CPI INTERNATIONAL, INC.
Form 10-Q
February 12, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 29, 2006

or

o 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)

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 x No o

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 o Accelerated filer o Non-accelerated filer x

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

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: 16,261,173 shares of Common Stock, $.01 par value, at January 31, 2007.

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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, pred 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 U.S. 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.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data unaudited)

	December 29, 2006	September 29, 2006
Assets		
Current Assets:		
Cash and cash equivalents	$ 32,629	$ 30,153
Restricted cash	1,951	1,746
Accounts receivable, net	40,744	43,628
Inventories	54,640	54,031
Deferred tax assets	11,884	11,520
Prepaid and other current assets	3,260	3,080
Total current assets	145,108	144,158
Property, plant, and equipment, net	65,120	63,851
Deferred debt issue costs, net	9,285	9,644
Intangible assets, net	74,878	75,489
Goodwill	147,459	147,489
Other long-term assets	976	1,128
Total assets	$ 442,826	$ 441,759
Liabilities and stockholders equity		
Current Liabilities:		
Current portion of long-term debt	$	$ 1,714
Accounts payable	15,707	19,101
Accrued expenses	27,936	23,269
Product warranty	5,842	5,958
Income taxes payable	9,105	10,693
Advance payments from customers	6,824	6,310
Total current liabilities	65,414	67,045
Deferred income taxes	29,977	29,933
Long-term debt, less current portion	241,794	245,067
Other long-term liabilities	51	41
Total liabilities	337,236	342,086
Commitments and contingencies		
Stockholders equity		
Common stock ($0.01 par value, 90,000,000 shares authorized; 16,086,445 and 16,049,577 shares issued and outstanding)	161	160
Additional paid-in capital	65,765	65,295
Accumulated other comprehensive income	290	679
Retained earnings	39,374	33,539
Total stockholders equity	105,590	99,673
Total liabilities and stockholders equity	$ 442,826	$ 441,759

See accompanying notes to the condensed consolidated financial statements.

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CONDENSED CONSOLIDATED
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(in thousands, except share and per share data unaudited)

	Quarter Ended December 29, 2006	December 30, 2005
Sales	$ 83,723	$ 82,379
Cost of sales	57,142	57,171
Gross profit	26,581	25,208
Operating costs and expenses:		
Research and development	1,891	1,910
Selling and marketing	4,829	5,024
General and administrative	4,404	7,302
Amortization of acquisition-related intangible assets	548	548
Net loss on disposition of fixed assets	18	65
Total operating costs and expenses	11,690	14,849
Operating income	14,891	10,359
Interest expense, net	5,339	6,064
Income before income taxes	9,552	4,295
Income tax expense	3,717	2,080
Net income	$ 5,835	$ 2,215
Other comprehensive income, net of tax Net unrealized loss on cash flow hedges	(389)	(183)
Comprehensive income	$ 5,446	$ 2,032
Earnings per share - Basic	$ 0.36	$ 0.17
Earnings per share - Diluted	$ 0.33	$ 0.15
Shares used to compute earnings per share - Basic	16,063,221	13,078,954
Shares used to compute earnings per share - Diluted	17,544,363	14,768,082

See accompanying notes to the condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands unaudited)

	Quarter Ended December 29, 2006	December 30, 2005
Cash flows from operating activities		
Net cash provided by operating activities	$ 10,042	$ 198
Cash flows from investing activities		
Expenses relating to sale of San Carlos property		(3)
Capital expenditures	(2,871)	(2,945)
Net cash used in investing activities	(2,871)	(2,948)
Cash flows from financing activities		
Proceeds from issuance of debt		10,000
Repayments of debt	(5,000)	
Proceeds from issuance of common stock to employees	197	
Proceeds from exercise of stock options	66	
Stockholder distribution payments		(17,000)
Excess tax benefit on stock option exercises	42	
Net cash used in financing activities	(4,695)	(7,000)
Net increase (decrease) in cash and cash equivalents	2,476	(9,750)
Cash and cash equivalents at beginning of period	30,153	26,511
Cash and cash equivalents at end of period	$ 32,629	$ 16,761
Supplemental cash flow disclosures		
Cash paid for interest	$ 961	$ 1,810
Cash paid for taxes, net of refunds	$ 5,150	$ 2,554

See accompanying notes to the condensed consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

1. Organization and Basis of Presentation

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 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 (VEDs), microwave amplifiers, modulators and various other power supply equipment and devices. The Company has two reportable segments, VED and satcom equipment.

