COMARCO, INC.

ANNUAL REPORT 2001

Comarco Wireless Technologies

CORPORATE PROFILE

WHO WE ARE • WHAT WE DO

COMARCO IS

A Leading Provider of Products, Services, and Expertise Which Enable Wireless Carriers to Optimize Quality of Service, Maximize Revenue Streams, and Minimize Capital Investments.

WIRELESS INFRASTRUCTURE

PRODUCTS AND SERVICES

RF PLANNING & NETWORK DESIGN

Delivering Cost-Effective Planning and Design Tools and Services to the Wireless Industry

OPTIMIZATION

Maximizing Capital Efficiency Through Network Performance Analysis and Optimization Tools and Services

QoS BENCHMARKING

Providing Network Performance and Competitive Quality of Service Evaluation Tools and Outsourced Engineering Services

REVENUE ASSURANCE

Increasing Wireless Carrier Profits Through Products, Systems, and Services Designed to Ensure Revenue Stream Integrity

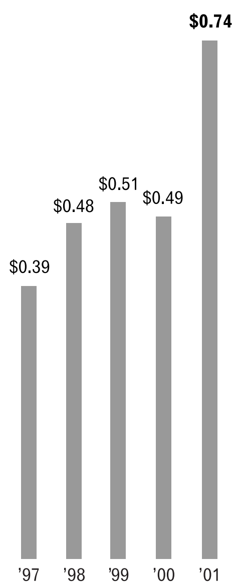
MEASURING
OUR SUCCESS

FINANCIAL HIGHLIGHTS

Years Ended January 31,	2001[1]	2000	1999
(Dollars in thousands, except per share data)			
Statement of Operations Data[2]			
Revenue	$49,464	$39,224	$34,004
Gross profit	24,646	18,430	18,962
Net income from continuing operations	5,468	3,586	3,971
Earnings per share from continuing operations	$ 0.74	$ 0.49	$ 0.51
Balance Sheet Data			
Cash and cash equivalents	24,903	5,064	3,220
Total assets	66,051	44,694	43,001
Long-term debt	—	—	—
Shareholders' equity	43,495	31,754	31,202

REVENUE
(DOLLARS IN MILLIONS)

NET INCOME
(DOLLARS IN MILLIONS)



EARNINGS PER SHARE

(1) Excludes severance and acquisition-related expenses.
(2) Operating data is for continuing operations only. Per share amounts have been adjusted to reflect a 3-for-2 stock split effective October 27, 2000.

LOOKING FORWARD

OUR PERFORMANCE AND THE OPPORTUNITIES AHEAD

TO OUR SHAREHOLDERS

Over the past year, we completed our corporate transition with the successful divestiture of our non-wireless businesses.

During this period of transition, we significantly strengthened our management team, advanced our core competencies, and added new industry-leading products and services. The new COMARCO is a company of uniquely talented and dedicated technologists, and has more than a decade of accumulated wireless technology expertise. We are now well positioned to continue our record of profitable growth as we help build the next generation "wireless Internet."

FOR THE FISCAL YEAR ended January 31, 2001, revenue from continuing operations reached $49.5 million, up 26.1 percent over 2000. Net income from continuing operations, excluding severance and acquisition-related expense, increased to $5.5 million or $0.74 per share, up from $3.6 million or $0.49 per share. And during fiscal 2001 we returned $1.7 million to shareholders through our share repurchase program. Our financial position was improved with proceeds from the divestiture, and we enter the new year debt-free and with $24.9 million in cash.

THE WIRELESS COMMUNICATIONS INDUSTRY is rapidly approaching one billion subscribers, and is still growing at a high rate. Monthly minutes of use per subscriber are projected to grow from 200 to 500 minutes over the next five years. And the industry is planning to provide more data-oriented services with dramatically increasing data rates. The multiplier effect of subscriber growth, increased minutes of use, and higher data rates will stress worldwide network capacity, even as carriers invest aggressively in new spectrum and infrastructure. Network performance and quality of service will be severely impacted as new subscribers, minutes of use, and data rates continue to rise.

OUR PRODUCTS AND SERVICES directly address these formidable challenges. COMARCO's unique suite of complementary products and services helps our customers maximize capacity, improve the Quality of Service of existing wireless infrastructure, and efficiently deploy new infrastructure and technologies.

WITH THE INFORMATION provided by our industry-leading benchmarking tool, carriers can effectively measure the quality of service delivered to their geographically dispersed subscribers, thereby obtaining information necessary to improve the subscriber experience and decrease customer churn. During the year, our *BaseLINE* product line gained further acceptance with major wireless carriers. This product line has become the industry's dominant system for Quality of Service benchmarking programs.

TO HELP CARRIERS obtain additional network capacity and quality of service, we successfully introduced our *X-series* test and optimization product line. The *X-series* is the most advanced test and optimization system available and supports all second-generation air interface standards—CDMA, GSM, iDEN, TDMA—used throughout the world today.

IN DECEMBER 2000, we acquired EDX Engineering, Inc., which allows us to offer advanced RF design and planning software to mobile and fixed broadband carriers. This acquisition gives us access to essential radio engineering expertise and supports our entry into network design and optimization engineering services.

DURING FISCAL 2001, we developed an offering of engineering services primarily focused on Quality of Service and competitive benchmarking. The addition of EDX and the launch of our engineering services business provide a complementary platform from which to grow our wireless infrastructure business.

The wireless industry is striving to become more efficient even as it embarks on its transition toward 3G.

The outsourcing of high-end engineering work to third parties is expected to continue and even accelerate. EDX and our engineering services business unit are well positioned to provide valuable products and services as carrier networks evolve and grow. At the beginning of our new fiscal year, we received a substantial contract for network upgrade support services. We expect to receive additional contract awards from other wireless infrastructure providers and carriers for engineering services.

OUR NEW distributed test platform for wireless revenue assurance applications is nearing release. This new product will help the wireless telecommunications carriers to increase profitability and enhance customer satisfaction through the avoidance of billing errors. In the future, this platform will support development and testing of VoIP, traveler, concierge, banking, and other advanced data services.

OUR *CHARGESOURCE* product line advanced as the next generation universal-charging product was launched. This mobile product supports a wide range of wireless products such as laptop computers, cell phones, and PDAs. Additional complementary products are planned for release in the new fiscal year.

WE CONTINUE TO UPGRADE our installed base of call box systems. Of a total installed base of 18,000 units, more than 10,000 have been upgraded and 1,500 are planned for upgrade during fiscal 2002. A number of states including Texas, Georgia, Hawaii, Pennsylvania, and Nevada are considering large projects. As statewide projects are authorized, we would expect to capitalize on our position as the dominant supplier of cellular call box systems.

AS THE WORLD TRANSITIONS from legacy circuit and packet switched copper networks, telecommunications companies will invest huge sums to convert to optical and wireless "last mile" delivery systems. We are well positioned to offer advanced products and services for design, deployment, and optimization of advanced wireless networks worldwide. In the new fiscal year, we will expand and adapt our product lines to be compatible with next generation 1XRTT, GPRS, and 3G technologies, and we will enhance our sales and service infrastructure in Asia, Europe, and South America. With solid, technologically advanced products and services offered worldwide, we expect to produce sustainable and profitable growth.

OUR MARKET is large and growing, and there is strong customer acceptance of our products and services. Through the talent and dedication of our people and the leveraging of our core competencies, we continue to innovate, launching new products and services designed to help our customers succeed and thrive. With our strong financial position and deep cultural commitment to sustainable, profitable growth, we believe that we will become the leading provider of products and services for the planning, deployment, optimization, and use of wireless networks.

Tom Franza
PRESIDENT AND CEO

Don Bailey
CHAIRMAN

DESIGN

PLANNING FOR THE FUTURE

> SITE LOCATION

> COVERAGE ANALYSIS

> FREQUENCY PLANNING

> CAPACITY ANALYSIS

RF PLANNING

PROFITABLE wireless networks are designed, not built. Constrained by spectrum capacity and challenged by rapid growth in subscribers and minutes of use, carriers are continually striving to improve network efficiency while ensuring Quality of Service. As an expanded offering of enhanced data services supplements the revenues generated from existing voice networks, capital efficiency will be paramount to continued profitability.

