenues of \$23.9 million, Earnings before interest, taxes, depreciation and amortization (“EBITDA”) of \$4.4 million and net income of \$2.1 million. Defendant Levy, commenting on the results, stated, in pertinent part, as follows:

I am very pleased with our strong fourth quarter. We had solid performances from our operations and we expect our defense business will drive growth in fiscal 2002, as evidenced by a quarterly record amount of new bookings and Herley’s record backlog.

29. Herley’s financial results for the fiscal fourth quarter and year end of 2001, the period ended July 29, 2001, were reported in the Company’s Report on Form 10-K filed with the SEC on or about October 23, 2001, which was signed by defendants Blatt, Levy and Garefino, among others.

30. On December 6, 2001, the Company issued a press release announcing its financial results for the fiscal first quarter of 2002, the period ended October 28, 2001. For the quarter, Herley reported revenues of \$23.0 million, EBITDA of \$4.4 million, net income of \$2.3 million and diluted earnings per share of \$0.20. Defendant Levy, commenting on the results, stated, in pertinent part, as follows:

I am very pleased with the first quarter of what we expect to be an excellent year for Herley. Defense business is our primary growth driver. We believe the continuing increases in defense spending will extend our visibility which is excellent for fiscal 2002 and 2003.

We have successfully completed the consolidation of two facilities, Anaheim, CA and Nashua, NH. The efficiencies and cost savings from these consolidations should result in an expansion of margins in the second half of fiscal 2002.

31. Herley’s financial results for the fiscal first quarter of 2002, the period ended Oct. 28, 2001, were reported in the Company’s Report on Form 10-Q filed with the SEC on or about December 11, 2001, which was signed by defendants Levy and Garefino.

32. On March 6, 2002, the Company issued a press release announcing its financial results for the fiscal second quarter of 2002, the period ended January 27, 2002. For the quarter, Herley reported revenues of \$21.8 million, income from operations of \$3.6 million and diluted

earnings per share from continuing operations of \$0.20. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We are very pleased with the results of the second quarter and expect revenue and earnings momentum to continue as we enter the second half of our fiscal year. Herley's core defense business is strong and we expect to enjoy defense growth opportunities for several years. Our focus will continue to be on expanding the company's global defense business to achieve profitable growth and increased earnings to grow shareholder value.

The decision to exit the commercial wireless arena has been under review for several months. In our view, the business conditions of the commercial wireless industry are not improving. Overcapacity and economic deterioration in the markets we serve continue with no positive change in sight. We no longer believe our commercial wireless business will generate returns necessary to justify continued investment. Our defense opportunities are just too great to maintain what is a business distraction. Accordingly, we have discontinued the operations of our commercial wireless business and eliminated Herley's exposure to this market.

We completed the sale of the commercial wireless business as of the end of our second quarter fiscal 2002. The financial impact from the discontinued operations have been provided for and are reflected in the company's financial statements.

33. Herley's financial results for the fiscal second quarter of 2002, the period ended January 27, 2002, were reported in the Company's Report on Form 10-Q filed with the SEC on or about March 8, 2002, which was signed by defendants Levy and Garefino.

34. On April 25, 2002, the Company issued a press release announcing that it priced the public offering of 3,000,000 shares of Herley's common stock at \$23.00 per share. The net proceeds to the company will be approximately \$65 million and will be used for general corporate purposes, including potential acquisitions.

35. On May 29, 2002, the Company issued a press release announcing its financial results for the fiscal third quarter of 2002, the period ended April 28, 2002. For the quarter, Herley reported revenues of revenues of \$23.5 million, EBITDA of \$5.2 million, operating income of \$4.1 million, and income from continuing operations of \$2.7 million, or \$0.22 diluted earnings per share.

Defendant Blatt, commenting on the results, stated, in pertinent part, as follows:

We are especially pleased by our strong organic growth this quarter. Our organic growth projection is to grow at twice the rate of growth of domestic defense spending, which was budgeted at 5-8% per annum. We won many of the multi-year defense programs we targeted over the past three years and they are now beginning to mature into their steady production rate, providing us with very good revenue visibility for several years.

Herley is an active integrator of acquisitions. The effects of plant closings completed this past year along with our exit from the commercial wireless business have improved our operating efficiencies and are making positive contributions to our margins. We should see further cost savings from our manufacturing operations as we achieve greater utilization of the automated equipment installed during the last two years at our major manufacturing facilities.

With all of our previous acquisitions now fully integrated, we look forward to reviewing new acquisition targets. The successful secondary offering completed in April when combined with cash on hand gives us approximately \$80 million available for acquisitions. Additionally, we are completing negotiations with our commercial bankers to increase our credit facility to \$50 million. With a variety of financing options available to us, we will continue to seek acquisitions that make strategic and financial sense knowing that we have the resources necessary to do a significant acquisition that meets our criteria.

36. Herley's financial results for the fiscal third quarter of 2002, the period ended April 28, 2002, were reported in the Company's Report on Form 10-Q filed with the SEC on or about June 11, 2002, which was signed by defendants Levy and Garefino.

37. On September 25, 2002, the Company issued a press release announcing its financial results for the fiscal fourth quarter and year end of 2002, the period ended July 28, 2002. For the quarter, Herley reported revenues of \$25.3 million, EBITDA of \$5.3 million, income from continuing operations of \$3.2 million, or \$0.21 per share on a fully diluted basis. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Herley achieved excellent results for the fourth quarter and fiscal year 2002. It was yet another year of strong business performance due in part to our participation on long-term production programs and the company's consistent focus on margins and profitability.

