

CPI INTERNATIONAL, INC.  
Form 10-Q  
August 13, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE  
COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended June 29, 2007**

**or**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission file number: 000-51928**

**CPI INTERNATIONAL, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**75-3142681**

(I.R.S. Employer Identification No.)

**811 Hansen Way  
Palo Alto, California 94303-1110  
(650) 846-2900**

(Address of Principal Executive Offices and Telephone Number,  
Including Area Code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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

### **APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding for each of the registrant's classes of Common Stock, as of the latest practicable date: 16,355,696 shares of Common Stock, \$0.01 par value, at August 6, 2007.

CPI INTERNATIONAL, INC.

and Subsidiaries

**10-Q REPORT**

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**CPI INTERNATIONAL, INC.**

and Subsidiaries

***Cautionary Statements Regarding Forward-Looking Statements***

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that relate to future events or our future financial performance. In some cases, readers can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, predict, continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

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 assumes responsibility for the accuracy and completeness of the forward-looking statements. Forward-looking statements are subject to known and unknown risks and uncertainties, which could cause actual results to differ materially from the results projected, expected or implied by the forward-looking statements. These risk factors include, without limitation, competition in our end markets; our significant amount of debt; changes or reductions in the United States defense budget; U.S. government contracts laws and regulations; changes in technology; the impact of unexpected costs; inability to obtain raw materials and components; and currency fluctuations. All written and oral forward-looking statements made in connection with this report that are attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing risk factors and other cautionary statements included herein and in our other filings with the Securities and Exchange Commission (SEC). We are under no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

The information in this report is not a complete description of our business or the risks and uncertainties associated with an investment in our securities. You should carefully consider the various risks and uncertainties that impact our business and the other information in this report and in our other filings with the SEC before you decide to invest in our securities or to maintain or increase your investment.

**CPI INTERNATIONAL, INC.**

and Subsidiaries

**Part I: FINANCIAL INFORMATION****Item 1. Unaudited Condensed Consolidated Financial Statements****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share data   unaudited)

	<b>June 29, 2007</b>	<b>September 29, 2006</b>
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 39,420	\$ 30,153
Restricted cash	3,046	1,746
Accounts receivable, net	46,591	43,628
Inventories	60,350	54,031
Deferred tax assets	11,190	11,520
Prepaid and other current assets	5,907	3,080
Total current assets	166,504	144,158
Property, plant, and equipment, net	65,362	63,851
Deferred debt issue costs, net	8,543	9,644
Intangible assets, net	73,689	75,489
Goodwill	147,270	147,489
Other long-term assets	844	1,128
Total assets	\$ 462,212	\$ 441,759
<b>Liabilities and stockholders' equity</b>		
Current Liabilities:		
Current portion of long-term debt	\$ 1,000	\$ 1,714
Accounts payable	20,580	19,101
Accrued expenses	26,037	23,269
Product warranty	5,527	5,958
Income taxes payable	6,820	10,693
Advance payments from customers	8,970	6,310
Total current liabilities	67,934	67,045
Deferred income taxes	29,865	29,933
Long-term debt, less current portion	240,822	245,067
Other long-term liabilities	79	41
Total liabilities	339,700	342,086
Commitments and contingencies		
Stockholders' equity		
Common stock (\$0.01 par value, 90,000,000 shares authorized; 16,333,794 and 16,049,577 shares issued and outstanding)	163	160
Additional paid-in capital	67,991	65,295
Accumulated other comprehensive income	1,093	679
Retained earnings	53,265	33,539
Total stockholders' equity	122,512	99,673
Total liabilities and stockholders' equity	\$ 462,212	\$ 441,759

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



**CONDENSED CONSOLIDATED  
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

(In thousands, except share and per share data    unaudited)