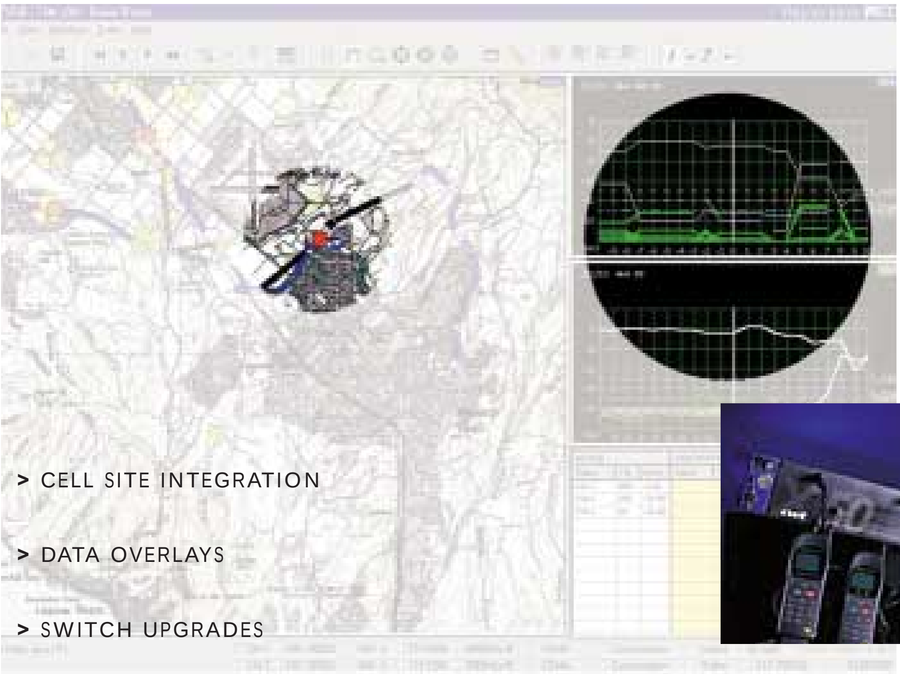
FROM initial technology evaluation and selection through network design and deployment, COMARCO offers proven and comprehensive solutions for wireless network planning. The acquisition of EDX Engineering uniquely positions us to provide advanced engineering software and services that enable the wireless communications industry to efficiently plan and deploy tomorrow's global wireless infrastructure. The EDX portfolio of planning software includes SignalPro®, a comprehensive software package that provides a complete set of planning tools. Leveraging extensive expertise in radio frequency (RF) engineering and a leadership position in the deployment of broadband wireless systems, our tools and services position COMARCO to assist in the creation of performance-driven networks.

OPTIMIZE
FOR CAPITAL EFFICIENCY

NETWORK OPTIMIZATION

OPTIMIZATION is at the heart of maximizing existing capital investment. Incremental expansion, changes in traffic patterns, and interference from neighboring or competing networks create a dynamic environment that compromises original design parameters. The result—sub-optimal performance. Network problems are often complex and difficult to resolve without building additional costly cell sites. Our value proposition is a simple one—help carriers identify the key problems that affect network performance, isolate the causes, and find cost effective solutions. This proactive process allows carriers to get more—more capacity from existing spectrum, more minutes of use from existing infrastructure, more revenue and profit—without deploying additional capital.

COMARCO's integrated solutions for network optimization are based on a portfolio of advanced technology tools and engineering services designed to simplify and automate the task of fault finding and resolution. Our top-of-the-line X-series optimization systems combine sophisticated interference measurement techniques with information from real wireless phone calls to pinpoint and identify service problems. These systems in the hands of our RF engineers and professional technicians combine to create a powerful engineering services offering.



> CELL SITE INTEGRATION

> DATA OVERLAYS

> SWITCH UPGRADES

> NETWORK MAINTENANCE

VERIFY
QUALITY OF SERVICE

> WIRELESS INFRASTRUCTURE TESTING

> MOBILE DATA COLLECTION

> ANALYSIS AND REPORT GENERATION

> OPTIMIZATION INFORMATION AND SERVICES

QUALITY OF SERVICE

THE DAYS of single carrier markets are long gone. The proliferation of new technologies and systems means several strong competitors vying for the same customer. Delivering and maintaining the highest Quality of Service is fundamental to attracting and, most importantly, retaining customers. Staying at the forefront is therefore a matter of knowing your network's strengths and all your competitors' weaknesses.

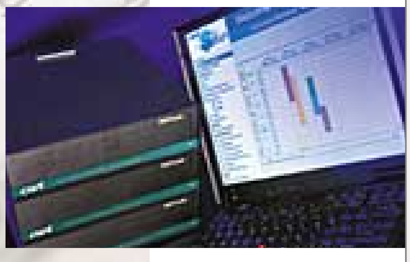
SUPPORTING the wireless technologies of all competing networks, COMARCO's BaseLINE systems are deployed by leading carriers to drive a process of continual verification and quality improvement. Our BaseLINE systems are advanced technology tools used to simulate and evaluate network performance in real world conditions from the subscriber's perspective. To this end, our systems measure all aspects that provide high perceived value to the customer, such as Audio Quality, Dropped Calls, and Out of Service occurrences. Leveraging our expertise and developed technology, COMARCO also offers comprehensive outsourced Quality of Service benchmarking services as a supplement or an alternative to internal programs.

MAXIMIZE
REVENUE POTENTIAL

REVENUE ASSURANCE

WITH PROFITS pressured by relentless competition, making every dollar count, and making sure every dollar is counted, has never been more critical. Leveraging our leading position in wireless revenue assurance, our mission is to quantify, identify, and resolve points of failure that result in revenue leakage. Through a combination of hardware and software systems and services, we work with carriers to implement a system that will form the heart of a comprehensive revenue assurance management process.

UTILIZING RAPcentral™, the first application based on our newly developed stationary testing platform, COMARCO experts deploy a system whereby continuous test call placement and data analysis reveal areas of potential revenue loss on an ongoing basis. Offered as an outsourced service, RAPcentral™ permits carriers to rapidly deploy a reliable, proven process without investment of capital and other resources to develop an in-house program. Extracting critical data from the revenue generation process, RAPcentral™ offers carriers the ability to continually verify revenue stream integrity, with full audit capabilities.



> AUTOMATED CALL GENERATION

> DISTRIBUTED INTERNET CONTROL ARCHITECTURE

> REVENUE CAPTURE AND LEAKAGE REPORT GENERATION

> SWITCH DATABASE VERIFICATION

EXPAND
WIRELESS APPLICATIONS

REMOTE VOICE SYSTEMS

WITH OVER 18,000 units installed and patents protecting our developed technology, COMARCO is the leading provider of wireless call box systems. These systems provide emergency communication to motorists and others over existing wireless networks. Currently, our systems are installed in California, Georgia, Pennsylvania, and New York. As other states choose to deploy emergency call box systems, we are uniquely positioned to capture these opportunities and expand our dominant market position.

CHARGESOURCE

THE PROLIFERATION of wireless devices is increasing with the demand to stay connected. It's not uncommon for business people to travel with cell phones, laptop computers, PDAs, and other wireless devices, all limited by power requirements and battery capacity. With our unique and patented ChargeSource family of mobile power products, business travelers are able carry one compact power supply. The ChargeSource 70-watt universal AC power adapter is capable of powering and charging most laptop computers, handheld devices, and portable printers. Our patented SmartTip™ technology configures the electrical output of the power adapter to conform to the unique needs of each target device.

Mobility…Utility…Efficiency

INSIDE THE NUMBERS

COMARCO 2001 FINANCIALS

FINANCIAL REVIEW

SELECTED FINANCIAL DATA

Years Ended January 31,	2001	2000	1999	1998	1997
(In thousands, except per share data)					
Revenue:					
Products	$37,479	$33,499	$28,849	$25,586	$18,433
Services	11,985	5,725	5,155	3,938	1,086
	49,464	39,224	34,004	29,524	19,519
Cost of sales:					
Products	17,213	16,983	11,569	8,704	5,877
Services	7,605	3,811	3,473	2,751	748
	24,818	20,794	15,042	11,455	6,625
Gross profit	24,646	18,430	18,962	18,069	12,894
Selling, general and administrative costs	12,285	9,203	9,526	8,534	6,076
Engineering and support costs	4,758	3,808	3,480	3,592	2,536
Operating income before severance costs	7,603	5,419	5,956	5,943	4,282
Severance costs	1,325	—	—	—	—
Operating income	6,278	5,419	5,956	5,943	4,282
Other income, net	762	274	298	404	559
Minority interest in earnings of subsidiary	(7)	(46)	—	—	—
Income from continuing operations before income taxes	7,033	5,647	6,254	6,347	4,841
Income tax expense	2,483	2,061	2,283	2,317	1,622
Net income from continuing operations	4,550	3,586	3,971	4,030	3,219
Net income (loss) from discontinued operations	(9)	(433)	1,712	845	1,446
Net income	$ 4,541	$ 3,153	$ 5,683	$ 4,875	$ 4,665
Earnings per share:					
Continuing operations:					
Basic	$ 0.67	$ 0.55	$ 0.57	$ 0.57	$ 0.45
Diluted	$ 0.61	$ 0.49	$ 0.51	$ 0.48	$ 0.39
Earnings (loss) per share:					
Discontinued operations:					
Basic	$ —	$ (0.07)	$ 0.25	$ 0.12	$ 0.20
Diluted	$ —	$ (0.06)	$ 0.24	$ 0.11	$ 0.18
Earnings per share:					
Basic	$ 0.67	$ 0.48	$ 0.82	$ 0.69	$ 0.65
Diluted	$ 0.61	$ 0.43	$ 0.75	$ 0.59	$ 0.57

January 31,	2001	2000	1999	1998	1997
Working capital	$29,096	$25,637	$24,833	$23,763	$22,565
Total assets	66,051	44,694	43,001	40,494	36,754
Borrowing under line of credit	—	—	—	—	—
Long-term debt, including current maturities	—	—	—	—	—
Stockholders' equity	43,495	31,754	31,202	30,470	26,977

You should read the following discussion and analysis in conjunction with the consolidated financial statements and related notes thereto contained elsewhere in this report. The information contained in this report is not a complete description of our business or of the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our annual report on Form 10-K for the year ended January 31, 2001, which discusses our business in greater detail.