Free cash flow from business operations totaled more than \$7.3 million in the fourth quarter and \$7.7 million for the fiscal year and is expected to remain strong throughout fiscal 2003. Backlog increased 4.1 percent to \$82.7 million at fiscal year end 2002 even after record shipments for the year.

Herley's strong operating results for the quarter and fiscal year were achieved in spite of much higher than normal litigation expenses for the respective periods. The litigation costs of \$1.1 million for the fourth quarter and \$2.1 million for the full year were directly related to legal proceedings with Robinson Laboratories, Inc. and Ben Robinson. The impact to fourth quarter and fiscal 2002 earnings on an after tax basis was approximately \$0.05 and \$0.11 per share respectively.

In 2002, Herley's Defense Electronic business was consistent and grew at all of our operating facilities. We began the year with a record backlog and it has continued to grow. At the end of August 2002, Herley's funded backlog was approximately \$90 million. With this large and growing backlog and a broad range of products and domestic and international opportunities, we look to fiscal 2003 with optimism and confidence. Along with strong cash generation, we expect double-digit growth in earnings and revenues for the year.

38. Herley's financial results for the fiscal fourth quarter and year end of 2002, the period ended July 28, 2002, were reported in the Company's Report on Form 10-K filed with the SEC on or about October 25, 2002, which was signed by defendants Blatt, Levy and Garefino, among others.

39. On December 12, 2002, the Company issued a press release announcing its financial results for the fiscal first quarter of 2003, the period ended November 3, 2002. For the quarter, Herley reported revenues of \$27.3 million, EBITDA of \$6.1 million, net income of \$3.4 million, or \$0.22 per share on a fully diluted basis. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We are very pleased with the results of our first quarter of fiscal 2003. It seems clear that the strategy to increase facility automation through infrastructure improvements and select capital expenditures is beginning to be reflected in Herley's financial performance.

The addition of EW Simulation Technology, a U.K. company acquired by Herley in September, is generating near term benefits as it continues to successfully leverage its simulator expertise into new customer and geographic markets. Herley will aggressively pursue additional international opportunities for simulator and microwave products while we continue to expand our core capabilities in the domestic defense markets.

We intend to have acquisitions play a key part in our business strategy to maintain our position as a valued supplier of microwave technology to our defense customers. Prudent acquisitions will enable Herley to immediately enter into new business areas, complete and/or extend product lines, increase our engineering resources and improve profitability. We expect to be successful in making acquisitions that adhere to our acquisition criteria.

40. Herley's financial results for the fiscal first quarter of 2003, the period ended November 3, 2002, were reported in the Company's Report on Form 10-Q filed with the SEC on or about December 17, 2002, which was signed by defendants Levy and Garefino.

41. On March 12, 2003, the Company issued a press release announcing its financial results for the fiscal second quarter of 2003, the period ended February 2, 2003. For the quarter, Herley reported revenues of \$25.0 million, operating income from continuing operations of \$4.4 million and diluted earnings per share of \$0.22. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Herley's second quarter has traditionally held special challenges due to fewer business days resulting from the November and December holidays. Our operating facilities rose to the challenge and completed a very successful quarter. As we enter the third quarter, we believe that we are positioned to achieve the goals and objectives that we have set for this fiscal year.

Herley's funded backlog is in excess of \$100 million. This existing backlog will be the primary source of Herley's near term revenue. Longer-term revenues will come from contract awards now being booked. Herley has proved its ability to recognize opportunities and successfully execute the strategy to win the business. Business that we book today will fuel our revenue growth in fiscal 2004 and 2005.

In addition to organic growth, Herley's interest in growth through acquisition remains unabated. We will continue our efforts to acquire domestic and international companies. Our acquisition criteria are unchanged: accretive acquisitions of microwave companies or non-microwave businesses that are complimentary to our core business.

42. Herley's financial results for the fiscal second quarter of 2003, the period ended February 2, 2003, were reported in the Company's Report on Form 10-Q filed with the SEC on or about March 18, 2003, which was signed by defendants Levy and Garefino.

43. On June 5, 2003, the Company issued a press release announcing its financial results for the fiscal third quarter of 2003, the period ended May 4, 2003. For the quarter, Herley reported revenues of \$26.9 million, income from operations of \$4.8 million, and net income of \$3.4 million, or \$0.23 per diluted share. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Herley had a very strong third quarter and has had a very good nine months. During the quarter we had success in coordinating EWST's growing needs for microwave hardware with our Israeli and domestic operations, investing in new programs and products while sustaining margins that are among, if not the highest in the industry. As we enter our fourth quarter, we are confident that it will be our best quarter of fiscal 2003 and that we will be in a position to achieve excellent financial results in fiscal 2004.

44. On October 7, 2003, the Company issued a press release announcing its financial results for the fiscal fourth quarter and year end of 2003, the period ended August 3, 2003. For the quarter, Herley reported revenues of \$31.0 million, income from continuing operations of \$3.9 million, or \$0.27 per share on a fully diluted basis. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Fiscal year 2003 was a record-breaking year for Herley and also a year of change. We strengthened our management team and increased our commitment to international business markets. International revenues now account for approximately 36% of Herley's total revenues. The extent and success of our activities in foreign markets increases the number of potential revenue sources and clearly differentiates Herley from our peers.

Our interest and active involvement in acquisitions will continue in fiscal 2004. We will be aggressive, prudent and maintain our focus on target companies complimentary to Herley.