	<b>Three Months Ended June 29, 2007</b>	<b>June 30, 2006</b>	<b>Nine Months Ended June 29, 2007</b>	<b>June 30, 2006</b>
Sales	\$ 87,318	\$ 87,761	\$ 259,485	\$ 257,069
Cost of sales	58,667	60,867	176,548	179,223
Gross profit	28,651	26,894	82,937	77,846
Operating costs and expenses:				
Research and development	2,232	2,515	6,475	6,366
Selling and marketing	4,911	5,248	14,539	14,952
General and administrative	5,835	5,441	16,085	17,419
Amortization of acquisition-related intangible assets	548	548	1,642	1,642
Net loss on disposition of fixed assets	16	212	74	420
Total operating costs and expenses	13,542	13,964	38,815	40,799
Operating income	15,109	12,930	44,122	37,047
Interest expense, net	5,143	5,945	15,757	18,409
Income before income taxes	9,966	6,985	28,365	18,638
Income tax expense	1,835	2,517	8,639	7,610
Net income	\$ 8,131	\$ 4,468	\$ 19,726	\$ 11,028
Other comprehensive income, net of tax				
Net unrealized gain (loss) on cash flow hedges	820	(196)	414	(685)
Comprehensive income	\$ 8,951	\$ 4,272	\$ 20,140	\$ 10,343
Earnings per share - Basic	\$ 0.50	\$ 0.30	\$ 1.22	\$ 0.80
Earnings per share - Diluted	\$ 0.46	\$ 0.27	\$ 1.11	\$ 0.71
Shares used to compute earnings per share - Basic	16,306,256	15,039,754	16,206,873	13,736,031
Shares used to compute earnings per share - Diluted	17,796,425	16,766,822	17,696,217	15,443,427

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

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands unaudited)

	Nine Months Ended	
	June 29, 2007	June 30, 2006
<b>Cash flows from operating activities</b>		
Net cash provided by operating activities	\$ 19,259	\$ 1,918
<b>Cash flows from investing activities</b>		
Deferred expenses relating to sale of San Carlos property		(212 )
Capital expenditures	(6,392 )	(8,419 )
Capitalized expenses relating to potential business acquisition	(395 )	
Net cash used in investing activities	(6,787 )	(8,631 )
<b>Cash flows from financing activities</b>		
Proceeds from issuance of debt		10,000
Repayments of debt	(5,000 )	(47,500 )
Proceeds from issuance of common stock		52,942
Proceeds upon exercise of stock options	604	
Proceeds from ESPP shares issued	520	
Payment of IPO financing costs		(5,634 )
Stockholder distribution payments		(17,000 )
Excess tax benefit on stock option exercises	671	
Net cash used in financing activities	(3,205 )	(7,192 )
<b>Net increase (decrease) in cash and cash equivalents</b>	9,267	(13,905 )
Cash and cash equivalents at beginning of period	30,153	26,511
Cash and cash equivalents at end of period	\$ 39,420	\$ 12,606
<b>Supplemental disclosure of cash flow information</b>		
Interest paid	\$ 11,562	\$ 13,714
Income taxes paid, net of refunds	\$ 12,799	\$ 5,205

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



**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(All tabular dollar amounts in thousands except share and per share amounts)

**1. The Company and a Summary of its Significant Accounting Policies**

*The Company*

Unless the context otherwise requires, *CPI International* means CPI International, Inc., and *CPI* means Communications & Power Industries, Inc. CPI is a direct subsidiary of CPI International. CPI International is a holding company with no operations of its own. The term *the Company* refers to CPI International and its subsidiaries on a consolidated basis.

The accompanying unaudited condensed consolidated financial statements represent the consolidated results and financial position of CPI International, which is controlled by affiliates of The Cypress Group ( *Cypress* ). CPI International, through its wholly owned subsidiary, CPI, develops, manufactures, and distributes microwave and power grid Vacuum Electron Devices ( *VED* ), microwave amplifiers, modulators and various other power supply equipment and devices. The Company has two reportable segments, VED and satcom equipment.

*Basis of Presentation and Consolidation*

The Company's fiscal year is the 52- or 53-week period that ends on the Friday nearest September 30. Fiscal year 2007 comprises the 52-week period ending September 28, 2007 and fiscal year 2006 comprised the 52-week period ended September 29, 2006. All period references are to the Company's fiscal periods unless otherwise indicated.