This report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," or "continue," the negative of such terms, or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Important factors that may cause actual results to differ materially from the forward-looking statements are described in the section entitled "Risk Factors" and various other sections in Item 1 in our annual report on Form 10-K, and other risks identified from time to time in our filings with the Securities and Exchange Commission, press releases, and other communications.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

OVERVIEW

COMARCO, Inc., through its subsidiary Comarco Wireless Technologies, Inc. ("CWT"), is a leading provider of advanced technology tools and engineering services for the wireless communications industry. COMARCO also designs and manufactures remote voice systems and mobile power products for notebook computers, cellular telephones, and personal organizers. COMARCO is a California corporation that became a public company in 1971 when it was spun-off from Genge Industries, Inc. CWT was incorporated in the State of Delaware in September 1993. During October 1999, we embarked on a plan to divest our non-wireless businesses, which included the defense and commercial staffing businesses. The divestiture plan was completed during November 2000. Accordingly, our continuing operations consist solely of the operations of CWT.

RESULTS OF OPERATIONS—CONTINUING OPERATIONS

We have two reportable operating segments: wireless infrastructure and wireless applications.

Wireless Infrastructure

This operating segment designs and manufactures advanced technology hardware and software tools for use by wireless carriers, equipment vendors, and others. These tools are used by RF engineers, professional technicians, and others to design, deploy, and optimize wireless networks, and to test and measure the Quality of Service once the wireless networks are deployed. The wireless infrastructure segment is also a provider of value-added engineering services that assist wireless carriers, equipment vendors, and others in all phases of the wireless network lifecycle.

Wireless Applications

This operating segment designs and manufactures remote voice systems and mobile power products for notebook computers, cellular telephones, and personal organizers. Remote voice systems currently include various call box products that provide emergency communication via wireless networks. In addition to the call box products, we provide system installation and long-term maintenance services. Currently, there are approximately 18,000 installed call boxes, the majority of which are serviced and maintained under long-term agreements.

The wireless applications segment also includes the ChargeSource 70-watt universal AC power adapter, our second-generation mobile power system that powers and charges most laptop computers, cellular telephones, handheld devices, and portable printers. This product is distributed by Targus Group International ("Targus") and during the third quarter ended October 31, 2000, we began delivering on a $10 million order from Targus. We anticipate expanding the ChargeSource product offering with a companion product to the universal AC power adapter during the third quarter ending October 31, 2001.

The following table sets forth certain items as a percentage of revenue from our audited consolidated statements of income for 2001, 2000, and 1999. The table and discussion that follows provide information that management believes is relevant to an assessment and understanding of our consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and accompanying notes thereto included elsewhere herein.

Years Ended January 31,	2001	2000	1999
Revenues:			
Products	75.8%	85.4%	84.8%
Services	24.2	14.6	15.2
	100.0	100.0	100.0
Cost of sales:			
Products	34.8	43.3	34.0
Services	15.4	9.7	10.2
	50.2	53.0	44.2
Gross profit:			
Products	41.0	42.1	50.8
Services	8.8	4.9	5.0
	49.8	47.0	55.8
Selling, general and administrative costs	24.8	23.5	28.0
Engineering and support costs	9.6	9.7	10.3
Operating income before severance costs	15.4	13.8	17.5
Severance costs	2.7	—	—
Operating income	12.7	13.8	17.5
Other income, net	1.5	0.7	0.9
Minority interest in earnings of subsidiary	—	(0.1)	—
Income from continuing operations before income taxes	14.2	14.4	18.4
Income tax expense	5.0	5.3	6.7
Net income from continuing operations	9.2%	9.1%	11.7%

CONSOLIDATED

Revenue

Total revenue for 2001 increased 26.1 percent to $49.5 million compared with 2000, due to an increase in sales from our wireless infrastructure segment, partially offset by a decrease in sales from our wireless applications segment. Total revenue for 2000 increased 15.4 percent to $39.2 million compared with 1999, due to an increase in sales from our wireless applications segment, partially offset by a decrease in sales from our wireless infrastructure segment.

In 2001 compared to 2000, revenue from products increased 11.9 percent to $37.5 million while revenue from services increased 109.3 percent to $12.0 million. The product revenue growth was due to increased sales from our wireless infrastructure segment, partially offset by a decrease in sales from our wireless applications segment. The services revenue growth was due to increased sales of engineering services from our wireless infrastructure segment. In 2000 compared to 1999, revenue from products increased 16.1 percent to $33.5 million while revenue from services increased 11.1 percent to $5.7 million. The product revenue growth was due to increased sales from both our segments. The services revenue growth was due to sales of engineering services from our wireless infrastructure segment that were initially offered during the quarter ended January 31, 2000.

Cost of Sales and Gross Margin

Total cost of sales in 2001 increased 19.4 percent to $24.8 million compared with 2000. As a percentage of revenue, gross margin increased to 49.8 percent from 47.0 percent in 2000. This increase was primarily due to increased volume in our higher margin wireless infrastructure segment, including increased sales of hardware and software tools and engineering services, partially offset by decreased volumes and margins in our wireless applications segment. Total cost of sales in 2000 increased 38.2 percent to $20.8 million compared with 1999. As a percentage of revenue, gross margin decreased to 47.0 percent from 55.8 percent in 1999. This decrease was primarily due to increased volumes and lower margins in our wireless applications segment.

Selling, General and Administrative Costs

Selling, general and administrative costs increased 33.5 percent in 2001 compared to 2000 and decreased 3.4 percent in 2000 compared to 1999. The increase in 2001 was due to staffing increases in support of the engineering services offering that commenced full operations during the first quarter of 2001, costs related to the marketing of the ChargeSource 70-watt universal AC power adapter, and increased commissions on wireless infrastructure product sales. The decrease in 2000 was due to decreased international selling expenses, which was consistent with an economic downturn in a number of international markets. As a percentage of revenue, selling, general and administrative costs were 24.8 percent, 23.5 percent, and 28.0 percent for 2001, 2000, and 1999, respectively.

Engineering and Support Costs

Engineering and support costs increased 24.9 percent in 2001 compared to 2000 and increased 9.4 percent in 2000 compared to 1999. These increases reflect the ongoing efforts in developing new products and new technologies for the wireless communications industry.

Severance Costs

During the second quarter ended July 31, 2000 and in conjunction with the disposition of our non-wireless businesses, we were required to record a $1.3 million charge to continuing operations for costs related to severance agreements for outgoing corporate staff. No comparable costs were incurred during 2000 and 1999.

Other Income

Other income, consisting primarily of interest income, increased $0.5 million to $0.8 million in 2001 from $0.3 million in 2000. The increase in 2001 was primarily due to higher cash balances during the year.

Income Tax Expense

The effective tax rate for 2001 was 35.3 percent and 36.5 percent for both 2000 and 1999. The decrease in 2001 was due to tax credits earned from increased research and development activity during the year.

Wireless Infrastructure

Years Ended January 31,	2001	2000	1999
(In thousands)			
Revenue	$34,678	$19,259	$23,670
Cost of sales	14,315	7,575	8,058
Gross profit	$20,363	$11,684	$15,612
Gross margin	58.7%	60.7%	66.0%

Revenue

Revenue from our wireless infrastructure segment increased 80.1 percent to $34.7 million in 2001 compared with 2000 and decreased 18.6 percent to $19.3 million in 2000 compared to 1999. The increase in 2001 was due to strong growth in sales of our hardware and software tools and increased sales of engineering services that were initially offered during the fourth quarter of 2000. The decrease in 2000 was due to product transition issues and fourth quarter delays in receiving orders from wireless carriers for existing products, which resulted in decreased sales of our hardware and software tools. The resolution of both these factors had a positive effect on revenue for 2001.

Cost of Sales and Gross Margin

Cost of sales from our wireless infrastructure segment in 2001 increased 89.0 percent to $14.3 million compared with 2000. As a percentage of revenue, gross margin decreased to 58.7 percent from 60.7 percent in 2000. The increase in cost of sales was primarily due to increased sales volume of both hardware and software tools and engineering services. The decrease in gross margin was primarily due to increased sales volume of lower margin engineering services. Cost of sales in 2000 decreased 6.0 percent to $7.6 million compared with 1999. As a percentage of revenue, gross margin decreased to 60.7 percent from 66.0 percent in 1999. The decrease in cost of sales was consistent with the decrease in sales volume of hardware and software tools. The decrease in gross margin was primarily due to fourth quarter delays in receiving orders from wireless carriers. As a portion of our costs are fixed, a short timing delay in recognizing revenue could have a negative impact on our gross margins.

Wireless Applications

Years Ended January 31,	2001	2000	1999
(In thousands)			
Revenue	$14,786	$19,965	$10,334
Cost of sales	10,503	13,219	6,984
Gross profit	$ 4,283	$ 6,746	$ 3,350
Gross margin	29.0%	33.8%	32.4%

Revenue

Revenue from our wireless applications segment decreased 26.0 percent to $14.8 million in 2001 compared with 2000 and increased 93.2 percent to $20.0 million in 2000 compared to 1999. The decrease in 2001 was primarily due to decreased sales of upgrades to previously installed call box systems. Call box systems are upgraded periodically based on the age of the technology, condition of the call boxes, and the needs of the respective customers. System upgrades do not recur annually. The decrease in 2001 was partially offset by a $1.0 million increase in sales of the ChargeSource 70-watt universal AC power adapter, our second-generation mobile power system that went into production during the fourth quarter of 2001. The increase in 2000 was due to sales of upgrades of several call box systems as well as the ChargeSource 35-watt universal AC power adapter, our first-generation mobile power system that went into production during the fourth quarter of 1999.