45. On December 11, 2003, the Company issued a press release announcing its financial results for the fiscal first quarter of 2004, the period ended November 2, 2003. For the quarter, Herley reported revenues of \$28.3 million, operating income of \$5.9 million, and net income of \$3.9 million. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Our first quarter results gave Herley an excellent start to the year. For the period, record results were achieved in revenues and profitability, and new orders increased funded backlog \$1.8 million to \$91.7 million. The combination of international sales, domestic product mix, and increased inter-company sales generated very good margins for the quarter. Operating Margin for the first quarter was 20.7% of revenue compared to 17.6% for the same period last year. Net Income as a percentage of revenue was 13.9% compared to 12.3% for the first quarter of last year."

We reiterate our previous comments that Herley's strategic objective is to grow our defense electronics business organically and by making accretive acquisitions of complementary companies, business units, and product lines. We continue to be

optimistic that we will be able to successfully invest some, most, or all of our existing cash into a domestic or international acquisition.

46. On March 15, 2004, the Company issued a press release announcing its financial results for the fiscal second quarter of 2004, the period ended February 1, 2004. For the quarter, Herley reported revenues of \$29.4 million, operating income of \$5.2 million, net income of \$3.5 million, diluted earnings per share of \$0.24. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We feel very good about Herley's near-term and long-term prospects. This belief is based, in part, on the strength of the programs with Herley content and the increasing level of new business opportunities. Our Defense and Aerospace business remained strong during the second quarter with Defense and Aerospace revenues growing 19.6%, compared to the same period last year. A variety of programs contributed to this revenue growth, including F-16, F-18, AMRAAM and THAAD."

Second quarter bookings hit historic levels producing a book-to-bill ratio of 1.4 to 1. For the first half of fiscal 2004, Herley's book-to-bill ratio was 1.2 to 1. Our strong booking activity is expected to continue through the year. We are also continuing our efforts to acquire companies that will extend our product line, assist in Herley's expansion into complementary military markets, and secure new positions on desired programs.

47. On June 14, 2004, the Company issued a press release announcing its financial results for the fiscal third quarter of 2004, the period ended May 2, 2004. For the quarter, Herley reported net sales of \$30.2 million, operating income of \$5.4 million, and net income of \$3.9 million, or \$0.26 per diluted share. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We are pleased with the way we are executing our business plan. Sequential revenue growth, healthy booking levels, increased use of automation to improve efficiencies and lower costs all contributed to strong margins and profits for the quarter.

Herley continues its focus on achieving durable growth by improving the quality of its products, streamlining to reduce costs, and looking at ways to do a better job of marketing products and capabilities.

48. On October 15, 2004, the Company issued a press release announcing its financial results for the fiscal fourth quarter and year end of 2004, the period ended August 1, 2004. For the

quarter, Herley reported revenues of \$34.2 million and net income of \$3.5 million. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Herley's fourth quarter results reflected the ongoing investment in business development and efforts to complete engineering on several projects in order to transition these projects into production. We see major changes in defense procurement and planning taking place immediately after this presidential election, no matter which candidate wins. We believe the long-awaited transformation from outdated cold war policies to defending against today's regional terrorist threats will finally begin to come about. To prepare for these changes Herley has been making the investments necessary to support such programs as UAV's capable of carrying payloads and Network Centric Communications. This kind of investment will position Herley to continue its growth and profitability in the changed defense business of the future.

Two items should be especially noted in our financial report. The first is the approximate \$1.6 million payment to Robinson as a result of a jury award after the 2002 trial. This is viewed as a one-time event. The second is the 2-1/2% increase in SG&A due to what we view as our continuing investment in our Business Development unit. Our success in reaching our goal of \$250 million in annual revenues by fiscal year 2007 is heavily dependent on the success of this unit.

During fiscal 2004, we produced successful results on several fronts. We were awarded contracts on very important programs, including ICAP, Trident, and AFSAT. Additionally, we received authorization to proceed to production on major engineering projects, including two systems on the F18.

Those engineering projects that have been completed are expected to impact positively on Herley's financial performance beginning in the second quarter of fiscal 2005.

49. On December 9, 2004, the Company issued a press release announcing its financial results for the fiscal first quarter of 2005, the period ended October 31, 2004. For the quarter, Herley reported net sales of \$33.6 million and net income of \$3.6 million. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Although our results for the quarter were mixed, we did make good progress, both domestically and at our U.K. facility, on several of the engineering issues that impacted gross margins in the quarter.

We are pleased with the Company's free cash flow in the quarter. Generating healthy cash flow has been an area of emphasis for us and we expect to continue to see the positive results of our actions in fiscal 2005.

50. On March 9, 2005, the Company issued a press release announcing its financial results for the fiscal second quarter of 2005, the period ended January 30, 2005. For the quarter, Herley reported net revenues of \$33.8 million, operating income of \$2.5 million, net income of \$2.1 million and earnings per diluted share of \$0.14. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

Herley's margins in the second quarter and the first six months of fiscal 2005 were lower due to our business decision to make significant investments in engineering development and IR & D in order to have Herley in a position for the changes we see coming in future U.S. defense budgets.

We have previously stated that we want to get involved with our customers as early as possible in the decision-making process. Herley's business development group was created as a result of this strategy. As a result of our success in business development and customer initiatives, we are currently active in more development projects than at any time in the Company's history.