The accompanying unaudited condensed consolidated financial statements of the Company as of June 29, 2007 and for the three and nine months ended June 29, 2007 are unaudited and reflect all normal recurring adjustments which are, in the opinion of management, necessary for the fair statement of such financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 29, 2006. The condensed consolidated balance sheet as of September 29, 2006 has been derived from the audited financial statements at that date. The results of operations for the interim period ended June 29, 2007 are not necessarily indicative of results to be expected for the full year.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances, transactions, and stockholdings have been eliminated in consolidation.

*Use of Estimates and Assumptions*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of sales and costs and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to provision for revenue recognition, market values for inventories reported at lower of cost or market, product warranty, and recoverability and valuation of recorded amounts of long-lived assets and identifiable intangible assets, including goodwill. The Company bases its estimates on various factors and information, which may include, but are not limited to, history and prior experience, experience of other enterprises in the same industry, new related events, current economic conditions and

information from third party professionals that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

#### *Revenue Recognition*

Sales are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, and collectibility is reasonably assured. The Company's products are generally subject to warranties, and the Company provides for the estimated future costs of repair, replacement or customer accommodation in cost of sales.

The Company has commercial and U.S. Government fixed-price contracts that are accounted for under American Institute of Certified Public Accountants Statement of Position No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. These contracts are generally longer than one year in duration and include a material amount of product development. The Company uses the percentage-of-completion method when reasonably dependable estimates of the extent of progress toward completion, contract revenues and contract costs can be made. The portion of revenue earned or the amount of gross profit earned for a period is determined by measuring the extent of progress toward completion using total cost incurred to date and estimated costs at contract completion.

Sales under cost-reimbursement contracts, which are primarily for research and development, are recorded as costs are incurred and include estimated earned fees in the proportion that costs incurred to date bear to total estimated costs. The fees under certain commercial and U.S. Government contracts may be increased or decreased in accordance with cost or performance incentive provisions that measure actual performance against established targets or other criteria. Such incentive fee awards or penalties are included in revenue at the time the amounts can be reasonably determined.

## 2. Supplemental Balance Sheet Information

**Accounts Receivable:** Accounts receivable are stated net of allowances for doubtful accounts of approximately \$0.1 million and \$0.5 million at June 29, 2007 and September 29, 2006, respectively.

**Inventories:** The following table provides details of inventories, net of reserves:

	June 29, 2007	September 29, 2006
Raw material and parts	\$ 38,475	\$ 35,160
Work in process	12,982	10,481
Finished goods	8,893	8,390
	\$ 60,350	\$ 54,031

**Reserve for excess, slow moving and obsolete inventory:** The following table summarizes the activity related to reserves for excess, slow moving and obsolete inventory:

	Nine Months Ended	
	June 29, 2007	June 30, 2006
Balance at beginning of period	\$ 8,822	\$ 8,655
Inventory provision, charged to cost of sales	803	898
Inventory write-offs	(710 )	(259 )
Balance at end of period	\$ 8,915	\$ 9,294

**Reserve for loss contracts and cost in excess of market inventory:** The following table summarizes the activity related to reserves for loss contracts and cost in excess of market inventory:

	Nine Months Ended	
	June 29, 2007	June 30, 2006
Balance at beginning of period	\$ 1,702	\$ 1,430
Provision for loss contracts and cost in excess of market inventory, charged to cost of sales	970	1,350
Credit to cost of sales upon revenue recognition	(1,202 )	(1,145 )
Balance at end of period	\$ 1,470	\$ 1,635

**Intangible Assets:** The following tables present the details of the Company's total acquisition-related intangible assets:

