

CPI INTERNATIONAL, INC.  
Form 10-Q  
August 06, 2008

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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 27, 2008

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: 00051928

CPI INTERNATIONAL, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Delaware	75-3142681
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

811 Hansen Way, Palo Alto, California 94303  
(Address of Principal Executive Offices and Zip Code)

(650) 846-2900  
(Registrant's telephone number, including area code)

Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

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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, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒  
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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: 16,393,356 shares of Common Stock, \$0.01 par value, at August 5, 2008.

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CPI INTERNATIONAL, INC.  
and Subsidiaries  
10-Q REPORT

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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,” “predict,” “potential” or “continue,” the negative 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; currency fluctuations; U.S. Government contracts laws and regulations; changes in technology; the impact of unexpected costs; and inability to obtain raw materials and components. 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. Unaudited Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except per share data – unaudited)

	June 27, 2008	September 28, 2007
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 26,197	\$ 20,474
Restricted cash	1,205	2,255
Accounts receivable, net	48,379	52,589
Inventories	67,868	67,447
Deferred tax assets	10,023	9,744
Prepaid and other current assets	5,057	4,639
Total current assets	158,729	157,148
Property, plant, and equipment, net	63,487	66,048
Deferred debt issue costs, net	5,362	6,533
Intangible assets, net	79,355	81,743
Goodwill	162,392	161,573
Other long-term assets	795	3,177
Total assets	\$ 470,120	\$ 476,222
<b>Liabilities and stockholders' equity</b>		
Current Liabilities:		
Current portion of long-term debt	\$ 2,000	\$ 1,000
Accounts payable	21,950	21,794
Accrued expenses	26,373	26,349
Product warranty	4,533	5,578
Income taxes payable	7,594	8,748
Advance payments from customers	12,184	12,132
Total current liabilities	74,634	75,601
Deferred income taxes	26,760	28,394
Long-term debt, less current portion	228,642	245,567
Other long-term liabilities	1,199	754
Total liabilities	331,235	350,316
Commitments and contingencies		
Stockholders' equity		
Common stock (\$0.01 par value, 90,000 shares authorized; 16,511 and 16,370 shares issued; 16,375 and 16,370 shares outstanding)	165	164

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Additional paid-in capital	70,987	68,763
Accumulated other comprehensive (loss) income	(997)	937
Retained earnings	70,530	56,042
Treasury stock, at cost (136 and 0 shares)	(1,800)	-
Total stockholders' equity	138,885	125,906
Total liabilities and stockholders' equity	\$ 470,120	\$ 476,222

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

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

	Three Months Ended		Nine Months Ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Sales	\$ 90,734	\$ 87,318	\$ 271,448	\$ 259,485
Cost of sales	63,502	58,667	192,014	176,548
Gross profit	27,232	28,651	79,434	82,937
Operating costs and expenses:				
Research and development	2,766	2,232	8,420	6,475
Selling and marketing	5,012	4,911	15,512	14,539
General and administrative	5,136	5,835	16,781	16,085
Amortization of acquisition-related intangible assets	782	548	2,344	1,642
Net loss on disposition of fixed assets	128	16	203	74
Total operating costs and expenses	13,824	13,542	43,260	38,815
Operating income	13,408	15,109	36,174	44,122
Interest expense, net	4,627	5,143	14,244	15,757
Loss on debt extinguishment	121	-	514	-
Income before income taxes	8,660	9,966	21,416	28,365
Income tax expense	2,836	1,835	6,928	8,639
Net income	\$ 5,824	\$ 8,131	\$ 14,488	\$ 19,726
Other comprehensive income, net of tax				
Net unrealized gain (loss) on cash flow hedges	1,268	820	(1,934)	414
Comprehensive income	\$ 7,092	\$ 8,951	\$ 12,554	\$ 20,140
Earnings per share - Basic	\$ 0.36	\$ 0.50	\$ 0.88	\$ 1.22
Earnings per share - Diluted	\$ 0.33	\$ 0.46	\$ 0.82	\$ 1.11
Shares used to compute earnings per share - Basic	16,395	16,306	16,384	16,207
	17,669	17,796	17,719	17,696



Shares used to compute  
earnings per share - Diluted

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands – unaudited)

	Nine Months Ended	
	June 27, 2008	June 29, 2007
Cash flows from operating activities		
Net cash provided by operating activities	\$ 24,699	\$ 19,259
Cash flows from investing activities		
Capital expenditures	(3,288)	(6,392)
Proceeds from adjustment to acquisition purchase price	1,615	-
Capitalized expenses relating to potential business acquisition	-	(395)
Payment of patent application fees	(147)	-
Net cash used in investing activities	(1,820)	(6,787)
Cash flows from financing activities		
Purchases of treasury stock	(1,800)	-
Repayments of debt	(16,000)	(5,000)
Proceeds from issuance of common stock to employees	639	520
Proceeds from exercise of stock options	3	604
Excess tax benefit on stock option exercises	2	671
Net cash used in financing activities	(17,156)	(3,205)
Net increase in cash and cash equivalents	5,723	9,267
Cash and cash equivalents at beginning of period	20,474	30,153
Cash and cash equivalents at end of period	\$ 26,197	\$ 39,420
Supplemental cash flow disclosures		

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Cash paid for interest	\$	10,020	\$	11,562
Cash paid for income taxes, net of refunds	\$	9,846	\$	12,799

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

CPI INTERNATIONAL, INC.  
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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 direct and indirect subsidiaries on a consolidated basis.

The accompanying consolidated financial statements represent the consolidated results and financial position of CPI International, which is controlled by affiliates of The Cypress Group L.L.C. (“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.

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 2008 comprises the 53-week period ending October 3, 2008 and fiscal year 2007 comprised the 52-week period ending September 28, 2007. The third quarters of fiscal years 2008 and 2007 both include 13 weeks. The first three quarters of fiscal years 2008 and 2007 both include 39 weeks. 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 27, 2008 and for the three and nine months ended June 27, 2008 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 28, 2007. The condensed consolidated balance sheet as of September 28, 2007 has been derived from the audited financial statements at that date. The results of operations for the interim period ended June 27, 2008 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 and disclosure of contingent assets and liabilities at the date of the 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; inventory and inventory reserves; product warranty; business combinations; recoverability and valuation of recorded amounts of long-lived assets and identifiable intangible assets, including goodwill; recognition of share-based compensation; and recognition and

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(All tabular dollar amounts in thousands except share and per share amounts)

measurement of current and deferred income tax assets and liabilities. 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.