The condensed consolidated financial statements include those of the Company and its subsidiaries. Significant intercompany balances, transactions, and stockholdings have been eliminated in 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. These interim financial statements should be read in conjunction with the condensed consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended September 29, 2006.

On May 3, 2006, the Company completed the initial public offering of its common stock (see Note 4 for further disclosure).

2. Supplemental Balance Sheet Information

Accounts Receivable: Accounts receivable are stated net of allowances for doubtful accounts of $0.2 million and $0.5 million at December 29, 2006 and September 29, 2006, respectively.

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

	December 29, 2006	**September 29, 2006**
Raw material and parts	$ 34,427	$ 35,160
Work in process	12,418	10,481
Finished goods	7,795	8,390
	$ 54,640	$ 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 during the first quarter of fiscal years 2007 and 2006:

	Quarter Ended December 29, 2006	December 30, 2005
Balance at beginning of period	$ 8,822	$ 8,655
Inventory provision, charged to cost of sales	307	316
Inventory write-offs	(60)	(28)
Balance at end of period	$ 9,069	$ 8,943

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 during first quarter of fiscal years 2007 and 2006:

	Quarter Ended December 29, 2006	December 30, 2005
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	32	306
Credit to cost of sales upon revenue recognition	(101)	(222)
Balance at end of period	$ 1,633	$ 1,514

Product Warranty: The following table summarizes the activity related to product warranty during the first quarter of fiscal years 2007 and 2006:

	Quarter Ended December 29, 2006	December 30, 2005
Beginning accrued warranty	$ 5,958	$ 6,359
Accruals for product warranty, charged to cost of sales	1,211	1,048
Cost of warranty claims	(1,327)	(1,217)
Ending accrued warranty	$ 5,842	$ 6,190

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

	December 29, 2006			September 29, 2006		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
VED Core Technology	$ 30,700	$ (1,813)	$ 28,887	$ 30,700	$ (1,659)	$ 29,041
VED Application Technology	19,800	(2,328)	17,472	19,800	(2,130)	17,670
X-ray Generator and Satcom ApplicationTechnology	8,000	(1,574)	6,426	8,000	(1,441)	6,559
Customer backlog	17,450	(17,450)		17,450	(17,450)	
Land lease	11,810	(769)	11,041	11,810	(706)	11,104
Tradename	5,800		5,800	5,800		5,800
Customer list and programs	5,700	(508)	5,192	5,700	(451)	5,249
Noncompete agreement	110	(50)	60	110	(44)	66
	$ 99,370	$ (24,492)	$ 74,878	$ 99,370	$ (23,881)	$ 75,489

The estimated future amortization expense of purchased intangibles as of December 29, 2006, excluding the Company s unamortized tradename, is as follows:

Fiscal Year	Amount
2007 (remaining nine months)	1,831
2008	2,441
2009	2,441
2010	2,419
2011	2,419
Thereafter	57,527
	$ 69,078

Goodwill: The following table presents goodwill by reportable segment at December 29, 2006 and September 29, 2006:

	December 29, 2006	September 29, 2006
VED	$ 133,607	$ 133,637
Satcom Equipment	13,852	13,852
	$ 147,459	$ 147,489

The decrease in goodwill from September 29, 2006 to December 29, 2006 was due to an adjustment for tax benefits realized from the exercise of fully vested stock options that were acquired in a business combination.

3. Long-Term Debt

Long-term debt comprises the following:

	December 29, 2006	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 $706 and $719	79,294	79,281
	241,794	246,781
Less: Current portion		1,714
Long-term portion	$ 241,794	$ 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 December 29, 2006, 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. In December 2005, CPI borrowed $10.0 million on the Term Loan to pay a dividend to CPI International. CPI International used the proceeds of that dividend to pay a portion of the special cash dividend of $17.0 million to its stockholders. 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 assets.