	June 29, 2007			September 29, 2006		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
VED Core Technology	\$ 30,700	\$ (2,120 )	\$ 28,580	\$ 30,700	\$ (1,659 )	\$ 29,041
VED Application Technology	19,800	(2,723 )	17,077	19,800	(2,130 )	17,670
X-ray Generator and Satcom						
ApplicationTechnology	8,000	(1,840 )	6,160	8,000	(1,441 )	6,559
Customer backlog	17,450	(17,450 )		17,450	(17,450 )	
Land lease	11,810	(865 )	10,945	11,810	(706 )	11,104
Tradename	5,800		5,800	5,800		5,800
Customer list and programs	5,700	(622 )	5,078	5,700	(451 )	5,249
Noncompete agreement	110	(61 )	49	110	(44 )	66
	\$ 99,370	\$ (25,681 )	\$ 73,689	\$ 99,370	\$ (23,881 )	\$ 75,489

The estimated future amortization expense of purchased intangibles as of June 29, 2007, excluding the Company's unamortized tradename, was as follows:

#### Fiscal Year

2007 (remaining three months)	\$ 611
2008	2,442
2009	2,441
2010	2,420
2011	2,420
Thereafter	57,555
	\$ 67,889

### 3. Long-Term Debt

Long-term debt comprises the following:

	June 29, 2007	September 29, 2006
Term loan, expiring 2010	\$ 37,500	\$ 42,500
8% Senior subordinated notes, due 2012	125,000	125,000
Floating rate senior notes, due 2015, net of issue discount of \$678 and \$719	79,322	79,281
	241,822	246,781
Less: Current portion	1,000	1,714
Long-term portion	\$ 240,822	\$ 245,067

**Senior Credit Facility and Term Loan of CPI:** In fiscal year 2004, CPI entered into a \$130.0 million credit agreement, which was amended and restated on November 29, 2004, and further amended on February 16, 2005, April 13, 2005, and December 15, 2005 (the "Senior Credit Facility"). The Senior Credit Facility consists of a \$40.0 million revolving commitment, with a sub-facility of \$15.0 million for letters of credit and \$5.0 million for swingline loans ("Revolver"), which expires on January 23, 2010, and a \$90.0 million term loan ("Term Loan"), which expires on July 23, 2010. As of June 29, 2007, the Company had no outstanding borrowings under the Revolver and \$37.5 million outstanding under the Term Loan, after taking into account a \$5.0 million Term Loan repayment in December 2006 using available operating cash. The \$5.0 million Term Loan repayment included a \$1.7 million ECF (as defined below) payment, and an optional prepayment of \$3.3 million. Upon certain specified conditions, including compliance on a pro forma basis with the covenants in the Senior Credit Facility, CPI may seek commitments for a new class of term loans, not to exceed \$65.0 million. The Senior Credit Facility is guaranteed by CPI International and all of CPI's domestic subsidiaries and is secured by substantially all of their and CPI's assets.

Borrowings under the Revolver would bear interest at a rate equal to, at CPI's option, London Interbank Offered Rate (LIBOR) plus 2.75% per annum, or the Alternate Base Rate (ABR) plus 1.75% per annum. Available borrowings under the Revolver are reduced by any amounts secured through letters of credit; at June 29, 2007, the Company had letters of credit commitments for \$3.7 million. The Term Loan borrowings bear interest at a rate equal to, at CPI's option, LIBOR plus 2.25% per annum or the

ABR plus 1.25% per annum, payable quarterly. The ABR is the greater of the (a) Prime Rate and (b) Federal Funds Rate plus 0.50%. In addition to customary fronting and administrative fees under the Senior Credit Facility, CPI pays letter of credit participation fees equal to the applicable Revolver LIBOR margin per annum on the average daily amount of the letter of credit exposure, and a commitment fee of 0.50% per annum on the average daily unused amount of revolving commitment. As of June 29, 2007 (1) the Term Loan borrowings consisted of one tranche of \$5.5 million and one tranche of \$32.0 million with interest payable on July 16, 2007 and July 25, 2007, each at 7.6% per annum, and (2) a Revolving commitment of \$3.7 million for letter of credit exposure, with letter of credit participation fees and fronting fees payable quarterly at a combined interest rate of 3.0% per annum.