### 2. Recently Issued Accounting Standards

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 48, "Accounting for Income Tax Uncertainties." FIN No. 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN No. 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. Effective in the first quarter of fiscal year 2008 starting September 29, 2007, the Company adopted FIN No. 48. The adoption of FIN No. 48 did not have any impact on the Company's financial position, net income or prior year financial statements. See Note 10, "Income Taxes," for further discussion.

In September 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value under other accounting pronouncements that permit or require fair value measurements, changes the methods used to measure fair value and expands disclosures about fair value measurements. In particular, disclosures are required to provide information on: the extent to which fair value is used to measure assets and liabilities; the inputs used to develop measurements; and the effect of certain of the measurements on earnings (or changes in net assets). SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities and for fiscal years beginning after November 15, 2008 for non-financial assets and liabilities. Early adoption, as of the beginning of an entity's fiscal

year, is also

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(All tabular dollar amounts in thousands except share and per share amounts)

permitted, provided interim financial statements have not yet been issued. The Company will be required to adopt SFAS No. 157 in its fiscal year 2009 commencing October 4, 2008 for financial assets and liabilities and in its fiscal year 2010 commencing October 2, 2009 for non-financial assets and liabilities. The Company is currently evaluating the potential impact, if any, that the adoption of this new standard will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS No. 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will be required to adopt SFAS No. 159 in its fiscal year 2009 commencing October 4, 2008 and is currently evaluating the impact, if any, that the adoption of this new standard will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statement—amendments of ARB No. 51." SFAS No. 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company will be required to adopt SFAS No. 160 in its fiscal year 2010 commencing October 3, 2009. The Company does not believe the adoption of SFAS No. 160 will have a material impact on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ("SFAS No. 141(R)"), "Business Combinations," which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The Statement also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. The Company will be required to adopt SFAS No. 141(R) in its fiscal year 2010 commencing October 3, 2009.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133." SFAS No. 161 requires enhanced disclosures about an entity's derivative instruments and hedging activities including: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with earlier application encouraged. The Company will be required to adopt SFAS No. 161 in its





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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(All tabular dollar amounts in thousands except share and per share amounts)

second quarter of fiscal year 2009 commencing January 3, 2009. This standard is not expected to have a material effect on the Company's financial position or results of operations, and will likely result in additional disclosures related to the Company's derivatives.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3 ("FSP FAS 142-3"), "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets." More specifically, FSP FAS 142-3 removes the requirement under paragraph 11 of SFAS No. 142 to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions and instead, requires an entity to consider its own historical experience in renewing similar arrangements. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company will be required to adopt FSP FAS 142-3 in its fiscal year 2010 commencing October 3, 2009 and is currently evaluating the impact, if any, that the adoption of this new standard will have on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles, or GAAP, in the U.S. for non-governmental entities. SFAS No. 162 is effective 60 days following the Securities and Exchange Commission's ("SEC") approval of the Public Company Accounting Oversight Board amendments to AU Section 411, the meaning of "Present Fairly in Conformity with GAAP." Any effect of applying the provisions of SFAS No. 162 is to be reported as a change in accounting principle in accordance with SFAS No. 154, "Accounting Changes and Error Corrections." The Company is currently evaluating the impact that the adoption of SFAS No. 162, once effective, will have on its financial position and results of operations.

In June 2008, the FASB Issued Emerging Issues Task Force ("EITF") No. 08-3, "Accounting by Lessees for Nonrefundable Maintenance Deposits." EITF No. 08-3 requires that nonrefundable maintenance deposits paid by a lessee under an arrangement accounted for as a lease be accounted for as a deposit asset until the underlying maintenance is performed. When the underlying maintenance is performed, the deposit may be expensed or capitalized in accordance with the lessee's maintenance accounting policy. If finalized, EITF No. 08-3 would be effective for fiscal years beginning after December 15, 2008, including interim periods within those fiscal years, and would be adopted by making a cumulative-effect adjustment to beginning retained earnings in the period of adoption. The Company will be required to adopt EITF No. 08-3 in its fiscal year 2010 commencing October 3, 2009 and is currently evaluating the impact, if any, that the adoption of this new standard will have on its consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(All tabular dollar amounts in thousands except share and per share amounts)

3. Supplemental Balance Sheet Information

Accounts Receivable: Accounts receivable are stated net of allowances for doubtful accounts as follows:

	June 27, 2008	September 28, 2007
Accounts receivable	\$ 48,477	\$ 52,678
Less: Allowance for doubtful accounts	(98)	(89)
Accounts receivable, net	\$ 48,379	\$ 52,589

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

	June 27, 2008	September 28, 2007
Raw material and parts	\$ 39,168	\$ 40,725
Work in process	20,899	18,168
Finished goods	7,801	8,554
	\$ 67,868	\$ 67,447

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

	June 27, 2008	June 29, 2007
Balance at beginning of fiscal year	\$ 9,784	\$ 8,822
Inventory provision, charged to cost of sales	988	803
Inventory write-offs	(1,619)	(710)
Balance at end of period	\$ 9,153	\$ 8,915

Reserve for loss contracts: The following table summarizes the activity related to reserves for loss contracts:

	June 27,	June 29,
	Nine Months Ended	Nine Months Ended

	2008	2007
Balance at beginning of fiscal year	\$ 2,700	\$ 1,702
Provision for loss contracts, charged to cost of sales	1,932	970
Reduction upon revenue recognition	(2,702)	(1,202)
Balance at end of period	\$ 1,930	\$ 1,470

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(All tabular dollar amounts in thousands except share and per share amounts)

Reserve for loss contracts are reported in the condensed consolidated balance sheet in the following accounts:

	June 27, 2008	June 29, 2007
Inventories	\$ 1,112	\$ 1,294
Accrued expenses	818	176
	\$ 1,930	\$ 1,470