On several major programs we are transitioning from engineering development to the early stage of production, which by definition, has higher costs associated with engineering without offsetting production revenues. We believe revenues and profits will quickly catch up once these programs enter full production.

We are confident that the contracts we have won and are now investing in are long-term programs that enjoy both political and military support. If our decisions are correct and these are sustainable, multi-year programs, our aforementioned investment in current engineering development projects will grow revenues and generate profits for many years. We expect to begin to see the positive effects from these investments as early as the third quarter of fiscal year 2005. Bookings in the following major programs are forecast for the next two quarters:

- Next generation Air Force targets
- ICAP III electronic warfare systems
- Trident missile upgrades
- Ballistic Missile Defense programs
- F/A - 18 ACLS and IFF systems
- Electronic warfare target generators and simulators
- High Power Amplifiers for electronic warfare jamming and network centric communication systems.

51. On June 9, 2005, the Company issued a press release announcing its financial results for the fiscal third quarter of 2005, the period ended May 1, 2005. For the quarter, Herley reported net revenues of \$41.3 million, net income of \$3.6 million, or \$0.24 per diluted share, and operating income of \$4.6 million. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We made very good progress on several fronts during the quarter including:

-- The engineering development projects are in line with expectations and approximately on schedule. Most of this business should be in a production phase in the fourth quarter of fiscal 2005.

-- Our investment in corporate business development is generating tangible financial results both domestically and internationally. Business development is also gaining greater visibility for Herley's capabilities with customers.

-- As a result of Herley's decision to make Micro Systems the Center of Excellence for Command & Control, we are transitioning all new business and most of Herley's legacy command & control business to our Ft. Walton Beach facility.

-- Innovative Concepts continues to benefit from market acceptance of its IDM Technology (R), as today's military thinking parallels ICI's product offering of mobile, interoperable, tactical data communications in hostile environments. Herley plans to leverage its excellent business relationships with all branches of the U.S. military which should generate new program and platform opportunities for ICI products.

-- Herley Power Amplifiers is completing several design projects and expects production contracts to follow. Herley amplifiers have applications in electronic warfare environments (jamming) and anti-IED solutions. We are pursuing both of these markets and we expect to increase our level of activity in the fourth quarter of fiscal 2005 and fiscal year 2006.

Herley's organic revenue growth was 6.3% for the third quarter of fiscal 2005 and we expect organic growth to continue its upward trend. Backlog increased approximately \$37 million to \$131.2 million at the end of the third quarter of fiscal 2005. Bookings for the third quarter of fiscal 2005 were \$44.9 million, reflecting a book - to - bill of 1.1 to 1.

52. On October 25, 2005, the Company issued a press release announcing its financial results for the fiscal fourth quarter and year end of 2005, the period ended July 31, 2005. For the quarter, Herley reported net sales from continuing operations of \$42.8 million, operating income of

\$2.6 million, and net income of \$1.5 million, or \$0.10 per diluted share. The press release revealed, in pertinent part, as follows:

John M. Kelley, Herley President, said, "Herley financial results for the fourth quarter and fiscal year were mixed. Below are events that had an impact on fiscal 2005 earnings."

-- ACQUISITIONS. Herley acquired three companies and a new millimeter wave seeker technology in fiscal 2005. The absorption and integration process was a considerable effort, and it continues to this day. However, we have worked through most of the problems and are now on the downside of this activity. We believe these acquisitions are essential to increasing our technological diversity and will increase our growth prospects as we prepare the company for the defense business of the future.

-- ADMINISTRATION. Increased legal and Sarbanes-Oxley costs. These costs are a fact of business life. However, we will continue our efforts to reduce costs whenever possible.

-- OPERATIONS. Delivery delays related primarily to two simulation projects at EWST negatively impacted margins in the fourth quarter and fiscal 2005. We believe the problems have been solved, and we expect to complete factory acceptance tests and ship both simulators within the next 30 days. These simulators are the last of the original orders requiring extensive hardware, software and integration development. Going forward, new simulator orders will be based on existing product designs which include actual costs for material, labor and overhead. Recent actions have been taken that should improve EWST's performance in fiscal 2006.

Kelley continued, "We are disappointed in our performance in 2005. For those problems which we were able to immediately identify, we have taken the corrective actions necessary to fix them. We continue to remain optimistic about our business prospects for fiscal year 2006. Revenue growth is expected to be strong based on the company's existing contracts with the U.S. Government, major prime contractors and countries worldwide."

53. Herley's financial results for the fiscal fourth quarter and year end of 2005, the period ended July 31, 2005, were reported in the Company's Report on Form 10-K filed with the SEC on or about , which was signed by defendants Blatt, Levy and Garefino, among others. With regard to Herley's business strategy, the annual report stated, in pertinent part, as follows:

We have developed mutually beneficial relationships with various agencies of the U.S. Government and defense and commercial companies. We expect to continue to build and strengthen these relationships with industry leaders by anticipating and

recognizing their needs and providing them with on-time and cost-effective solutions.

With regard to the Company's strengths, the annual report stated, in pertinent part, as follows:

Our competitive strengths include:

- TECHNICAL EXPERTISE. We have developed a leading position in the field of microwave technology through our 40 year focus on research and development and our state-of-the-art design and production capabilities. In fiscal 2002 we completed the expansion of our facilities in Lancaster, Pennsylvania, including state-of-the-art manufacturing capacity, where we now have a full range of capabilities including long and short run production, hardware assembly and full- service engineering. In addition, we have highly capable manufacturing facilities located in Woburn, Massachusetts; Farmingdale, New York; Whippany, New Jersey; Melbourne, Florida; Fort Walton Beach FL; Farnborough, England; and Jerusalem, Israel. We continue to develop and reward our engineers in order to maintain our expertise in-house.