CPI is required to make an annual prepayment within 90 days after the end of each fiscal year based on a calculation of Excess Cash Flow ( ECF ), as defined in the Senior Credit Facility, multiplied by a factor of 25%, 50% or 75% depending on the leverage ratio at the end of the fiscal year, less optional prepayments made during the fiscal year. The Company made an ECF payment of \$1.7 million for the fiscal year ended September 29, 2006 in December 2006 and there is no expected ECF payment due for fiscal year 2007, primarily because of the \$3.3 million optional prepayment that was made in December 2006.

CPI can make optional prepayments on the outstanding loans at any time without premium or penalty, except for customary breakage costs with respect to LIBOR loans. In March 2005, CPI made an optional prepayment of \$5.7 million; in May 2006, CPI made additional optional prepayments of \$47.5 million in the aggregate using proceeds from the initial public offering of CPI International's common stock; and in December 2006, CPI made an additional prepayment of \$3.3 million.

See Note 12 for information regarding the recent refinancing of the Senior Credit Facility.

**8% Senior subordinated notes of CPI:** In connection with a business combination on January 23, 2004, CPI issued \$125.0 million in aggregate principal amount of its 8% Senior Subordinated Notes (the 8% Notes ). The 8% Notes have no sinking fund requirements.

The 8% Notes bear interest at the rate of 8.0% per year, payable on February 1 and August 1 of each year. The 8% Notes will mature on February 1, 2012. The 8% Notes are unsecured obligations, jointly and severally guaranteed by CPI International and each of CPI's domestic subsidiaries. The payment of all obligations relating to the 8% Notes are subordinated in right of payment to the prior payment in full in cash or cash equivalents of all senior debt (as defined in the indenture governing the 8% Notes) of CPI, including debt under the Senior Credit Facility. Each guarantee of the 8% Notes is and will be subordinated to guarantor senior debt (as defined in the indenture governing the 8% Notes) on the same basis as the 8% Notes are subordinated to CPI's senior debt.

At any time or from time to time on or after February 1, 2008, CPI, at its option, may redeem the 8% Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount) set forth below, together with accrued and unpaid interest thereon, if any, to the redemption date, if redeemed during the 12-month period beginning on February 1 of the years indicated below:

Year	Optional Redemption Price	
2008	104	%
2009	102	%
2010 and thereafter	100	%

At any time on or prior to February 1, 2008, the 8% Notes may also be redeemed or purchased (by CPI or any other person) in whole but not in part, at CPI's option, upon the occurrence of a change of control (as defined in the indenture governing the 8% Notes) at a price equal to 100% of the principal amount of the 8% Notes, plus a make-whole premium (as defined in the indenture governing the 8% Notes) to the redemption price on February 1, 2008, and accrued and unpaid interest, if any, to, the date of redemption or purchase. Upon a change of control, CPI may be required to purchase all or any part of the 8% Notes for a cash price equal to 101% of the principal amount, plus accrued and unpaid interest thereon, if any, to the date of purchase.

The indenture governing the 8% Notes contains a number of covenants that, among other things, restrict, subject to certain exceptions, the ability of CPI and its restricted subsidiaries (as defined in the indenture governing the 8% Notes) to incur additional indebtedness, sell assets, consolidate or merge with or into other companies, pay dividends or repurchase or redeem capital stock or subordinated indebtedness, make certain investments, issue capital stock of their subsidiaries, incur liens and enter into certain types of transactions with their affiliates.

Events of default under the indenture governing the 8% Notes include: failure to make payments on the 8% Notes when due; failure to comply with covenants in the indenture governing the 8% Notes; a default under certain other indebtedness of CPI or any of its restricted subsidiaries that is caused by a failure to make payments on such indebtedness or that results in the acceleration of the maturity of such indebtedness; the existence of certain final judgments or orders against CPI or any of the restricted subsidiaries; and the occurrence of certain insolvency or bankruptcy events.