Any borrowings under the Revolver would currently bear interest at a rate equal to, at CPI s option, 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 December 29, 2006, the Company had letters of credit commitments for $3.8 million. The Term Loan borrowings currently 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 (a) the Prime Rate and (b) the 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 December 29, 2006 (1) the Term Loan borrowing consisted of one tranche of $5.5 million and one tranche of $32.0 million with interest payable on January 11, 2007 and January 22, 2007, each at 7.6% per annum, and (2) a Revolving commitment of $3.8 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.

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The Senior Credit Facility requires 1.0% of the original Term Loan amount to be repaid annually in quarterly installments of 0.25% beginning June 30, 2004 and continuing for five years, with the remainder due in equal quarterly installments thereafter. CPI is required to prepay its outstanding loans, subject to certain exceptions and limitations, with net cash proceeds received from certain events, including, without limitation (1) all such proceeds received from certain asset sales by CPI International, CPI or any of CPI s subsidiaries, (2) all such proceeds received from issuances of debt (other than certain specified permitted debt) or preferred stock by CPI International, CPI or any of CPI s subsidiaries, (3) all such proceeds paid to CPI International, CPI or any of CPI s subsidiaries from casualty and condemnation events in excess of amounts applied to replace, restore or reinvest in any properties for which proceeds were paid within a specified period and (4) 50% of such proceeds received from issuances of common equity by, or equity contributions to, CPI International.

CPI is also required to make an annual prepayment within 90 days after the end of each fiscal year based on a calculation of Excess Cash Flow, as defined in the Senior Credit Facility (ECF), 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. On December 30, 2004, CPI made an ECF payment of $3.9 million. The ECF payment was applied pro rata, in accordance with the provisions of the Senior Credit Facility, against the remaining scheduled installments of Term Loan principal due up to, but not including, the September 30, 2009 scheduled principal installment. 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 (the IPO); and in December 2006, CPI made an additional prepayment of $3.3 million. The optional prepayments were applied pro rata, in accordance with the provisions of the Senior Credit Facility, against the remaining scheduled installments of Term Loan principal due up to June 30, 2009, with the balance applied to scheduled installment amounts on or after September 30, 2009, in direct order of maturity.

The Senior Credit Facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, the ability of CPI International, CPI and CPI s domestic subsidiaries to: sell assets; engage in mergers and acquisitions; pay dividends and distributions or repurchase their capital stock; incur additional indebtedness or issue equity interests; make investments and loans; create liens or further negative pledges on assets; engage in certain transactions with affiliates; enter into sale and leaseback transactions; amend agreements or make prepayments relating to subordinated indebtedness; and amend or waive provisions of charter documents in a manner materially adverse to the lenders. CPI and CPI s subsidiaries must comply with: a minimum interest coverage ratio; a maximum total leverage ratio; a minimum fixed charge coverage ratio; and a maximum capital expenditures limitation, each calculated on a consolidated basis for CPI and CPI s subsidiaries. CPI International must also comply with a minimum interest coverage ratio, a minimum fixed charge coverage ratio and a maximum leverage ratio, each calculated on a consolidated basis for CPI International and its subsidiaries. As of December 29, 2006, CPI and CPI International were in compliance with all Senior Credit Facility financial covenants.

Subject in certain cases to applicable notice provisions and grace periods, events of default under the Senior Credit Facility include, among other things: failure to make payments when due; breaches of representations and warranties in the documents governing the Senior Credit Facility; non-compliance by CPI International, CPI and/or CPI s subsidiaries with certain covenants; failure by CPI International, CPI and/or CPI s subsidiaries to pay certain other indebtedness or to observe any other covenants or agreements that would allow acceleration of such indebtedness, collectively in excess of $5.0 million at any time; events of bankruptcy or insolvency of CPI International, CPI and/or CPI s subsidiaries; certain uninsured and unstayed judgments of $5.0 million or more against CPI International; impairment of the security interests in the collateral or the guarantees under the Senior Credit Facility; and a change in control, as defined in the documents governing 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.

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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 (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 February 1, 2007 is approximately 11.30% 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.

Debt Maturities: As of December 29, 2006, maturities on long-term debt were as follows:

Fiscal Year	**Term Loan**	**Floating Rate Senior Notes**	**8% Senior Subordinated Notes**	**Total**
2007	$	$	$	$
2008				
2009				
2010	37,500			37,500
2011				
Thereafter		80,000	125,000	205,000
	$ 37,500	$		