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

	Weighted Average Useful Life (in years)	June 27, 2008			September 28, 2007		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
VED Core Technology	50	\$ 30,700	\$ (2,734)	\$ 27,966	\$ 30,700	\$ (2,273)	\$ 28,427
VED Application Technology	25	19,800	(3,515)	16,285	19,800	(2,921)	16,879
X-ray Generator and Satcom Application Technology	15	8,000	(2,374)	5,626	8,000	(1,974)	6,026
Antenna and Telemetry Technology	25	5,300	(188)	5,112	5,300	(29)	5,271
Customer backlog	1	580	(513)	67	580	(78)	502
Land lease	46	11,810	(1,118)	10,692	11,810	(928)	10,882
Tradename	Indefinite	7,600	-	7,600	7,600	-	7,600
Customer list and programs	25	6,280	(884)	5,396	6,280	(684)	5,596
Noncompete agreement	5	640	(176)	464	640	(80)	560
Patent application fees	-	147	-	147	-	-	-
		\$ 90,857	\$ (11,502)	\$ 79,355	\$ 90,710	\$ (8,967)	\$ 81,743

Intangible assets, net as of June 27, 2008 include a total of approximately \$0.1 million of application costs and associated legal costs incurred to obtain certain patents. Upon obtaining these patents, these costs will be amortized on a straight-line basis and charged to operations over their estimated useful lives, not to exceed 17 years.

The amortization of intangible assets amounted to \$0.8 million and \$2.5 million for the three and nine months ended June 27, 2008, respectively, and \$0.6 million and \$1.8 million for the corresponding periods of fiscal year 2007.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(All tabular dollar amounts in thousands except share and per share amounts)

The estimated future amortization expense of intangible assets, excluding the Company's unamortized tradenames, is as follows:

Fiscal Year	Amount
2008 (remaining three months)	\$ 769
2009	2,808
2010	2,786
2011	2,786
2012	2,772
Thereafter	59,834
	\$ 71,755

Goodwill: The following table sets forth the changes in goodwill by reportable segment:

	VED	Satcom	Other	Total
Balance at September 28, 2007	\$ 132,897	\$ 13,830	\$ 14,846	\$ 161,573
Malibu purchase price and allocation adjustment	-	-	925	925
Other adjustments	-	-	(106)	(106)
Balance at June 27, 2008	\$ 132,897	\$ 13,830	\$ 15,665	\$ 162,392

During the first nine months of fiscal year 2008, the Company finalized the purchase price valuation and allocation associated with its acquisition of Malibu Research Associates, Inc. in August 2007, resulting in a \$0.9 million increase in goodwill. See Note 4 for details. Other adjustments primarily represent the change in Malibu goodwill recognized in connection with the filing of the 2007 income tax return during the third quarter of fiscal year 2008.

Product Warranty: The following table summarizes the activity related to product warranty:

	Nine Months Ended	
	June 27, 2008	June 29, 2007
Balance at beginning of fiscal year	\$ 5,578	\$ 5,958
Estimates for product warranty, charged to cost of sales	2,171	3,801

Actual costs of warranty claims	(3,216)	(4,232)
Balance at end of period	\$ 4,533	\$ 5,527



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4. Acquisition

Malibu Research Associates

On August 10, 2007, the Company completed its acquisition of all outstanding common stock of the privately held Malibu Research Associates, Inc. ("Malibu"). Malibu, headquartered in Camarillo, California, is a designer, manufacturer and integrator of advanced antenna systems for radar, radar simulators and telemetry systems, as well as for data links used in ground, airborne, unmanned aerial vehicles ("UAV") and shipboard systems. Under the terms of the purchase agreement, at the closing of the acquisition, the Company paid cash of approximately \$22.4 million, which included \$2.3 million and \$1.0 million placed into indemnity and working capital escrow accounts, respectively. The indemnity escrow amount was provided to ensure funds are available to satisfy potential indemnification claims asserted prior to January 1, 2009, and the working capital escrow amount was provided to satisfy any negative differences between the estimated working capital amount as of the acquisition closing date and the actual working capital amount at the acquisition closing date.

For financial reporting purposes, consideration of approximately \$2.6 million, which was part of the cash consideration paid for Malibu at the closing of the acquisition, was excluded from the purchase price allocation and was reported as other long-term assets in the consolidated balance sheet at September 28, 2007. This amount represents the difference between the estimated working capital amount as of the acquisition closing date and the actual working capital amount as of the acquisition closing date. In accordance with SFAS No. 141, any contingent consideration that has not been determined beyond a reasonable doubt is excluded from the purchase price allocation until the contingency is resolved. The Company intended to make a claim against the working capital escrow account of \$1.0 million and, if necessary, the indemnity escrow account of \$2.3 million to recover the working capital shortfall once the amount of such shortfall had been finally determined.

During the second quarter of fiscal year 2008, the valuation of Malibu's net working capital amount as of the acquisition closing date was finalized, resulting in a disbursement of cash to the Company of \$1.6 million from the escrow accounts. The remaining \$1.0 million of consideration was allocated to goodwill as the working capital contingency was resolved, which resulted in an adjusted cash purchase price of \$20.7 million. The remaining \$1.8 million, including interest, held in the indemnity escrow account is available to cover potential indemnification claims asserted prior to January 1, 2009.

During the third quarter of fiscal year 2008, Malibu's income tax return for its short fiscal period ended immediately preceding the closing date of the acquisition was finalized, resulting in a decrease in the assumed income tax payable and an offsetting reduction to goodwill of approximately \$0.1 million.

Additionally, the Company may be required to pay a potential earnout to the former stockholders of Malibu of up to \$14.0 million, which is primarily contingent upon the achievement of certain financial objectives over the three years following the acquisition ("Financial Earnout"); and a discretionary earnout of up to \$1.0 million contingent upon achievement of certain succession planning goals by June 30, 2010. As of June 27, 2008, the Company has not accrued any of these contingent earnout amounts as achievement of the objectives and goals has not occurred. Any earnout consideration paid based on financial performance will be recorded as additional goodwill. Any discretionary succession earnout consideration paid will be recorded as general and administrative expense. Preliminary calculations of the first year's Financial Earnout as of June 27, 2008 indicate that no earnout was earned for the first



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earnout period, and the maximum potential Financial Earnout that could be earned over the three years following the acquisition is reduced from \$14.0 million to \$12.3 million.

Under the purchase method of accounting, the assets and liabilities of Malibu were adjusted to their fair values and the excess of the purchase price over the fair value of the net assets acquired was recorded as goodwill. The allocation of the purchase price to specific assets and liabilities was based, in part, upon internal estimates of cash flow and recoverability. The valuation of identifiable intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. This purchase price allocation was generally based on the fair value of these assets determined using the income approach.