-HIGH PROPORTION OF LONG-TERM SOLE-PROVIDER PRODUCTION PROGRAMS. We generate a significant proportion of our revenue from continuing, long-term programs, both in the production and upgrade phases, and continue to target high growth, high priority defense programs. Typically, on such long-term defense programs we are the sole provider of microwave equipment.

* * *

-LONG-STANDING INDUSTRY RELATIONSHIPS. We have established long-standing relationships with the U.S. Government and other key organizations in the aerospace and defense industry after 40 years in the defense electronic industry. Over this period, we have become recognized for our ability to develop new technologies and meet stringent program requirements.

With regard to government regulation, the annual report stated, in pertinent part, as follows:

GOVERNMENT REGULATION

Because of our participation in the defense industry, we are subject to audits by various government agencies for our compliance with government regulations. We are also subject to a variety of local, state and federal government regulations relating to, among other things, the storage, discharge, handling, omission, generation, manufacture and disposal of toxic or other hazardous substances used to manufacture our products. ***We believe that we operate our business in material compliance with applicable laws and regulations. However, any failure to comply with existing or future laws or regulations could have a material adverse impact on our business, financial condition and results of operations.*** [Emphasis added.]

With regard to its increases in selling and administrative expenses, the annual report stated, in pertinent part, as follows:

An increase of approximately \$935,000 in legal costs associated with Robinson Laboratories and a continuing investigation by the U.S. Attorneys' office in Pennsylvania which, inter alia, involves pricing under two contracts with the U.S. Department of Defense relating to voltage control oscillators and a contract relating to powerheads.

With regard to its revenue and cost recognition policies, the annual report stated, in pertinent part, as follows:

Revenue and Cost Recognition

The Company generally recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. Payments received from customers in advance of products delivered are recorded as customer advance payments until earned. Substantially all of our customer contracts are firm, fixed price contracts, providing for a predetermined fixed price for the products sold, regardless of the costs incurred. A certain percentage of revenues are derived from long-term, fixed price contracts. Revenues and estimated profits are recognized on these contracts using the percentage of completion method of accounting and are based on estimated completion to date (the total contract amount multiplied by the percentage of performance, based on total costs incurred in relation to total estimated cost at completion). Prospective losses on long-term contracts are based upon the anticipated excess of manufacturing costs over the selling price of the remaining units to be delivered and are recorded in the period when first determinable. Actual losses could differ from those estimated due to changes in the ultimate manufacturing costs and contract terms.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance. Selling, general and administrative costs are charged to expense as incurred.

54. On December 13, 2005, the Company issued a press release announcing its financial results for the fiscal first quarter of 2006, the period ended October 30, 2005. For the quarter, Herley reported net sales of \$41.9 million, net income of \$4.0 million, or \$0.26 per diluted share and operating income of \$5.5 million. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We are very pleased with the progress made during the quarter on a number of projects, including I-CAP III, E/A-18G, and Trident D-5. Herley has hardware and software on a significant number of major weapon systems and missile and munitions for the U.S. and allied countries. The programs are very important to the U.S. government, and we expect funding will continue for many years. New production programs along with our legacy business should drive revenue growth in fiscal 2006 and the out-years.

Herley is nearing completion of the integration process of our recent acquisitions. It is important to note that the acquisitions we make are not bolt-on or isolated from the activities at our other divisions. As a result, we have overlapping manufacturing capability. The integration process requires that we make each of our divisions complementary to each other, while eliminating the competitive areas.

We expect our acquisitions to contribute to the competitiveness and overall effectiveness of the company. We work hard to do it right, because when the process is completed successfully, the benefits flow, not just to Herley, but also to our customers, making us more visible and more valuable to them.

55. On March 8, 2006, the Company issued a press release announcing its financial results for the fiscal second quarter of 2006, the period ended January 29, 2006. For the quarter, Herley reported net sales of \$45.8 million, net income of \$4.0 million, or \$0.26 per diluted share and operating income of \$5.3 million. Defendant Kelley, commenting on the results, stated, in pertinent part, as follows:

We are very pleased with our second quarter financial results and the Company's position in key market segments as we enter the second half of our fiscal 2006.

Financial performance from Herley's first quarter to its second quarter has historically fallen due to extended holiday vacation days in November and December, effectively reducing the number of shipping days. Improved execution and operational efficiencies in the second quarter allowed us to overcome the lost days and increase revenues and earnings compared to historical second quarter results. In addition, many of the engineering programs underway in Q2 of fiscal 2005 were completed successfully and introduced to production in Q2 2006. We are beginning to see the rise in revenues and earnings that we expected.

56. The statements referenced above in ¶¶28-33 and 35-55 were materially false and misleading because they misrepresented and failed to disclose the following adverse facts:

(a) that the Company's financial results were achieved through illegal conduct, specifically the misrepresentation of manufacturing costs on contracts with the U.S. Government and the falsification of a bid in order to win the award of a contract;

(b) that the Company lacked adequate internal controls; and

(c) that, as a result of the foregoing, the Company would likely be subject to enhanced governmental scrutiny, governmental fines for improper conduct, and the Company's ability to receive new contract awards from the U.S. Government and its ability to reap future revenues would be in serious doubt.