Cost of Sales and Gross Margin

Cost of sales from our wireless applications segment in 2001 decreased 20.5 percent to $10.5 million compared with 2000. As a percentage of revenue, gross margin decreased to 29.0 percent from 33.8 percent in 2000. The decrease in cost of sales was consistent with the decrease in sales volume of call box systems and upgrades. The decrease in gross margin was due to increased costs associated with providing maintenance services for installed call box systems and costs incurred transitioning to the ChargeSource 70-watt universal AC power adapter from the 35-watt, a first-generation product. Cost of sales in 2000 increased 89.3 percent to $13.2 million compared with 1999. As a percentage of revenue, gross margin increased to 33.8 percent from 32.4 percent in 1999. The increase in cost of sales was consistent with the increase in sales volume of both call box system upgrades and the ChargeSource 35-watt universal AC power adapter. The increase in gross margin was primarily due to a favorable change in product mix.

DISCONTINUED OPERATIONS

As discussed above, we embarked on a plan to divest our non-wireless businesses, which included the defense and commercial staffing businesses. The divestiture plan was completed during November 2000.

Net loss from discontinued operations was $9,000 for 2001, which includes net income during phase-out of $348,000 on revenue of $21.7 million, less an after-tax loss of $357,000 on the disposition of our non-wireless businesses. For 2000, the net loss from discontinued operations was $433,000 on revenue of $51.7 million, compared with net income from discontinued operations of $1.7 million on revenue of $58.0 million for 1999. The decrease in revenue and the loss from discontinued operations for 2000 were due to the sales of the various non-wireless businesses and loss provisions established on fixed price government contracts.

LIQUIDITY AND CAPITAL RESOURCES

Our financial position remains strong, with cash and cash equivalents of $24.9 million at January 31, 2001.

Cash Flows from Operating Activities

We generated cash from operations of $20.8 million in 2001 compared to $9.9 million in 2000 and $6.3 million in 1999. In 2001, cash from operations was primarily a result of net income from continuing operations adjusted for non-cash charges for depreciation and amortization, a refund of a tax benefit on stock options exercised of $2.4 million, an increase in current liabilities primarily attributable to accrued costs related to discontinued operations, partially offset by an increase in accounts receivable. In 2000 and 1999, cash from operations was primarily a result of net income from continuing operations adjusted for depreciation and amortization and changes in working capital.

Cash Flows from Investing Activities

Net cash used in investing activities was $9.4 million in 2001 compared to $5.3 million in 2000 and $2.5 million in 1999. In all periods, capital expenditures for property and equipment, acquisitions, and software development partially offset by proceeds from sales and maturities of investments constituted substantially all of our cash used in investing activities.

The development of software is critical to our products currently under development. We intend to invest aggressively in a software development program designed to bring new products and services for the wireless communications industry to market in a timely manner. Software and hardware development programs are expected to be funded with current cash balances and cash provided by operating activities.

On December 7, 2000, we acquired all the outstanding common stock of EDX Engineering, Inc. ("EDX") for 257,428 shares of our common stock, valued at $4.2 million on the day the transaction closed, and $2.3 million in cash.

Cash Flows from Financing Activities

Net cash provided by financing activities was $0.5 million in 2001 as compared to net cash used in financing activities of $4.0 million and $5.1 million in 2000 and 1999, respectively. In all periods, proceeds from the sales of common stock issued through employee and director stock option plans, offset by the repurchase of our common stock, constituted substantially all of our cash provided by and used in financing activities.

During 1992, our Board of Directors authorized a stock repurchase program of up to 3.0 million shares of our common stock. From program inception through January 31, 2001, the Company has repurchased approximately 2.3 million shares for an average price of $7.78 per share. During 2001, we repurchased approximately 100,000 shares in the open market for an average price of $16.74 per share.

The Company maintains a $10.0 million unsecured revolving credit facility (the "Credit Facility") which expires June 30, 2001. Borrowings under the Credit Facility bear interest at the bank's prime rate or the London Interbank Offered Rate plus 150 basis points, at the option of the Company. At January 31, 2001 and as of the date of this annual report on Form 10-K, there are no amounts outstanding on the Credit Facility and the entire $10.0 million commitment is available to the Company.

Our liquidity is affected by many factors, some of which are based on the normal ongoing operations of our businesses and some of which arise from fluctuations related to domestic and global economies and markets. We believe that cash generated from operations and our unused line of credit will be sufficient to satisfy our working capital, capital expenditure, and development funding requirements for the foreseeable future.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, including changes in currency exchange rates. As of January 31, 2001, we had no material accounts receivable denominated in foreign currencies. Our standard terms require customers to pay for our products and services in U.S. dollars. For those orders denominated in foreign currencies, we may limit our exposure to losses from foreign currency transactions through forward foreign exchange contracts. To date, sales denominated in foreign currencies have not been significant.

OTHER INFORMATION

Significant additional information about the business and finances of our company is included in our annual report on Form 10-K for the year ended January 31, 2001 filed with the Securities and Exchange Commission. The section entitled "Risk Factors" and various other sections in Item 1 in our annual report on Form 10-K, discuss some of the important risk factors that may affect our business, results of operations, and financial condition. You may obtain a copy of our annual report on Form 10-K without charge by contacting our Investor Relations office, the address of which is on the inside back cover of this report, or by visiting the Securities and Exchange Commission's EDGAR Web site at www.sec.gov.

CONSOLIDATED BALANCE SHEETS

January 31,	2001	2000
(In thousands, except share data)		
Assets		
Current Assets:		
Cash and cash equivalents	$24,903	$ 5,064
Short-term investments	3,819	3,721
Accounts receivable, net	8,418	6,695
Inventory	5,277	4,852
Deferred tax assets, net	2,133	1,454
Net assets of discontinued operations	—	9,361
Other current assets	1,746	2,651
Total current assets	46,296	33,798
Property and equipment, net	3,695	2,763
Software development costs, net	7,249	5,839
Goodwill and acquired intangible assets, net	8,381	2,222
Other assets	430	72
	$66,051	$44,694
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$ 1,050	$ 666
Deferred revenue	6,786	3,077
Accrued liabilities	9,364	4,418
Total current liabilities	17,200	8,161
Deferred compensation	3,918	3,634
Deferred tax liabilities, net	1,406	1,145
Minority interest	32	—
Commitments and contingencies (Note 19)		
Stockholders' Equity:		
Common stock, $0.10 par value, 50,625,000 shares authorized; 7,066,560 and 6,510,543 shares outstanding at January 31, 2001 and 2000, respectively	707	651
Additional paid-in capital	11,619	4,475
Accumulated other comprehensive income	3	3
Retained earnings	31,166	26,625
Total stockholders' equity	43,495	31,754
	$66,051	$44,694

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

Years Ended January 31,	2001	2000	1999
(In thousands, except share data)			
Revenue:			
Products	$37,479	$33,499	$28,849
Services	11,985	5,725	5,155
	49,464	39,224	34,004
Cost of sales:			
Products	17,213	16,983	11,569
Services	7,605	3,811	3,473
	24,818	20,794	15,042
Gross profit	24,646	18,430	18,962
Selling, general and administrative costs	12,285	9,203	9,526
Engineering and support costs	4,758	3,808	3,480
Operating income before severance costs	7,603	5,419	5,956
Severance costs	1,325	—	—
Operating income	6,278	5,419	5,956
Other income, net	762	274	298
Minority interest in earnings of subsidiary	(7)	(46)	—
Income from continuing operations before income taxes	7,033	5,647	6,254
Income tax expense	2,483	2,061	2,283
Net income from continuing operations	4,550	3,586	3,971
Discontinued operations (Note 5):			
Net income (loss) from discontinued operations, net of income tax expense (benefit)	—	(433)	1,712
Loss on disposal of discontinued operations, including operating income during phase-out period, net of income tax expense	(9)	—	—
Net income	$ 4,541	$ 3,153	$ 5,683
Earnings per share—continuing operations:			
Basic	$ 0.67	$ 0.55	$ 0.57
Diluted	$ 0.61	$ 0.49	$ 0.51
Earnings (loss) per share—discontinued operations:			
Basic	$ —	$ (0.07)	$ 0.25
Diluted	$ —	$ (0.06)	$ 0.24
Earnings per share:			
Basic	$ 0.67	$ 0.48	$ 0.82
Diluted	$ 0.61	$ 0.43	$ 0.75

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at January 31, 1998, 7,078,065 shares	$708	$ 2,838	$ —	$26,924	$30,470
Net income	—	—	—	5,683	5,683
Exercise of stock options, 28,875 shares	3	84	—	—	87
Tax benefit from exercise of stock options	—	140	—	—	140
Purchase and retirement of common stock, 422,250 shares	(43)	(489)	—	(4,662)	(5,194)
Recognition of unrealized holding gain on available-for-sale securities	—	—	16	—	16
Balance at January 31, 1999, 6,684,690 shares	668	2,573	16	27,945	31,202
Net income	—	—	—	3,153	3,153
Exercise of stock options, 125,438 shares	13	578	—	—	591
Tax benefit from exercise of stock options	—	865	—	—	865
Purchase and retirement of common stock, 368,850 shares	(37)	(424)	—	(4,355)	(4,816)
Minority interest resulting from exercise of subsidiary options	—	—	—	(118)	(118)
Issuance of common stock to acquire subsidiary minority interest, 69,265 shares	7	883	—	—	890
Recognition of unrealized holding loss on available-for-sale securities	—	—	(13)	—	(13)
Balance at January 31, 2000, 6,510,543 shares	651	4,475	3	26,625	31,754
Net income	—	—	—	4,541	4,541
Exercise of stock options, 392,270 shares	39	2,039	—	—	2,078
Tax benefit from exercise of stock options	—	2,413	—	—	2,413
Purchase and retirement of common stock, 99,597 shares	(10)	(1,657)	—	—	(1,667)
Minority interest resulting from exercise of subsidiary options	—	41	—	—	41
Issuance of common stock to acquire subsidiary minority interest, 5,916 shares	1	87	—	—	88
Issuance of common stock to acquire outstanding shares of EDX Engineering, 257,428 shares	26	4,221	—	—	4,247
Balance at January 31, 2001, 7,066,560 shares	$707	$11,619	$ 3	$31,166	$43,495