The following table summarizes the allocation of the fair value of Malibu's assets acquired and liabilities assumed:

Net current liabilities	\$ (3,854)
Property, plant and equipment	719
Deferred tax liabilities	(703)
Identifiable intangible assets	8,790
Goodwill	15,781
	\$ 20,733

The following table presents details of the purchased intangible assets acquired:

	Weighted Average Useful Life (in years)	Amount
Non compete agreements	5	\$ 530
Tradenname	Indefinite	1,800
Antenna and Telemetry technology	25	5,300
Backlog	1	580
Customer relationships	15	580
		\$ 8,790

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and indefinite lived intangibles will not be amortized but will be tested for impairment at least annually.

The Company's consolidated financial statements include Malibu's financial results from the acquisition date.

#### Pro Forma Results

Pro forma information giving effect to the Malibu acquisition has not been presented because the pro forma information would not differ materially from the historical results of the Company.



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5. Long-Term Debt

Long-term debt comprises the following:

	June 27, 2008	September 28, 2007
Term loan, expiring 2014	\$ 91,750	\$ 99,750
8% Senior subordinated notes due 2012	125,000	125,000
Floating rate senior notes due 2015, net of issue discount of \$108 and \$183	13,892	21,817
	230,642	246,567
Less: Current portion	2,000	1,000
Long-term portion	\$ 228,642	\$ 245,567
Standby letters of credit	\$ 4,986	\$ 3,725

Senior Credit Facilities: On August 1, 2007, CPI amended and restated its then existing senior credit facilities. The amended and restated senior credit facilities (the “Senior Credit Facilities”) provide for borrowings of up to an aggregate principal amount of \$160 million, consisting of a \$100 million term loan facility (“Term Loan”) and a \$60 million revolving credit facility (“Revolver”), with a sub-facility of \$15 million for letters of credit and \$5 million for swing line loans. Upon certain specified conditions, including maintaining a senior secured leverage ratio of 3.75:1 or less on a pro forma basis, CPI may seek commitments for a new class of term loans, not to exceed \$125 million in the aggregate. The Senior Credit Facilities are guaranteed by CPI International and all of CPI’s domestic subsidiaries and are secured by substantially all of the assets of CPI International, CPI and CPI’s domestic subsidiaries.

Except as provided in the following sentence, the Term Loan will mature on August 1, 2014 and the Revolver will mature on August 1, 2013. However, if, prior to August 1, 2011, CPI has not repaid or refinanced its \$125 million 8% Senior Subordinated Notes due 2012, both the Term Loan and the Revolver will mature on August 1, 2011.

The Senior Credit Facilities replaced CPI’s previous senior credit facilities of \$130 million. On the closing date of the Senior Credit Facilities, CPI borrowed \$100 million under the Term Loan. Borrowings under the Senior Credit Facilities bear interest at a rate equal to, at CPI’s option, LIBOR or the ABR plus the applicable margin. The ABR is the greater of the (a) the prime rate and (b) the federal funds rate plus 0.50%. For Term Loans, the applicable margin will be 2.00% for LIBOR borrowings and 1.00% for ABR borrowings. The applicable margins under the Revolver vary depending on CPI’s leverage ratio, as defined in the Senior Credit Facilities, and range from 1.25% to 2.00% for LIBOR borrowings and from 0.25% to 1.00% for ABR borrowings.

In addition to customary fronting and administrative fees under the Senior Credit Facilities, CPI will pay letter of credit participation fees equal to the applicable LIBOR margin per annum on the average daily amount of the letter of credit exposure, and a commitment fee on the average daily unused commitments under the Revolver. The commitment fee will vary depending on CPI’s leverage ratio, as defined in the Senior Credit Facilities, and will range

from 0.25% to 0.50%.

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The Senior Credit Facilities require that CPI repay \$250,000 of the Term Loan at the end of each fiscal quarter prior to the maturity date of the Term Loan, with the remainder due on the maturity date. CPI is required to prepay its outstanding loans under the Senior Credit Facilities, 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, and (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.

If CPI's leverage ratio, as defined in the Senior Credit Facilities, exceeds 3.5:1 at the end of any fiscal year, CPI will also be required to make an annual prepayment within 90 days after the end of such fiscal year equal to 50% of excess cash flow, as defined in the Senior Credit Facilities, less optional prepayments made during the fiscal year. 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.

The Senior Credit Facilities contain a number of covenants that, among other things, restrict, subject to certain exceptions, the ability of CPI International, CPI or any of CPI's 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 its subsidiaries must comply with a maximum capital expenditure limitation and a maximum total secured leverage ratio, each calculated on a consolidated basis for CPI.

CPI made repayments on the Term Loan of \$8.0 million during the first nine months of fiscal year 2008 and \$250,000 during the fourth quarter of fiscal year 2007, leaving a principal balance of \$91.75 million as of June 27, 2008. The \$8.0 million Term Loan repayment during the first nine months of fiscal year 2008 comprised the scheduled amortization payment of \$250,000 for the first quarter of fiscal year 2008 and an optional prepayment of \$7.75 million. A portion of the optional prepayment was applied against the scheduled amortization payment due for the second and third quarters of fiscal year 2008. Another portion of the optional prepayment will be applied against the scheduled amortization payment due for the fourth quarter of fiscal year 2008 and those scheduled amortization payments due through fiscal year 2014.

At June 27, 2008, the amount available for borrowing under the Revolver, after taking into account the Company's outstanding letters of credit of \$5.0 million, was approximately \$55.0 million.

See Note 13 "Subsequent Event" for a discussion of the additional \$2.0 million prepayment of the Term Loan made in July 2008.

8% Senior Subordinated Notes due 2012 of CPI: As of June 27, 2008, CPI had \$125.0 million in aggregate principal amount of its 8% Senior Subordinated Notes due 2012 (the "8% Notes"). The 8% Notes have no sinking fund requirements.