The Truth Begins to Emerge

57. On June 5, 2006, the Company issued a press release announcing that its fiscal 2006 third quarter earnings would be below Company expectations and analyst consensus estimates. Curiously, the Company made no mention of the impending indictment and its effect on the Company's present and future prospects. The press release continued, in pertinent part, as follows:

John Kelley, Herley President, said, "Two of our domestic divisions will report third-quarter losses in contrast to expectations of moderate profits. A significant portion of these losses were caused by non-recurring engineering investments that the Company believes will result in additional business in the coming year."

Mr. Kelley continued, "A review of our operations suggests that we may have been too cautious in our approach to consolidating facilities. We know the strengths of each of our manufacturing facilities and we plan to move more aggressively to eliminate redundancies within the Company and build on our strengths. Notwithstanding our third quarter performance, we are seeing strength in a number of areas:

-- Our operations in Israel and the United Kingdom continue to strengthen. Herley Israel is having the best year in their history and EWST has been successful at winning repeat business which should improve their on-time delivery and profitability.

-- We have also made good progress with our recent large domestic contract wins and we expect to continue our good batting average as we compete for new business.

-- The major engineering programs which have dampened recent earnings are moving forward, and Herley will benefit in fiscal 2007 as they begin to enter the initial production phase of these projects.

-- International orders to our domestic divisions are on an upward trend, and could reach record levels for the year. Herley's international business may reach 30% of our overall sales, and would act as a good hedge against the anticipated downturn in U.S. defense spending."

58. Upon this announcement, shares of Herley fell \$1.88 per share, or approximately 10%, to close at \$17.50 per share, on heavy trading volume.

59. On June 6, 2006, the Company issued a press release revealing that the U.S. Attorney's office for the Eastern District in Pennsylvania had indicted the Company and Defendant Blatt on multiple charges in connection with excessive profits improperly earned by the Company on three contracts with the U.S. Department of Defense. The press release continued, in pertinent part, as follows:

One contract is with respect to the sale of voltage controlled oscillators which was completed in January 2001 and two contracts involve the sale of powerheads to the U.S. government which were completed in April 2002 and October 2002, respectively. The three contracts aggregate approximately \$3.9 million in total revenues to the Company over three fiscal years. The Company's total revenue for those three fiscal years was approximately \$280 million. Expected revenue for the Company's fiscal year ending July 31, 2006 will exceed \$180 million. No other officer, director or employee has been named in the indictment.

The Company and its Chairman, Lee N. Blatt, believe that no criminal conduct has occurred, will vigorously contest the charges, and prove their innocence at trial.

60. On June 6, 2006, after the markets closed, in an article entitled *Herley, Chairman Indicted on Fraud Charges*, the *Associated Press*, with regard to the indictment, reported, in pertinent part, as follows:

An electronic components manufacturer and its chairman were indicted Tuesday on charges alleging they schemed to defraud the U.S. military of millions of dollars.

Herley Industries Inc. reaped profits of up to 300 percent on more than \$3.9 million in sales of electronic components for which it was the only supplier, according to the grand jury indictment against the Lancaster-based company and its founder and board chairman, Lee N. Blatt.

The indictment alleges that ***Blatt misrepresented the company's manufacturing costs and was behind the creation of a fake bid to justify the prices charged to the government.*** [Emphasis added.]

The company sold an oscillator used in F-16 fighter jet radar systems and a component that prevents power-surge damage on E-2C Hawkeye aircraft.

“Blatt abused his position and used his company’s advantage as a sole supplier to systematically gouge the U.S. military,” U.S. Attorney Pat Meehan said in a statement. “Not only did the Air Force and Navy deserve better, but so did the taxpayers and the company’s shareholders.”

The indictment includes charges of wire fraud, lying to the government, obstruction, aiding and abetting, and major fraud against the United States.

* * *

If convicted, Blatt, 78, of Vero Beach, Fla., could face jail time, and both he and the company could be fined more than \$13 million. The company also could be forced to forfeit more than \$2.8 million paid under the contracts.

61. Upon these announcements, shares of Herley fell \$0.98 per share, or 6%, to close at \$16.52 per share, on heavy trading volume. Shares of Herley stock continued to decline on the next trading day as news leaked out on the details of the indictment. On the next trading day, June 7, 2006, shares of the Company’s stock fell an additional \$1.48 per share, or 9%, to close at \$15.04 per share, on heavy trading volume.

62. On June 9, 2006, the Company announced that Defendant Blatt resigned as Chairman of the Board and as a director of the Company on June 8, 2006.

63. On June 13, 2006, the Company issued a press release announcing that its operations in Lancaster, Pennsylvania, Woburn, Massachusetts, Chicago, Illinois and Herley’s subsidiary in Farmingdale, New York were suspended from receiving new contract awards from the U.S. Government. The press release revealed, in pertinent part, as follows:

The result of this suspension is that these facilities will not be solicited for or awarded new contracts or contract extensions without special exceptions, pending the outcome of legal proceedings. The suspended facilities may receive contract awards or subcontracts from the Federal Government if the head of the agency states in writing the compelling reason to do so. A significant portion of Herley’s business is received where the company is the only qualified supplier on critical defense programs. For this reason the effect of the suspension on these manufacturing facilities cannot easily be determined at this time. Currently, Herley has a funded backlog of approximately \$142 million, which is not affected by this action, and which will be delivered to customers within the next year or two.