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended January 31,	2001	2000	1999
(In thousands)			
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income from continuing operations	$ 4,550	$ 3,586	$ 3,971
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	5,231	3,159	2,925
Loss (gain) on disposal of property and equipment	(6)	85	(4)
Tax benefit from exercise of stock options	2,413	865	140
Deferred income taxes	54	(383)	(63)
Provision for doubtful accounts receivable	24	24	24
Minority interest in earnings of subsidiary	7	46	—
Changes in operating assets and liabilities, net of acquisitions:			
Trading securities	(110)	(975)	(980)
Accounts receivable	(1,464)	4,512	(2,189)
Inventory	(425)	(695)	1,090
Other assets	1,607	(2,293)	92
Deferred compensation	284	975	980
Current liabilities	8,670	949	347
Net cash provided by operating activities	20,835	9,855	6,333
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sales and maturities of investments	12	542	2,407
Purchases of property and equipment	(2,505)	(1,876)	(995)
Proceeds from sales of property and equipment	14	29	4
Software development costs	(4,641)	(3,563)	(2,936)
Cash paid for acquisition of minority interest	—	(433)	—
Cash paid for acquisitions, net of cash acquired	(2,324)	—	(1,000)
Net cash used in investing activities	(9,444)	(5,301)	(2,520)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from issuance of common stock	2,078	591	87
Proceeds from issuance of subsidiary common stock	88	179	—
Purchase and retirement of common stock	(1,667)	(4,816)	(5,194)
Net cash provided by (used in) financing activities	499	(4,046)	(5,107)
Net increase (decrease) in cash and cash equivalents—continuing operations	11,890	508	(1,294)
Net increase (decrease) in cash and cash equivalents—discontinued operations	7,949	1,336	(742)
Net increase (decrease) in cash and cash equivalents	19,839	1,844	(2,036)
Cash and cash equivalents, beginning of period	5,064	3,220	5,256
Cash and cash equivalents, end of period	$24,903	$ 5,064	$ 3,220

The accompanying notes are an integral part of these consolidated financial statements.

1. ORGANIZATION

COMARCO, Inc., through its subsidiary Comarco Wireless Technologies, Inc. (collectively, "COMARCO" or the "Company"), is a leading provider of advanced technology tools and engineering services for the wireless communications industry. COMARCO also designs and manufactures remote voice systems and mobile power products for notebook computers, cellular telephones, and personal organizers. COMARCO is a California corporation that became a public company in 1971 when it was spun-off from Genge Industries, Inc. Comarco Wireless Technologies, Inc. ("CWT") was incorporated in the state of Delaware in September 1993. During October 1999, the Company embarked on a plan to divest its non-wireless businesses, which included the defense and commercial staffing businesses. The divestiture plan was completed during November 2000. Accordingly, the Company's continuing operations consist solely of the operations of CWT.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation:

The consolidated financial statements of the Company include the accounts of COMARCO, Inc., CWT, and wholly owned subsidiaries primarily reported as discontinued operations. All material inter-company balances, transactions, and profits have been eliminated.

Use of Estimates:

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period reported. Actual results could differ from those estimates.

Revenue Recognition:

Revenue from product sales is generally recognized upon shipment of products provided there are no uncertainties regarding customer acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and collectibility is deemed probable.

Service revenue is recognized as the services are performed. Maintenance revenue from customer support and product upgrades, including maintenance bundled with original product sale, is deferred and recognized ratably over the term of the maintenance agreement, typically 12 months.

Estimated costs to repair or replace products that may be returned under warranty are accrued at the time of shipment. The Company's warranty period typically extends 12 months from the date of shipment.

Revenue on long-term contracts is recognized using the percentage-of-completion method on the basis of percentage of costs incurred to date on a contract, relative to the estimated total contract costs. Profit estimates on long-term contracts are revised periodically based on changes in circumstances and any losses on contracts are recognized in the period that such losses become known.

Cash and Cash Equivalents:

All highly liquid investments with original maturity dates of three months or less are classified as cash and cash equivalents. The fair value of cash and cash equivalents approximates the amounts shown in the financial statements.

Short-Term Investments:

Short-term investments consist primarily of balances maintained in a non-qualified deferred compensation plan funded by Company executives and directors. These investments are tradable at the discretion of the funding executives and directors and are subject to claims by the Company's general creditors. Accordingly, these investments are classified as trading securities. Trading securities are recorded at market value based on current market quotes and totaled $3.7 million and $3.6 million as of January 31, 2001 and 2000, respectively. Unrealized holding gains (losses) on these short-term investments recorded for the years ended January 31, 2001, 2000, and 1999 were ($574,000), $173,000, and $281,000, respectively.

Short-term investments also consist of investments in certain equity securities. These short-term investments are classified as available-for-sale securities and are carried at their estimated fair market value based on current market quotes, which totaled $75,000 and $87,000 as of January 31, 2001 and 2000, respectively. The unrealized gain on the value of these investments totaled $3,000 as of January 31, 2001 and 2000. Realized gains and losses on sales of investment securities are included in the consolidated statements of income and have not been material for any period presented.

Inventory:

Inventories are valued at the lower of cost (calculated on average cost, which approximates first-in, first-out basis) and net realizable value.

Property and Equipment:

Property and equipment are stated at cost less accumulated depreciation. Additions, improvements, and major renewals are capitalized; maintenance, repairs, and minor renewals are expensed as incurred. Depreciation and amortization is calculated on a straight-line basis over the expected useful lives of the property and equipment. The expected useful lives of office furnishings and fixtures are five to seven years, and of equipment and purchased software are two to five years.

Research and Development and Software Development Costs:

Research and development costs are charged to expense as incurred and have been included in engineering and support costs. Costs incurred for the development of software that will be sold are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated future revenue and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of software development costs begins when the product is available for general release. Amortization is provided on a product-by-product basis on either the straight-line method over periods not exceeding five years or the sales ratio method that is based on expected unit sales and the estimated life of the product. Unamortized software development costs determined to be in excess of net realizable value of the product are expensed immediately.

Goodwill and Acquired Intangible Assets:

Goodwill, which represents the excess of purchase price over fair value of net assets acquired in a business combination, is recorded at cost less accumulated amortization.

Amortization of goodwill and intangible assets is provided on a straight-line method over the estimated useful life of the asset, principally in the range of five to fifteen years.

The Company assesses the recoverability of goodwill and intangible assets quarterly or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company will determine whether the amortization of the asset balance over its remaining life can be recovered through undiscounted future cash flows of the acquired business. If the amortization cannot be fully recovered, the amount of impairment is based on projected discounted future cash flows or appraised values, depending on the nature of the asset. In addition, the Company continually evaluates the periods of amortization associated with goodwill and intangible assets not identified with an impaired asset to determine whether events and circumstances warrant revised estimates of useful lives.

Long-Lived Assets:

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When such events or changes in circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of assets.

Income Taxes:

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Minority Interest:

During the years ended January 31, 2001 and 2000, the Company issued 7,000 and 58,000 shares of CWT stock, respectively, from the exercise of CWT stock options, which resulted in the creation of a minority interest. The option holder is required to hold the CWT stock purchased from the exercise of the stock options for at least six months.

In 2001, the Company acquired an additional 3,000 minority shares of CWT by the issuance of 5,916 shares of Company stock. In 2000, the Company acquired the 58,000 minority shares of CWT through the payment of $433,000 in cash and the issuance of 69,265 shares of Company stock.

Under the purchase method of accounting, the excess purchase price over fair value of the CWT stock acquired from the minority stockholders has been recorded as goodwill. During 2001 and 2000, the Company recognized goodwill of $62,000 and $980,000, respectively.

Concentrations of Credit Risk and Major Customers:

The Company's cash and cash equivalents are principally on deposit in a short-term asset management account at a large financial institution. Accounts receivable potentially subject the Company to concentrations of credit risk. The Company's customer base is comprised primarily of large companies. The Company generally does not require collateral for accounts receivable. When required, the Company maintains allowances for credit losses, and to date such losses have been within management's expectations.

Two customers each accounted for between 13 percent and 15 percent of total revenue in 2001. Three customers each accounted for between 10 percent and 12 percent of total revenue in 2000. No one customer accounted for more than 10 percent of revenue in 1999.

Segment Reporting:

The Company adopted Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS 131"), for the year ended January 31, 2000. SFAS 131 establishes standards for the manner in which public companies report information about operating segments in annual and interim financial statements. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. The method for determining what information to report is based on the way management organizes the operating segments within a company for making operating decisions and assessing financial performances.

The Company's chief executive officer (CEO) is its chief operating decision-maker. The financial information that the CEO reviews is similar to the information presented in the accompanying statements of operations. The Company operates in two business segments: wireless infrastructure and wireless application products and services.