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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 Facilities. 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%

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 due 2015 of CPI International: As of June 27, 2008, \$14.0 million of aggregate principal amount remained outstanding under CPI International's Floating Rate Senior Notes due 2015 (the "FR Notes") after giving effect to the redemption of \$6.0 million and \$2.0 million in the second and third quarters of fiscal year 2008, respectively. The FR Notes were originally issued at a 1% discount. 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, 2008 is 8.9% 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 after August 1, 2006 and on or before February 1,

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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 Communications & Power Industries to satisfy its obligations under the FR Notes. The Senior Credit Facilities and the indenture governing the 8% Notes restrict CPI's ability to make distributions to CPI International. The Senior Credit Facilities prohibit CPI from making distributions to CPI International unless there is no default under the Senior Credit Facilities and CPI satisfies a senior secured leverage ratio of 3.75:1, and in the case of distributions to pay amounts other than interest on the FR Notes, the amount of the distribution and all prior such distributions do not exceed a specified amount. 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 on or after February 1, 2007, CPI International, at its option, may redeem the FR 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.



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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 June 27, 2008, maturities on long-term debt were as follows:

Fiscal Year	Term Loan	8% Senior Subordinated Notes	Floating Rate Senior Notes	Total
2008 (remaining three months)	\$ 2,000	\$ -	\$ -	\$ 2,000
2009	-	-	-	-
2010	-	-	-	-
2011	89,750	-	-	89,750
2012	-	125,000	-	125,000
Thereafter	-	-	14,000	14,000
	\$ 91,750	\$ 125,000	\$ 14,000	\$ 230,750

The above table assumes (1) that the respective debt instruments will be outstanding until their scheduled maturity dates, except for the Term Loan under the Senior Credit Facilities, which is assumed to mature on the earlier date of August 1, 2011 as described above under "Senior Credit Facilities," and (2) a debt level based on mandatory repayments according to the contractual amortization schedule. The \$2.0 million amount shown for fiscal year 2008 for the Term Loan is an optional prepayment made on July 30, 2008. See Note 13.

As of June 27, 2008, the Company was in compliance with the covenants under the indentures governing the 8% Notes and FR Notes and the agreements governing the Senior Credit Facilities, and the Company expects to remain in compliance with those covenants throughout the remainder of fiscal year 2008 and fiscal year 2009.

Loss on debt extinguishment: The redemption of \$8.0 million in aggregate principal amount of the FR Notes in the second and third quarters of fiscal year 2008, as discussed above, resulted in a loss on debt extinguishment of approximately \$0.5 million, including non-cash write-offs of \$0.3 million of unamortized debt issue costs and issue discount costs and \$0.2 million in cash payments primarily for call premiums.

Interest rate swap agreements: See Note 6 for information on the interest rate swap agreements entered into by the Company to hedge the interest rate exposure associated with the Term Loan.

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6. Derivative Financial Instruments

The Company uses forward exchange contracts to hedge the foreign currency exposure associated with forecasted manufacturing costs in Canada. As of June 27, 2008, the Company had outstanding forward contract commitments to purchase \$17.0 million Canadian dollars. The last forward contract expires on December 29, 2008. At June 27, 2008 and September 28, 2007, the fair value of foreign currency forward contracts was a net asset of \$0.2 million and \$1.3 million, respectively, and the unrealized gain, net of related tax expense, was \$0.2 million and \$1.2 million, respectively.

The Company's foreign currency forward contracts are designated as a cash flow hedge and are considered highly effective, as defined by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The unrealized gains and losses from foreign exchange forward contracts are included in "accumulated other comprehensive income" in the condensed consolidated balance sheets, and the Company anticipates recognizing the entire unrealized gain in operating earnings within the next 12 months. Changes in the fair value of foreign currency forward contracts due to changes in time value are excluded from the assessment of effectiveness, and are immediately recognized in general and administrative in the consolidated statements of operations. The time value was not material for the first three quarters of fiscal years 2008 and 2007. If the transaction being hedged fails to occur, or if a portion of any derivative is ineffective, then the Company promptly recognizes the gain or loss on the associated financial instrument in the consolidated statements of operations. No ineffective amounts were recognized due to anticipated transactions failing to occur in the first three quarters of fiscal years 2008 and 2007. Realized gains and losses from foreign currency forward contracts are recognized in cost of sales and general and administrative in the condensed consolidated statements of operations. Net income for the three and nine months ended June 27, 2008 includes a recognized loss of \$0.1 million and gain of \$0.3 million, respectively, from foreign currency forward contracts. Net income in the three and nine months ended June 29, 2007 includes a recognized loss from foreign currency forward contracts of \$0.2 million.

The Company also uses derivatives to hedge the interest rate exposure associated with its long-term debt. On September 21, 2007, the Company entered into an interest rate swap contract (the "2007 Swap") to receive three-month USD-LIBOR-BBA (British Bankers' Association) interest and pay 4.77% fixed rate interest. Net interest positions are settled quarterly. The Company has structured the 2007 Swap with decreasing notional amounts to match the expected pay down of its Term Loan under the Senior Credit Facilities discussed in Note 5. The notional value of the 2007 Swap was \$80.0 million at June 27, 2008 and represented approximately 87% of the aggregate Term Loan balance. The Swap agreement is effective through June 30, 2011. Under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, this arrangement was initially designated and qualified as an effective cash flow hedge of interest rate risk related to the Term Loan, which permitted recording the fair value of the 2007 Swap and corresponding unrealized gain or loss to accumulated other comprehensive income in the condensed consolidated balance sheets. The interest rate swap gain or loss is included in the assessment of hedge effectiveness. At June 27, 2008, the fair value of the short-term and long-term portions of the 2007 Swap was a liability of \$1.0 million (accrued expenses) and \$0.7 million (other long-term liabilities), respectively. At September 28, 2007, the fair value of the short-term and long-term portions of the 2007 Swap was an asset of \$0.1 million (other current assets) and a liability of \$0.3 million (other long-term liabilities), respectively. At June 27, 2008 and September 28, 2007, the unrealized loss, net of tax, was \$1.0 million and \$0.1 million, respectively.



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7. Commitments and Contingencies

**Leases:** The Company is committed to minimum rentals under non-cancelable operating lease agreements, primarily for land and facility space, that expire on various dates through 2050. Certain of the leases provide for escalating lease payments. Future minimum lease payments for all non-cancelable operating lease agreements at June 27, 2008 were as follows:

Fiscal Year	Operating Leases
2008 (remaining three months)	\$ 573
2009	1,966
2010	1,657
2011	552
2012	456
Thereafter	3,094
	\$ 8,298

Real estate taxes, insurance, and maintenance are also obligations of the Company. Rental expense under non-cancelable operating leases amounted to \$0.5 million and \$1.7 million for the three and nine months ended June 27, 2008, respectively, and to \$0.5 million and \$1.4 million for the corresponding periods of fiscal year 2007. Assets subject to capital leases at June 27, 2008 and September 28, 2007 were not material.