64. Following this announcement, shares of Herley plunged \$5.19 per share, or 34%, to close at \$10.06 per share, on heavy trading volume.

65. On June 14, 2006, the Company issued a press release announcing its financial results for the fiscal third quarter of 2006, the period ended April 30, 2006. The Company also announced that its quarterly report on form 10-Q will be delayed since its auditors need to complete its review of procedures in connection with the Company's recent indictment. Defendant Kelley, commenting on the disappointing results, stated, in pertinent part, as follows:

The results from two of our domestic facilities prevented Herley from achieving solid financial results for three consecutive quarters in fiscal 2006.

66. Upon this announcement, shares of Herley continued to fall, losing an additional \$0.85 per share, or 8%, to close at \$9.21 per share, on heavy trading volume.

67. The markets for Herley's securities were open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, Herley's securities traded at artificially inflated prices during the Class Period. Plaintiff and other members of the Class purchased or otherwise acquired Herley's securities relying upon the integrity of the market price of Herley's securities and market information relating to Herley, and have been damaged thereby.

68. During the Class Period, defendants materially misled the investing public, thereby inflating the price of Herley's securities, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants' statements, as set forth herein, not false and misleading. Said statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the Company, its business and operations, as alleged herein.

69. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the

damages sustained by plaintiff and other members of the Class. As described herein, during the Class Period, defendants made or caused to be made a series of materially false or misleading statements about Herley's business, prospects and operations. These material misstatements and omissions had the cause and effect of creating in the market an unrealistically positive assessment of Herley and its business, prospects and operations, thus causing the Company's securities to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in plaintiff and other members of the Class purchasing the Company's securities at artificially inflated prices, thus causing the damages complained of herein.

Additional Scienter Allegations

70. As alleged herein, defendants acted with scienter in that defendants knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding Herley, their control over, and/or receipt and/or modification of Herley's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning Herley, participated in the fraudulent scheme alleged herein.

71. Defendants were further motivated to engage in this course of conduct in order to: (i) complete a public offering of its common stock, whereby the Company reaped approximately \$69 million in net proceeds; and (ii) allow the Individual Defendants to sell 273,939 shares of their

personally-held Herley stock for gross proceeds in excess of \$4.7 million. The insider shares sold during the Class Period are set forth more fully in the following chart:

Defendants	Date	Shares	Price	Proceeds
BLATT, LEE	10/11/2001	20,000	\$17.32	\$346,400.00
	12/28/2001	2,000	\$16.21	\$32,420.00
	3/1/2002	3,000	\$18.96	\$56,880.00
	11/26/2003	3,000	\$19.31	\$57,930.00
	4/16/2004	9,810	\$20.20	\$198,162.00
	4/19/2004	10,190	\$20.22	\$206,041.80
Total		48,000		\$897,833.80
GAREFINO, ANELLO	10/2/2001	20,000	\$17.00	\$340,000.00
	10/16/2001	17,000	\$17.00	\$289,000.00
	10/21/2003	19,239	\$18.23	\$350,726.97
	6/14/2005	9,000	\$18.05	\$162,450.00
	6/14/2005	9,000	\$18.05	\$162,450.00
	6/14/2005	7,200	\$18.05	\$129,960.00
	6/14/2005	2,250	\$18.05	\$40,612.50
	6/14/2005	2,250	\$18.05	\$40,612.50
	1/10/2006	3,000	\$17.50	\$52,500.00
Total		88,939		\$1,568,311.97
KELLEY, JOHN	3/14/2006	12,000	\$19.35	\$232,200.00
Total		12,000		\$232,200.00
LEVY, MYRON	10/16/2001	12,500	\$17.00	\$212,500.00
	10/19/2001	50,000	\$16.90	\$845,000.00
	10/22/2001	12,500	\$16.90	\$211,250.00
	10/24/2001	25,000	\$16.46	\$411,500.00
	10/31/2001	25,000	\$16.46	\$411,500.00
Total		125,000		\$2,091,750.00
Total:		273,939		\$4,790,095.77

LOSS CAUSATION/ECONOMIC LOSS

72. During the Class Period, as detailed herein, defendants engaged in a scheme to deceive the market and a course of conduct that artificially inflated the prices of Herley's securities and operated as a fraud or deceit on Class Period purchasers of Herley's securities by failing to disclose to investors that the Company's financial performance was the result of improper and illegal conduct engaged in by defendants with certain U.S. Government contracts. When defendants' prior misrepresentations and fraudulent conduct were disclosed and became apparent to the market, the prices of Herley's securities fell precipitously as the prior artificial inflation came out. As a result of

their purchases of Herley's securities during the Class Period, plaintiff and the other Class members suffered economic loss, i.e., damages under the federal securities laws.

73. By failing to disclose to investors that the Company's financial performance was the result of improper and illegal conduct engaged in by defendants with certain U.S. Government contracts, investors did not know that the Company's future prospects would be bleak and the Company would be subject to future governmental scrutiny. Therefore, defendants presented a misleading picture of Herley's business and prospects. Thus, instead of truthfully disclosing during the Class Period the true risks that Herley was exposed to, defendants caused Herley to conceal the truth.

74. Defendants' false and misleading statements had the intended effect and caused Herley's common stock to trade at artificially inflated levels throughout the Class Period, reaching as high as \$24.62 per share on April 16, 2002.

75. As a direct result of defendants' disclosures on June 6, 2006, June 13, 2006 and June 14, 2006, Herley's common stock price fell precipitously. These drops removed the inflation from the price of Herley's securities, causing real economic loss to investors who had purchased the Company's securities during the Class Period.