Net Income Per Common Share:

Basic earnings per share is computed by dividing net earnings (numerator) by the weighted-average number of common shares outstanding (denominator) during the period excluding the dilutive effect of potential common stock which consists of stock options and convertible securities. Diluted net earnings per share gives effect to all dilutive potential common stock outstanding during the period. The effect of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable.

Stock-Based Compensation:

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), provides for companies to recognize compensation expense associated with stock-based compensation plans over the anticipated service period based upon the fair value of the award at the date of grant. However, SFAS 123 allows for companies to continue to measure compensation costs as prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"). The Company has elected to continue its current policy, which is to account for stock-based compensation plans under APB 25.

In March 2000, the Financial Accounting Standards Board ("FASB") issued Financial Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation—an Interpretation of APB Opinion No. 25" ("FIN 44"), which must be applied prospectively to new stock option awards, exchanges of awards in a business combination, modifications to outstanding awards, and changes in grantee status that occur on or after July 1, 2000. The Company adopted FIN 44 effective July 1, 2000 with no impact on its historical consolidated statements and related disclosures.

Fair Value of Financial Instruments:

The estimated fair values of the Company's financial instruments have been determined using available market information. The estimates are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have an effect on the estimated fair value amounts. The fair value of current financial assets, current liabilities, and other assets are estimated to be equal to their carrying amounts.

Reclassifications:

Certain prior period balances have been reclassified to conform to the current period presentation.

Comprehensive Income:

Comprehensive income consists of net income and net unrealized gains on available-for-sale securities, net of income tax, and is presented in the consolidated statements of comprehensive income. Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"), requires only additional disclosures in the consolidated financial statements; it does not affect the Company's financial position or results of operations. The components of comprehensive income are as follows (dollars in thousands):

Years Ended January 31,	2001	2000	1999
Net income	$4,541	$3,153	$5,683
Other comprehensive income:			
Unrealized holding gains (losses) on investments, net of income taxes	—	(13)	16
Comprehensive income	$4,541	$3,140	$5,699

Stock Split:

In October 2000, the Company effected a stock split of three shares for every two of common stock outstanding. All references in the consolidated financial statements to the number of shares and to per share amounts have been retroactively restated to reflect this stock split.

3. RECENT ACCOUNTING PRONOUNCEMENTS

Pursuant to the Securities and Exchange Commission's Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"), the Company has reviewed its accounting policies for the recognition of revenue. SAB 101 was required to be implemented in the fourth quarter ended January 31, 2001. SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition in financial statements. The Company's policies for revenue recognition are consistent with the views expressed within SAB 101.

On February 1, 2000, the Company adopted Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" ("SFAS 138"). SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments. Specifically, SFAS 133 requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and to measure those instruments at fair value. Additionally, the fair value adjustments will affect either stockholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. The adoption of SFAS 133, as amended, had no effect on the Company's results of operations and financial position because the Company does not have any derivative instruments nor has the Company engaged in hedging activities.

4. ACQUISITION

On December 7, 2000, COMARCO acquired all of the outstanding shares of stock of EDX Engineering, Inc. ("EDX"), a leading developer of system planning tools for the wireless communications industry. Consideration for the acquisition consisted of approximately $2.3 million in cash and 257,428 shares of the Company's common stock. The excess purchase price paid over the fair value of tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill of $3.2 million was recognized and is being amortized over nine years. Acquired identifiable intangible assets of $3.4 million consist primarily of completed technology and customer base and are being amortized over nine years.

The purchase price for the acquisition of EDX during the year ended January 31, 2001 was allocated to assets acquired and liabilities assumed based on fair market value at the date of the acquisition. The total cost of the acquisition during the year ended January 31, 2001 is summarized as follows (dollars in thousands):

Cash paid for acquisition, net	$2,324
Common stock issued	4,247
Assumed liabilities	254
Purchase price	$6,825

Unaudited pro forma statement of income information has not been presented because the effects of the EDX acquisition were not significant.

5. DISCONTINUED OPERATIONS

In July 1999, COMARCO embarked on a plan to dispose of its non-wireless businesses. This plan, which was formalized in October 1999, involved selling the Company's defense and commercial staffing businesses. The disposition plan was completed with the sixth and final disposition transaction closing on November 17, 2000.

Pursuant to Accounting Principles Board Opinion ("APB") No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"), the consolidated financial statements of COMARCO have been reclassified to segregate the revenue, costs and expenses, assets and liabilities, and cash flows of the non-wireless businesses. The net operating results, net assets, and net cash flows of the non-wireless businesses have been reported as "discontinued operations." Gross proceeds from the disposition transactions totaled $11.0 million.

Following is summarized financial information for the discontinued operations (dollars in thousands):

Years Ended January 31,	2001	2000	1999
Revenue	$21,700	$51,700	$58,000
Income (loss) from discontinued operations (net of income tax expense (benefit) of $249, ($128) and $1,200, respectively)	348	(433)	1,712
Loss on disposal of businesses (net of income tax expense of $427)	(357)	—	—
Income (loss) from discontinued operations	$ (9)	$ (433)	$ 1,712

January 31,	2000
Current assets	$ 9,275
Total assets	12,544
Current liabilities	3,183
Total liabilities	3,183
Net assets of discontinued operations	$ 9,361

6. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following (dollars in thousands):

January 31,	2001	2000
Commercial	$8,502	$6,733
Other	12	72
	8,514	6,805
Less: Allowances for doubtful accounts	(96)	(110)
	$8,418	$6,695

7. INVENTORY

Inventory consists of the following (dollars in thousands):

January 31,	2001	2000
Raw materials	$4,695	$4,122
Work-in-process	363	274
Finished goods	219	456
	$5,277	$4,852

8. PROPERTY AND EQUIPMENT

Property and equipment consist of the following (dollars in thousands):

January 31,	2001	2000
Office furnishings and fixtures	$ 1,487	$ 1,362
Equipment	7,178	5,357
Purchased software	281	281
	8,946	7,000
Less: Accumulated depreciation and amortization	(5,251)	(4,237)
	$ 3,695	$ 2,763

9. SOFTWARE DEVELOPMENT COSTS

Software development costs consist of the following (dollars in thousands):

January 31,	2001	2000
Capitalized software development costs	$12,585	$ 7,944
Less: Accumulated amortization	(5,336)	(2,105)
	$ 7,249	$ 5,839

Capitalized software development costs for the years ended January 31, 2001, 2000, and 1999 totaled $4.6 million, $3.6 million, and $2.9 million, respectively. Amortization of software development costs for the years ended January 31, 2001, 2000, and 1999 totaled $3.2 million, $1.9 million, and $1.9 million, respectively, and have been reported in costs of sales in the accompanying consolidated financial statements.

10. GOODWILL AND ACQUIRED INTANGIBLE ASSETS

Goodwill and acquired intangible assets consist of the following (dollars in thousands):

January 31,	2001	2000
Purchased technology	$1,790	$ —
Customer base	930	—
Goodwill	4,947	1,724
Other acquired intangible assets	1,650	1,000
	9,317	2,724
Less: Accumulated amortization	(936)	(502)
	$8,381	$2,222

Amortization of intangible assets for the years ended January 31, 2001, 2000, and 1999 amounted to $434,000, $303,000, and $149,000, respectively.

11. LINE OF CREDIT

The Company maintains a $10 million unsecured revolving credit facility (the "Credit Facility"), which expires June 30, 2001. Borrowings under the Credit Facility bear interest at the bank's prime rate or the London Interbank Offered Rate (LIBOR) plus 150 basis points, at the option of the Company. The interest rates can be increased by the bank dependent upon the Company maintaining certain financial ratios. The bank's prime rate was 9.0 percent at January 31, 2001. There were no borrowings under the Credit Facility at January 31, 2001 or 2000. At January 31, 2001, the Company was in compliance with such covenants.

12. ACCRUED LIABILITIES

Accrued liabilities consist of the following (dollars in thousands):

January 31,	2001	2000
Accrued payroll and related expenses	$3,784	$2,161
Accrued divestiture liabilities	2,359	—
Inventory received not yet invoiced	1,333	840
Other	1,888	1,417
	$9,364	$4,418

13. INCOME TAXES

Income taxes from continuing operations consist of the following amounts (dollars in thousands):

Years Ended January 31,	2001	2000	1999
Federal:			
Current	$1,939	$1,906	$1,869
Deferred	45	(318)	(52)
State:			
Current	490	538	477
Deferred	9	(65)	(11)
	$2,483	$2,061	$2,283

The effective income tax rate or income before income taxes differs from the United States statutory income tax rates for the reasons set forth in the table below (dollars in thousands). The tax rate shown is for tax expense on income from continuing operations.

Years Ended January 31,	2001		2000		1999	
	Amount	Percent Pretax Income	Amount	Percent Pretax Income	Amount	Percent Pretax Income
Computed "expected" tax on income before income taxes	$2,391	34.0%	$1,920	34.0%	$2,126	34.0%
State tax, net of federal benefit	329	4.7	312	5.5	308	4.9
Research credit	(297)	(4.2)	(67)	(1.2)	(113)	(1.8)
Other, net	60	0.8	(104)	(1.8)	(38)	(0.6)
Income tax expense	$2,483	35.3%	$2,061	36.5%	$2,283	36.5%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at January 31, 2001 and 2000 are as follows (dollars in thousands):

January 31,	2001	2000
Deferred tax assets:		
Accounts receivable	$ 122	$ 398
Inventory	296	266
Property and equipment, principally due to differing depreciation methods	113	19
Employee benefits, principally due to accrual for financial reporting purposes	1,913	2,265
Accrued liabilities for financial reporting purposes	1,258	51
Other	175	118
Total gross deferred tax assets	3,877	3,117
Less valuation allowance	—	—
Net deferred tax assets	$3,877	$3,117
Deferred tax liabilities:		
Prepaid expenses	$ —	$ 91
Software development costs	2,900	2,452
Other	250	265
Total deferred tax liabilities	$3,150	$2,808
Net deferred tax asset	$ 727	$ 309

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. There was no valuation allowance for deferred tax assets as of February 1, 2000, and no change in the valuation allowance for the year ended January 31, 2001.