**Guarantees:** The Company has restricted cash of \$1.2 million and \$2.3 million as of June 27, 2008 and September 28, 2007, respectively, consisting primarily of bank guarantees from customer advance payments to the Company's international subsidiaries. The bank guarantees become unrestricted cash when performance under the sales or supply contract is complete.

**Purchase commitments:** As of June 27, 2008, the Company had the following known purchase commitments, which include primarily future purchases for inventory-related items under various purchase arrangements as well as other obligations in the ordinary course of business that the Company cannot cancel or where it would be required to pay a termination fee in the event of cancellation:

Fiscal Year	Purchase Contracts
2008 (remaining three months)	\$ 24,328
2009	11,939
2010	1,350
2011	419
	\$ 38,036

**Contingent Earnout Consideration:** As discussed in Note 4, in addition to the \$20.5 million of net cash consideration paid for the Malibu acquisition, there is a potential Financial Earnout payable to the former stockholders of Malibu of up to \$14.0 million, which is primarily contingent upon the achievement of certain financial objectives over the three years following the acquisition, and a discretionary earnout of up to \$1.0 million contingent upon achievement of



certain succession planning goals by June 30, 2010. Preliminary calculations of the first year's Financial Earnout as of June 27,

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2008 indicate that no earnout was earned for the first earnout period, and the maximum potential Financial Earnout that could be earned over the three years following the acquisition is reduced from \$14.0 million to \$12.3 million.

**Indemnification:** As permitted under Delaware law, the Company has agreements whereby the Company indemnifies its officers, directors and certain employees for certain events or occurrences while the employee, officer or director is, or was serving, at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has Director and Officer insurance policies that limit its exposure and may enable it to recover a portion of any future amounts paid.

The Company has entered into other standard indemnification agreements in its ordinary course of business. Pursuant to these agreements, the Company agrees to indemnify, defend, hold harmless, and to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally the Company's business partners or customers, in connection with any patent, copyright or other intellectual property infringement claim by any third party with respect to its products. The term of these indemnification agreements is generally perpetual after execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has not incurred significant costs to defend lawsuits or settle claims related to these indemnification agreements. The Company believes that the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of June 27, 2008.

**Employment Agreements:** The Company has entered into employment agreements with certain members of executive management that include provisions for the continued payment of salary, benefits and a pro-rata portion of annual bonus upon employment termination for periods ranging from 12 months to 30 months.

**Contingencies:** From time to time, the Company may be subject to claims that arise in the ordinary course of business. In the opinion of management, all such matters involve amounts that would not have a material adverse effect on the Company's consolidated financial position if unfavorably resolved.

8. **Stock Repurchase Program**

On May 28, 2008, the Company announced that its board of directors authorized the Company to implement a program to repurchase up to \$12.0 million of the Company's common stock from time to time, funded entirely from cash on hand. Repurchases made under the program are subject to the terms and limitations of Company's debt covenants, as well as market conditions and share price, and will be made at management's discretion in open market trades, through block trades or in privately negotiated transactions. The program may be modified or terminated by the Company's board of directors at any time. During the three months ended June 27, 2008, the Company repurchased 136,215 shares recorded as treasury stock, at an average per share price of \$13.17, plus brokerage commissions of \$0.04 per share, for an aggregate cost of \$1.8 million.

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9. Stock-based Compensation Plans

As of June 27, 2008, the Company had an aggregate of 1.2 million shares of its common stock available for future grant, and approximately 3.4 million options were outstanding, under its various equity plans. Awards are subject to terms and conditions as determined by the Company's Board of Directors.

Stock Options: The following table summarizes stock option activity as of June 27, 2008, and changes during the nine months ended June 27, 2008 under the Company's stock option plans:

	Outstanding Options				Exercisable Options			
	Weighted-Average		Remaining		Weighted-Average		Remaining	
	Number of	Exercise	Contractual	Aggregate	Number of	Exercise	Contractual	Aggregate
	Shares	Price	Term	Intrinsic	Shares	Price	Term	Intrinsic
			(Years)	Value			(Years)	Value
Balance at September 28, 2007	3,171,081	\$ 5.61	6.58	\$ 42,513	2,259,528	\$ 3.00	5.98	\$ 36,184
Granted	208,750	16.79						
Exercised	(599)	4.32						
Forfeited or cancelled	(4,400)	16.58						
Balance at June 27, 2008	3,374,832	\$ 6.29	6.04	\$ 25,131	2,565,069	\$ 3.83	5.41	\$ 23,774

The aggregate intrinsic value in the preceding table represents the total intrinsic value, based on the Company's closing stock price of \$12.91 as of June 27, 2008, that would have been received by the option holders had all option holders exercised their options as of that date. As of June 27, 2008, 2,417,394 exercisable options were in-the-money.

During the three and nine months ended June 27, 2008, cash received from option exercises was approximately \$2,600, and the total intrinsic value of options exercised was \$5,500. During the three and nine months ended June 29, 2007, cash received from option exercises was approximately \$0.1 million and \$0.6 million, respectively, and the total intrinsic value of options exercised was \$0.5 million and \$3.2 million, respectively. As of June 27, 2008, there was approximately \$4.6 million of total unrecognized compensation costs related to nonvested stock options, which is expected to be recognized over a weighted-average vesting period of 1.9 years.

Stock Purchase Plan: Employees purchased 25,946 shares for \$0.2 million and 52,689 shares for \$0.6 million in the three and nine months ended June 27, 2008, respectively, under the 2006 Employee Stock Purchase Plan (the "2006 ESPP"). As of June 27, 2008, there were no unrecognized compensation costs related to rights to acquire stock under the 2006 ESPP.

Restricted Stock and Restricted Stock Units: As of June 27, 2008 there were outstanding 119,554 shares of nonvested restricted stock and restricted stock units, and as of September 28, 2007 there were outstanding 11,466 shares of nonvested restricted stock, in each case granted to directors and employees. The restricted stock and restricted stock

units vest over periods of one to four years and have a 10 year contractual life. Upon vesting, each restricted stock unit will automatically convert into one share of common stock of CPI International.