**Floating rate senior notes of CPI International:** On February 22, 2005, CPI International issued \$80.0 million in principal amount of its Floating Rate Senior Notes (the "FR Notes"). The FR Notes were issued at a 1% discount. The proceeds from the issuance of FR Notes were used to make a distribution to stockholders of CPI International of approximately \$75.8 million and to pay fees and expenses of approximately \$3.5 million associated with the issuance of FR Notes. The FR Notes have no sinking fund requirements.

The FR Notes require interest payments at an annual interest rate, reset at the beginning of each semi-annual period, equal to the then six-month LIBOR plus 5.75%, payable semiannually on February 1 and August 1 of each year. The interest rate on the semi-annual interest payment due August 1, 2007 is approximately 11.15% per annum. CPI International may, at its option, elect to pay interest through the issuance of additional FR Notes for any interest payment date on or before February 1, 2010. If CPI International elects to pay interest through the issuance of additional FR Notes, the annual interest rate on the FR Notes will increase by an additional 1% step-up, with the step-up increasing by an additional 1% for each interest payment made through the issuance of additional FR Notes (up to a maximum of 4%). The FR Notes will mature on February 1, 2015.

The FR Notes are general unsecured obligations of CPI International. The FR Notes are not guaranteed by any of CPI International's subsidiaries but are structurally subordinated to all existing and future indebtedness and other liabilities of CPI International's subsidiaries. The FR Notes are senior in right of payment to CPI International's existing and future indebtedness that is expressly subordinated to the FR Notes.

Because CPI International is a holding company with no operations of its own, CPI International relies on distributions from CPI to satisfy its obligations under the FR Notes. The Senior Credit Facility and the indenture governing the 8% Notes restrict CPI's ability to make distributions to CPI International. The Senior Credit Facility prohibits CPI from making distributions to CPI International unless there is no default under the Senior Credit Facility and CPI International and CPI satisfy certain leverage ratios. The indenture governing the 8% Notes prohibits CPI from making distributions to CPI International unless, among other things, there is no default under the indenture and the amount of the proposed dividend plus all previous Restricted Payments (as defined in the indenture governing the 8% Notes) does not exceed a specified amount.

At any time or from time to time CPI International, at its option, may redeem the Notes in whole or in part at the redemption prices (expressed as percentages of principal amount) set forth below, together with accrued and unpaid interest thereon, if any, to the redemption date, if redeemed during the 12-month period beginning on February 1 of the years indicated below:

Year	Optional Redemption Price	
2007	103	%
2008	102	%
2009	101	%
2010 and thereafter	100	%

Upon a change of control, as defined in the indenture governing the FR Notes, CPI International may be required to purchase all or any part of the outstanding FR Notes for a cash price equal to 101% of the principal amount, plus accrued and unpaid interest thereon, if any, to the date of purchase.

The indenture governing the FR Notes contains certain covenants that, among other things, limit the ability of CPI International and its restricted subsidiaries (as defined in the indenture governing the FR Notes) to incur additional indebtedness, sell assets, consolidate or merge with or into other companies, pay dividends or repurchase or redeem capital stock or subordinated indebtedness, make certain investments, issue capital stock of their subsidiaries, incur liens and enter into certain types of transactions with their affiliates.

Events of default under the indenture governing the FR Notes include: failure to make payments on the FR Notes when due; failure to comply with covenants in the indenture governing the FR Notes; a default under certain other indebtedness of CPI International or any of its restricted subsidiaries that is caused by a failure to make payments on such indebtedness or that results in the acceleration of the maturity of such indebtedness; the existence of certain final judgments or orders against CPI International or any of the restricted subsidiaries; and the occurrence of certain insolvency or bankruptcy events.

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See Note 4 for information on the interest rate swap agreement entered into by the Company to hedge the interest rate exposure associated with the FR Notes. See also Note 12 for information on the recent repurchase of a portion of the FR Notes and the issuance of a notice of redemption for a portion of the FR Notes.

**Debt Maturities:** As of June 29, 2007, maturities on long-term debt were as follows:

Fiscal Year	Term Loan	8% Senior Subordinated Notes	Floating Rate Senior Notes	Total
2007	\$	\$	\$	\$
2008				
2009				