During 2001, the U.S. Internal Revenue Service completed its audit of the Company's income tax returns for the years ended January 31, 1997 and 1998. The resolution of the audit did not result in a material effect on the Company's financial condition or results of operations.

14. STOCK COMPENSATION

COMARCO has stock-based compensation plans under which outside directors and certain employees receive stock options. The employee stock option plans and a director stock option plan provide that officers, key employees, and directors may be granted options to purchase up to 2,704,337 shares of common stock of the Company at not less than 100 percent of the fair market value at the date of grant, unless the optionee is a 10 percent shareholder of the Company, in which case the price must not be less than 110 percent of the fair market value. Figures for these plans reflect a 3-for-2 stock split declared during the year ended January 31, 2001. The options are exercisable in installments determined by the compensation committee of the Company's Board of Directors; however, no option may be exercised prior to one year following the grant of the option. The options expire as determined by the committee, but no later than ten years and one week after the date of grant (five years for 10 percent shareholders). These plans expire through December 2010. Transactions and other information relating to these plans for the three years ended January 31, 2001 are summarized below:

	Outstanding Options	
	Number of Shares	Weighted-Average Exercise Price
Balance, January 31, 1998	977,813	$ 6.88
Options granted	96,000	14.00
Options canceled or expired	(12,750)	14.93
Options exercised	(28,875)	2.99
Balance, January 31, 1999	1,032,188	7.55
Options granted	105,000	13.45
Options canceled or expired	(23,250)	13.69
Options exercised	(125,438)	4.24
Balance, January 31, 2000	988,500	8.45
Options granted	273,750	21.45
Options canceled or expired	(20,810)	13.83
Options exercised	(392,270)	5.30
Balance, January 31, 2001	849,170	$14.02

The following table summarizes information about stock options outstanding at January 31, 2001:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$ 3.04 to 4.17	95,775	2.6 years	$ 3.29	95,775	$ 3.29
5.75 to 7.67	67,500	4.1	6.18	67,500	6.18
9.67 to 11.75	177,395	6.2	10.78	138,769	10.54
13.21 to 17.50	273,750	7.8	14.85	124,944	14.67
19.33 to 23.67	234,750	9.3	22.13	—	—
$ 3.04 to 23.67	849,170	7.0	$14.02	426,988	$ 9.43

Stock options exercisable at January 31, 2001, 2000, and 1999 were 426,988, 676,875, and 648,188, respectively, at weighted-average exercise prices of $9.43, $6.33, and $4.87, respectively. Shares available under the plans for future grants at January 31, 2001, 2000, and 1999 were 333,188, 275,033, and 356,783, respectively.

The per share weighted-average fair value of employee and director stock options granted during the years ended January 31, 2001, 2000, and 1999 was $10.36, $5.60, and $5.92, respectively, on the date of grant using the Black Scholes option-pricing model with the following weighted-average assumptions:

Years ended January 31,	2001	2000	1999
Expected dividend yield	0.0%	0.0%	0.0%
Expected volatility	39.1%	31.4%	32.5%
Risk-free interest rate	6.2%	5.5%	5.5%
Expected life	6 years	6 years	6 years

Comarco Wireless Technologies, Inc. ("CWT"), also has a subsidiary stock option plan. Figures for this plan reflect a 10-for-1 stock split declared during the year ended January 31, 1998. Under this plan, officers and key employees of CWT may be granted options to purchase up to 600,000 shares of common stock of CWT at not less than 100 percent of the fair market value at the date of grant.

As of January 31, 2001, the Company owned 3,061,000 out of the 3,065,000 outstanding shares of CWT common stock. The fair market value of the shares and the exercise dates of the options are determined by the Compensation Committee of the Company's Board of Directors; however, no option may be exercised prior to one year following the grant of the option. The options expire as determined by the Committee, but not later than ten years and one week after the date of grant.

In years ended January 31, 2001, 2000, and 1999, no options were granted. At January 31, 1999, there were 419,000 outstanding options at a weighted-average exercise price of $5.33. In the year ended January 31, 2000, 58,000 options were exercised at a weighted-average exercise price of $3.08 per share, and 5,000 options were canceled at a weighted-average exercise price of $13.22 per share. In the year ended January 31, 2001, 7,000 options were exercised at a weighted-average exercise price of $13.22. Stock options exercisable at January 31, 2001, 2000, and 1999 were 346,250, 345,500, and 361,750, respectively, at weighted-average exercise prices of $5.34, $5.28, and $4.53, respectively. Shares available under the plan for future grants at January 31, 2001, 2000, and 1999 were 186,000, 186,000, and 181,000, respectively.

The following table summarizes information about CWT stock options outstanding at January 31, 2001:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$ 2.53 to 4.30	265,000	3.8 years	$ 3.07	265,000	$ 3.07
11.97 to 13.22	73,000	4.9	12.19	73,000	12.19
17.62	11,000	6.1	17.62	8,250	17.62
$ 2.53 to 17.62	349,000	4.1	$ 5.43	346,250	$ 5.34

The Company applies APB 25 in accounting for its plans and, accordingly, no compensation cost has been recognized for its stock options in the financial statements. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (dollars in thousands, except per share data):

Years ended January 31,		2001	2000	1999
Net income:	As reported	$4,541	$3,153	$5,683
	Pro forma	3,885	2,634	5,150
Earnings per common share—basic:				
	As reported	$ 0.67	$ 0.48	$ 0.82
	Pro forma	0.58	0.40	0.75
Earnings per common share—diluted:				
	As reported	$ 0.61	$ 0.43	$ 0.75
	Pro forma	0.50	0.36	0.70

Pro forma net income and earnings per share reflect only options granted since February 1, 1995. Therefore, the full impact of calculating compensation cost for stock options under SFAS 123 is not reflected in the pro forma net income and earnings per share amounts presented above because compensation cost is reflected over the options' vesting periods of four years and compensation cost for options granted prior to February 1, 1995 is not considered.

15. NET INCOME PER SHARE

The Company calculates net income per share in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128"). Under SFAS 128, basic net income per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted net income per share reflects the effects of potentially dilutive securities. The reconciliation of the basic and diluted earnings per share computations is as follows (dollars in thousands, except per share data):

Years Ended January 31,	2001	2000	1999
Basic:			
Net income from continuing operations	$4,550	$3,586	$3,971
Weighted-average shares outstanding	6,751	6,572	6,912
Basic income per share from continuing operations	$ 0.67	$ 0.55	$ 0.57
Net income (loss) from discontinued operations	$ (9)	$ (433)	$1,712
Weighted-average shares outstanding	6,751	6,572	6,912
Basic income (loss) per share from discontinued operations	$ —	$ (0.07)	$ 0.25
Net income	$4,541	$3,153	$5,683
Weighted-average shares outstanding	6,751	6,572	6,912
Basic income per share	$ 0.67	$ 0.48	$ 0.82

Years Ended January 31,	2001	2000	1999
Diluted:			
Net income from continuing operations	$4,550	$3,586	$3,971
Effect of subsidiary options	(307)	(216)	(267)
Net income used in calculation of diluted income per share from continuing operations	$4,243	$3,370	$3,704
Weighted-average shares outstanding	6,751	6,572	6,912
Effect of dilutive securities—stock options	254	265	306
Weighted-average shares used in calculation of diluted income per share from continuing operations	7,005	6,837	7,218
Diluted income per share from continuing operations	$ 0.61	$ 0.49	$ 0.51
Net income (loss) from discontinued operations	$ (9)	$ (433)	$1,712
Effect of subsidiary options	—	—	—
Net income (loss) used in calculation of diluted income per share from discontinued operations	$ (9)	$ (433)	$1,712
Weighted-average shares outstanding	6,751	6,572	6,912
Effect of dilutive securities—stock options	254	265	306
Weighted-average shares used in calculation of diluted income (loss) per share from discontinued operations	7,005	6,837	7,218
Diluted income (loss) per share from discontinued operations	$ —	$ (0.06)	$ 0.24
Net income	$4,541	$3,153	$5,683
Effect of subsidiary options	(307)	(216)	(267)
Net income used in calculation of diluted income per share	$4,234	$2,937	$5,416
Weighted-average shares outstanding	6,751	6,572	6,912
Effect of dilutive securities—stock options	254	265	306
Weighted-average shares used in calculation of diluted income per share	7,005	6,837	7,218
Diluted income per share	$ 0.61	$ 0.43	$ 0.75

16. EMPLOYEE BENEFIT PLANS

The Company has a Savings and Retirement Plan (the "Plan") which provides benefits to eligible employees. Under the Plan, as amended effective January 1, 2000, employees who have been with the Company in excess of three months and are at least 18 years of age may participate by contributing between 1 percent and 20 percent of pre-tax earnings. Company contributions match employee contributions at levels as specified in the Plan document. In addition, the Company may contribute a portion of its net profits as determined by the Board of Directors. Company contributions, which consist of matching contributions, with respect to the Plan for the years ended January 31, 2001, 2000, and 1999 were approximately $733,000, $904,000, and $812,000, respectively.

17. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION AND NONCASH INVESTING AND FINANCING ACTIVITIES

Years Ended January 31,	2001	2000	1999
(Dollars in thousands)			
Cash paid during the year for:			
Interest	$ 131	$ —	$ —
Income taxes	1,013	3,648	3,459

In January 2001, the Company issued 5,916 shares of the Company's common stock in connection with the purchase of CWT shares held by minority interests.

In December 2000, the Company acquired the outstanding stock of EDX Engineering, Inc. for 257,428 shares of Company stock and approximately $2.3 million in cash (Note 4).

The following is a supplemental disclosure of noncash transactions in connection with the EDX acquisition for the year ended January 31, 2001 (dollars in thousands):

Fair value of assets acquired	$ 6,825
Assumed liabilities	(254)
Common stock issued	(4,247)
Cash paid for acquisition, net	$ 2,324

In December 1999, the Company issued 69,265 shares of the Company's common stock in connection with the purchase of CWT shares held by minority interests.

In May 1998, the Company acquired certain intellectual property and related software assets of Industrial Technology, Inc. for approximately $1.0 million.

18. BUSINESS SEGMENT INFORMATION

The Company has two operating segments: wireless infrastructure and wireless applications. Wireless infrastructure provides advanced technology tools and engineering services to the wireless communications industry. Wireless applications designs and manufactures remote voice systems and advanced technology products for notebook computers, cellular telephones, and personal organizers.

Performance measurement and resource allocation for the reportable segments are based on many factors. The primary financial measures used are revenue and gross profit. The revenue, gross profit, and gross margin attributable to these segments are as follows (dollars in thousands):

Year Ended January 31, 2001	Wireless Infrastructure	Wireless Applications	Total
Revenue	$34,678	$14,786	$49,464
Cost of sales	14,315	10,503	24,818
Gross profit	$20,363	$ 4,283	$24,646
Gross margin	58.7%	29.0%	49.8%

Year Ended January 31, 2000	Wireless Infrastructure	Wireless Applications	Total
Revenue	$19,259	$19,965	$39,224
Cost of sales	7,575	13,219	20,794
Gross profit	$11,684	$ 6,746	$18,430
Gross margin	60.7%	33.8%	47.0%

Year Ended January 31, 1999	Wireless Infrastructure	Wireless Applications	Total
Revenue	$23,670	$10,334	$34,004
Cost of sales	8,058	6,984	15,042
Gross profit	$15,612	$ 3,350	$18,962
Gross margin	66.0%	32.4%	55.8%

Revenue by geographic area consisted of the following (dollars in thousands):

Years Ended January 31,	2001	2000	1999
United States	$44,738	$35,280	$28,411
Canada	22	753	1,223
Europe	350	907	1,417
Asia	932	338	699
Latin America	3,422	1,946	2,254
	$49,464	$39,224	$34,004

Long-lived assets outside of North America were insignificant at January 31, 2001, 2000, and 1999.

19. COMMITMENTS AND CONTINGENCIES

Rental commitments under non-cancelable operating leases, principally on the Company's office space, equipment, and automobiles were $3.0 million at January 31, 2001, payable as follows: $955,000, $866,000, $779,000, and $393,000 in the years ended January 31, 2002, 2003, 2004, and 2005, respectively. Certain of the rental commitments are subject to increases based on the change in the Consumer Price Index. Rental expense for the years ended January 31, 2001, 2000, and 1999 was $1.7 million, $2.1 million, and $1.8 million, respectively.

The Company is subject to legal proceedings and claims that arise in the ordinary course of its business. In the opinion of management and the Company's legal counsel, the amount of ultimate liability with respect to these actions will not materially affect the financial condition of the Company.

Costs under cost-reimbursable contracts are subject to audit by the customer upon contract completion. Therefore, all contract costs, including direct and indirect costs, are potentially subject to adjustment prior to final reimbursement. Audits have been completed through January 31, 1999.

During 2001, the Company completed the divestiture of its non-wireless businesses in six separate transactions. The agreements included normal indemnification provisions. The indemnification provisions expire in May 2002.

Management believes that sufficient reserves have been established for its most probable assessment of the potential outcomes of the above open matters.

20. QUARTERLY FINANCIAL DATA (UNAUDITED)

Unaudited summarized financial data by quarter for 2001 and 2000 are as follows (dollars in thousands, except per share data):

	Fiscal Year Quarters			
Year Ended January 31, 2001	First	Second	Third	Fourth
Revenue from continuing operations	$10,097	$11,952	$13,153	$14,262
Gross profit from continuing operations	5,289	6,196	6,739	6,422
Operating income from continuing operations	1,299	636	2,264	2,079
Net income from continuing operations	865	473	1,643	1,569
Net income	$ 1,063	$ 774	$ 1,522	$ 1,182
Basic net income per share	$ 0.16	$ 0.12	$ 0.22	$ 0.17
Diluted net income per share	$ 0.15	$ 0.10	$ 0.20	$ 0.16

	Fiscal Year Quarters			
Year Ended January 31, 2000	First	Second	Third	Fourth
Revenue from continuing operations	$ 7,842	$ 8,973	$11,959	$10,450
Gross profit from continuing operations	3,861	3,979	5,701	4,889
Operating income from continuing operations	879	815	2,315	1,410
Net income from continuing operations	609	580	1,482	915
Net income (loss)	$ 959	$ 1,012	$ (412)	$ 1,594
Basic net income (loss) per share	$ 0.15	$ 0.15	$ (0.06)	$ 0.24
Diluted net income (loss) per share	$ 0.13	$ 0.14	$ (0.07)	$ 0.23

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
COMARCO, Inc.:

We have audited the consolidated financial statements of COMARCO, Inc. and Subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of COMARCO, Inc. and Subsidiaries as of January 31, 2001 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended January 31, 2001, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

KPMG LLP

Orange County, California
March 15, 2001

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is traded on the Nasdaq National Market® under the symbol "CMRO." The following table sets forth for the periods indicated the quarterly high and low closing prices per share as reported by the Nasdaq National Market. These prices represent actual reported sales transactions and reflect a 3-for-2 stock split distributed October 27, 2000 to shareholders of record on October 6, 2000.

	High	**Low**
Year ended January 31, 2001:		
First Quarter	$33.63	$17.25
Second Quarter	25.33	19.00
Third Quarter	24.67	18.50
Fourth Quarter	19.31	13.50
Year ended January 31, 2000:		
First Quarter	$16.50	$13.33
Second Quarter	15.50	12.67
Third Quarter	13.67	12.09
Fourth Quarter	17.59	11.33

Holders

As of April 23, 2001, there were approximately 620 holders of record of our common stock.

Dividends

The terms of our revolving credit facility generally prohibit the payment of dividends. We anticipate that dividends will not be paid for the foreseeable future and that all earnings will be retained for use in our business and for stock repurchases.

Sales of Unregistered Securities

In connection with our acquisition of EDX Engineering, Inc. ("EDX") on December 7, 2000, we issued 257,428 shares and approximately $2.3 million in cash to the former sole shareholder of EDX in exchange for all of the outstanding shares of capital stock of EDX. These shares were issued in reliance on the exemption provision provided under Section (4)2 of the Securities Act of 1933.

CORPORATE
INFORMATION

BOARD OF DIRECTORS

Don M. Bailey
Chairman of the Board

Thomas A. Franza
President and Chief Executive Officer

General Wilbur L. Creech (USAF, retired)
Executive Consultant
Former Commander of Tactical Air Command

Gerald D. Griffin
Executive Consultant
Former COMARCO Chairman (1988–1998)

Jeffrey R. Hultman
Partner, Big Bear Sports Ranch
Former CEO of Dial Page, Inc.

OFFICERS

Don M. Bailey
Chairman of the Board

Thomas A. Franza
President and Chief Executive Officer

Daniel R. Lutz
Vice President and Chief Financial Officer

Evelyn M. Evans
Vice President and Secretary

Harry R. Anderson
Vice President, EDX Division

Marc W. Booth
Vice President and Chief Technology Officer

Michael J. Burdiek
Senior Vice President, Engineering Services

Mark Chapman
Vice President, Wireless Infrastructure Products

Trisha Ray Cobb
Vice President, Manufacturing

Sebastian E. Gutierrez
Vice President, Remote Voice Systems

Thomas W. Lanni
Vice President, ChargeSource Division

Stephen W. Rogers
Senior Vice President and Chief Scientist

Peggy L. Vessell
Vice President, Administration

Robert E. Wattenberg, Jr.
Vice President, Operations

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INDEPENDENT AUDITORS

KPMG LLP
Orange County, California

LEGAL COUNSEL

Riordan & McKinzie
Los Angeles, California

ANNUAL MEETING OF SHAREHOLDERS

Tuesday, June 26, 2001

TRANSFER AGENT AND REGISTRAR

U.S. Stock Transfer Corporation
1745 Gardena Avenue
Glendale, California 91204
Tel: 818-502-1404
Fax: 818-502-0674

INVESTOR RELATIONS

For further information on COMARCO, additional copies of this report, our annual report on Form 10-K, or other financial information, available free of charge, please contact:

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Designed by Curran & Connors, Inc. / www.curran-connors.com

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