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A summary of the status of the Company's nonvested restricted stock and restricted stock unit awards as of June 27, 2008, and changes during the nine months then ended is presented below:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at September 28, 2007	11,466	\$ 17.44
Granted	114,461	15.22
Vested	(5,848)	17.60
Forfeited	(525)	16.79
Nonvested at June 27, 2008	119,554	\$ 15.31

Aggregate intrinsic value of the nonvested restricted stock and restricted stock unit awards at June 27, 2008 was \$1.5 million. As of June 27, 2008, there was \$1.6 million of total unrecognized compensation costs related to nonvested restricted stock and restricted stock units, which is expected to be recognized over a weighted average vesting period of 2.0 years.

The Company settles stock option exercises, restricted stock awards and restricted stock units with newly issued common shares.

#### Valuation and Expense Information under SFAS No. 123(R)

On October 1, 2005, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors, including employee stock options, restricted stock, restricted stock units and employee stock purchases related to the 2006 ESPP based on estimated fair values. The following table summarizes stock-based compensation expense for the three and nine months ended June 27, 2008 and June 29, 2007, which was allocated as follows:

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	Three Months Ended		Nine Months Ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Share-based compensation cost recognized in the income statement by caption:				
Cost of sales	\$ 116	\$ 75	\$ 307	\$ 196
Research and development	43	25	112	68
Selling and marketing	61	28	165	87
General and administrative	374	209	984	538
	\$ 594	\$ 337	\$ 1,568	\$ 889
Share-based compensation cost capitalized in inventory				
	\$ 120	\$ 78	\$ 335	\$ 206
Share-based compensation cost remaining in inventory at end of period				
	\$ 74	\$ 39	\$ 74	\$ 39
Share-based compensation expense by type of award:				
Stock options	\$ 421	\$ 277	\$ 1,153	\$ 712
Restricted stock and restricted stock units	134	27	301	85
Stock purchase plan	39	33	114	92
	\$ 594	\$ 337	\$ 1,568	\$ 889

The tax benefit realized from option exercises and restricted stock vesting totaled approximately \$3,000 and \$22,000 during the three and nine months ended June 27, 2008, respectively. The tax benefit realized from option exercises and restricted stock vesting totaled approximately \$0.1 million and \$1.1 million during the three and nine months ended June 29, 2007, respectively.

There were no stock options granted during the three months ended June 27, 2008. The weighted-average estimated fair value of stock options granted during the nine months ended June 27, 2008 was \$7.83 per share. The weighted-average estimated fair value of stock options granted during the three and nine months ended June 29, 2007 was \$10.71 and \$7.75 per share, respectively. Assumptions used in the Black-Scholes model to estimate the fair value of stock option grants during each period are presented below.

	Three Months Ended		Nine months ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Expected term (in years)	*	6.25	6.25	6.00 – 6.25
Expected volatility	*	49.33%	41.20%	49.33% – 45.66%
Risk-free rate	*	4.69%	3.82%	4.71%

Dividend yield	*	0%	0%	0%
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\* No new stock options were granted during the three months ended June 27, 2008.

Since the Company's common stock has not been publicly traded for a sufficient time period, the expected volatility is based on expected volatilities of similar companies that have a longer history of being publicly traded. The risk-free rates are based on the U.S. Treasury yield in effect at the time of the grant. Since the Company's historical data is limited, the expected term of options granted is based on the simplified method for plain vanilla options in accordance with SEC Staff Accounting Bulletin ("SAB")

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No. 107. In December 2007, the SEC issued SAB No. 110, an amendment of SAB No. 107. SAB No. 110 states that the staff will continue to accept, under certain circumstances, the continued use of the simplified method beyond December 31, 2007. Accordingly, the Company will continue to use the simplified method until it has enough historical experience to provide a reasonable estimate of expected term.

Based on the 15% discount received by the employees, the weighted-average fair value of shares issued under the 2006 ESPP was \$1.50 and \$2.14 per share during the three and nine months ended June 27, 2008, respectively, and \$2.88 and \$2.33 per share during the three and nine months ended June 29, 2007, respectively.

Using the market price of the Company's common stock on the date of grant, the weighted-average estimated fair value of restricted stock and restricted stock units granted was \$15.22 and \$17.09 per share during the nine months ended June 27, 2008 and June 29, 2007, respectively. There were no restricted stock or restricted stock units granted during the three months ended June 27, 2008 and June 29, 2007.

As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three and nine months ended June 27, 2008 and for the corresponding periods of fiscal year 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

#### 10. Income Taxes

The Company recorded an income tax provision of \$6.9 million and \$8.6 million for the nine months ended June 27, 2008 and June 29, 2007, respectively. The Company's effective tax rate was approximately 32% for the nine months ended June 27, 2008 as compared to approximately 30% for the corresponding period of fiscal year 2007.

Income tax expense for the three and nine months ended June 27, 2008 includes a reduction to the Company's annual tax rate of approximately 1% to reflect a change in estimate for Canadian tax credits. Income tax expense for the nine months ended June 27, 2008 also includes a tax benefit of approximately \$0.4 million attributable to the correction of an immaterial error that arose in the fourth quarter of fiscal year 2007 relating to the warranty expense tax deduction in a foreign tax jurisdiction.

Income tax expense for the three and nine months ended June 29, 2007 includes a discrete tax benefit of \$1.8 million related to the filing of amended income tax returns for prior years to reflect a change in estimate with regard to reporting Canadian income earned in the U.S.

CPI International adopted FIN No. 48, "Accounting for Uncertainty in Income Taxes," in the first quarter of fiscal year 2008 commencing on September 29, 2007. In connection with the Company's adoption of FIN No. 48, there was no cumulative effect adjustment necessary to the September 29, 2007 balance of retained earnings. The total unrecognized tax benefit, excluding any related interest accrual, was \$5.9 million and \$4.9 million as of June 27, 2008 and September 29, 2007, respectively, and is reported as a current liability (income taxes payable) since it is expected to be settled within 12 months of





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the reporting date. Of the total unrecognized tax benefit balance, \$4.8 million and \$4.4 million would reduce the effective tax rate if recognized as of June 27, 2008 and September 29, 2007, respectively. The Company's policy to classify interest and penalties on unrecognized tax benefits as a component of income tax expense in the statements of operations and comprehensive income did not change upon the adoption of FIN No. 48. As of June 27, 2008 and September 29, 2007, the Company had accrued \$1.7 million and \$1.3 million of interest, respectively. The Company had minimal penalties accrued in income tax expense.