76. The more than 50% decline in the price of Herley's common stock after these disclosures came to light was a direct result of the nature and extent of defendants' fraud finally being revealed to investors and the market. The timing and magnitude of Herley's common stock price declines negate any inference that the loss suffered by plaintiff and the other Class members was caused by changed market conditions, macroeconomic or industry factors or Company-specific facts unrelated to the defendants' fraudulent conduct. The economic loss, i.e., damages, suffered by plaintiff and the other Class members was a direct result of defendants' fraudulent scheme to artificially inflate the prices of Herley's securities and the subsequent significant decline in the value

of Herley's securities when defendants' prior misrepresentations and other fraudulent conduct were revealed.

**Applicability of Presumption of Reliance:
Fraud on the Market Doctrine**

77. At all relevant times, the market for Herley's securities was an efficient market for the following reasons, among others:

(a) Herley's stock met the requirements for listing, and was listed and actively traded on the NASDAQ, a highly efficient and automated market;

(b) as a regulated issuer, Herley filed periodic public reports with the SEC and the NASDAQ;

(c) Herley regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Herley was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

78. As a result of the foregoing, the markets for Herley's securities promptly digested current information regarding Herley from all publicly available sources and reflected such information in the prices of the securities. Under these circumstances, all purchasers of Herley's securities during the Class Period suffered similar injury through their purchase of Herley's securities at artificially inflated prices and a presumption of reliance applies.

NO SAFE HARBOR

79. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as “forward-looking statements” when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of Herley who knew that those statements were false when made.

COUNT I

Violation of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder Against All Defendants

80. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

81. During the Class Period, defendants carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public regarding Herley’s business, operations and management and the intrinsic value of Herley’s securities; (ii) enable the Individual Defendants to sell 273,939 shares of their personally-held Herley stock for gross proceeds in excess of \$4.7 million; (iii) enable the Company to complete a public offering of its common stock whereby the Company reaped approximately \$69 million in gross proceeds; and (iv) cause plaintiff and members of the Class to purchase Herley’s publicly

traded securities at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, defendants, and each of them, took the actions set forth herein.

82. Defendants: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company's securities in an effort to maintain artificially high market prices for Herley's securities in violation of Section 10(b) of the Exchange Act and Rule 10b-5. All defendants are sued either as primary participants in the wrongful and illegal conduct charged herein or as controlling persons as alleged below.

83. Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations and future prospects of Herley as specified herein.

84. These defendants employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Herley's value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about Herley and its business operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Herley's securities during the Class Period.

85. Each of the Individual Defendants' primary liability, and controlling person liability, arises from the following facts: (i) the Individual Defendants were high-level executives and/or

directors at the Company during the Class Period and members of the Company's management team or had control thereof; (ii) each of these defendants, by virtue of his responsibilities and activities as a senior officer and/or director of the Company was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (iii) each of these defendants enjoyed significant personal contact and familiarity with the other defendants and was advised of and had access to other members of the Company's management team, internal reports and other data and information about the Company's finances, operations, and sales at all relevant times; and (iv) each of these defendants was aware of the Company's dissemination of information to the investing public which they knew or recklessly disregarded was materially false and misleading.

86. The defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing Herley's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its securities. As demonstrated by defendants' overstatements and misstatements of the Company's business, operations and earnings throughout the Class Period, defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

87. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market prices of Herley's securities were artificially inflated during the Class Period. In ignorance of the fact that market prices of Herley's

publicly-traded securities were artificially inflated, and relying directly or indirectly on the false and misleading statements made by defendants, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or recklessly disregarded by defendants but not disclosed in public statements by defendants during the Class Period, plaintiff and the other members of the Class acquired Herley's securities during the Class Period at artificially high prices and were damaged thereby.

88. At the time of said misrepresentations and omissions, plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had plaintiff and the other members of the Class and the marketplace known the truth regarding Herley's financial results, which were not disclosed by defendants, plaintiff and other members of the Class would not have purchased or otherwise acquired their Herley's securities, or, if they had acquired such securities during the Class Period, they would not have done so at the artificially inflated prices which they paid.

89. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

90. As a direct and proximate result of defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's securities during the Class Period.

COUNT II

Violation of Section 20(a) of the Exchange Act Against the Individual Defendants

91. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

92. The Individual Defendants acted as controlling persons of Herley within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and

their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the false financial statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

93. In particular, each of these defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

94. As set forth above, Herley and the Individual Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of defendants' wrongful conduct, plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's securities during the Class Period.

WHEREFORE, plaintiff prays for relief and judgment, as follows:

A. Determining that this action is a proper class action, designating plaintiff as Lead Plaintiff and certifying plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure and plaintiff's counsel as Lead Counsel;

B. Awarding compensatory damages in favor of plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Awarding plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

D. Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Plaintiff hereby demands a trial by jury.

DATED: June 15, 2006

SCHIFFRIN & BARROWAY
MARC TOPAZ
RICHARD MANISKAS

MARC TOPAZ
280 King of Prussia Road
Radnor, PA 19087
Telephone: 610/667-7706
610/667-7056 (fax)

LERACH COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
SAMUEL H. RUDMAN
DAVID A. ROSENFELD
MARIO ALBA JR.
58 South Service Road, Suite 200
Melville, NY 11747
Telephone: 631/367-7100
631/367-1173 (fax)

Attorneys for Plaintiff