The Company is subject to U.S. federal, California, Massachusetts and Canada income tax as well as income tax in various other states, local and international jurisdictions. Fiscal years 2004 to 2007 remain open to examination by the foregoing taxing jurisdictions. The Company has not been audited for U.S. federal income tax matters. The Company has income tax audits in progress in Canada and in several states, local and international jurisdictions in which it operates. The years under examination by the Canadian taxing authorities are 2001 to 2002. The years under examination by other taxing authorities vary, with the earliest year being 2004.

Based on the outcome of examinations of the Company, the result of the expiration of statutes of limitations for specific jurisdictions, it is reasonably possible that the related unrecognized tax benefits could change from those recorded in the statement of financial position. The majority of the Company's unrecognized tax benefit is attributable to the Canada Revenue Agency ("CRA") income tax contingency. The CRA is conducting an audit of the Company's income tax returns in Canada for fiscal years 2001 and 2002. The Company received a proposed tax assessment, including interest expense from the CRA for fiscal years 2001 and 2002. The tax assessment is based on tax deductions related to the valuation of the Satcom business, which was purchased by Communications & Power Industries Canada Inc. from CPI in fiscal years 2001 and 2002. While the Company believes that it has meritorious defenses and intends to vigorously defend its position, it is reasonably possible that the CRA may issue a formal tax assessment requiring the Company to settle the tax deficiency within 12 months.

11. Earnings Per Share

Basic earnings per share are computed using the weighted-average number of common shares outstanding during the period, excluding outstanding nonvested restricted shares subject to repurchase. Diluted earnings per share are computed using the weighted-average number of common and dilutive potential common equivalent shares outstanding during the period. Potential common equivalent shares consist of common stock issuable upon exercise of stock options and nonvested restricted shares and nonvested restricted stock units using the treasury stock method.

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The following table is a reconciliation of the shares used to calculate basic and diluted earnings per share (in thousands):

	Three Months Ended		Nine Months Ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Weighted average common shares outstanding -- Basic	16,395	16,306	16,384	16,207
Effect of dilutive stock options and nonvested restricted stock awards and units	1,274	1,490	1,335	1,489
Weighted average common shares outstanding -- Diluted	17,669	17,796	17,719	17,696

The calculation of diluted net income per share excludes all anti-dilutive shares. For the three and nine months ended June 27, 2008, the number of anti-dilutive shares, as calculated based on the weighted average price of the Company's common stock for the periods, was approximately 0.9 million and 0.8 million shares, respectively. For the three and nine months ended June 29, 2007, the number of anti-dilutive shares, as calculated based on the weighted average price of the Company's common stock for the periods, was approximately 0.5 million shares.

## 12. Segments, Geographic and Customer Information

The Company's reportable segments are VED and satcom equipment. The VED segment develops, manufactures and distributes high power/high frequency microwave and radio frequency signal components. The satcom equipment segment manufactures and supplies high power amplifiers and networks for satellite communication uplink and industrial applications. Segment information reported below is consistent with the manner in which it is reviewed and evaluated by the Company's chief operating decision maker ("CODM"), its chief executive officer, and is based on the nature of the Company's operations and products offered to customers.

Amounts not reported as VED or satcom equipment are reported as Other. In accordance with quantitative and qualitative guidelines established by SFAS No. 131, Other includes the activities of the Company's recently acquired Malibu division and unallocated corporate expenses, such as business combination-related expenses, share-based compensation expense, and certain non-recurring or unusual expenses. The Malibu division is a designer, manufacturer and integrator of advanced antenna systems for radar, radar simulators and telemetry systems, as well as for data links used in ground, airborne, UAV and shipboard systems.

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Summarized financial information concerning the Company's reportable segments is shown in the following tables:

	Three Months Ended		Nine Months Ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
<b>Sales to external customers</b>				
VED	\$ 68,770	\$ 70,651	\$ 206,504	\$ 209,842
Satcom equipment	18,550	16,667	53,259	49,643
Other	3,414	-	11,685	-
	\$ 90,734	\$ 87,318	\$ 271,448	\$ 259,485
<b>Intersegment product transfers</b>				
VED	\$ 7,799	\$ 6,903	\$ 20,947	\$ 16,608
Satcom equipment	9	1	72	10
	\$ 7,808	\$ 6,904	\$ 21,019	\$ 16,618
<b>Capital expenditures</b>				
VED	\$ 529	\$ 1,009	\$ 1,873	\$ 6,240
Satcom equipment	-	13	654	35
Other	201	24	761	117
	\$ 730	\$ 1,046	\$ 3,288	\$ 6,392
<b>EBITDA</b>				
VED	\$ 17,548	\$ 19,231	\$ 49,835	\$ 54,747
Satcom equipment	1,332	1,842	3,709	4,460
Other	(2,814)	(3,739)	(9,713)	(8,478)
	\$ 16,066	\$ 17,334	\$ 43,831	\$ 50,729

	June 27, 2008	September 28, 2007
<b>Total assets</b>		
VED	\$ 326,311	\$ 335,926
Satcom equipment	49,583	49,266
Other	92,712	91,030
	\$ 468,606	\$ 476,222

EBITDA represents earnings before net interest expense, provision for income taxes and depreciation and amortization. For the reasons listed below, the Company believes that GAAP-based financial information for leveraged businesses such as the Company's business should be supplemented by EBITDA so that investors better understand the Company's financial performance in connection with their analysis of the Company's business:

EBITDA is a component of the measures used by the Company's board of directors and management team to evaluate the Company's operating performance;

the Senior Credit Facilities contain a covenant that requires the Company to maintain a senior secured leverage ratio that contains EBITDA as a component, and the Company's management team uses EBITDA to monitor compliance with this covenant;

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EBITDA is a component of the measures used by the Company's management team to make day-to-day operating decisions;

EBITDA facilitates comparisons between the Company's operating results and those of competitors with different capital structures and therefore is a component of the measures used by the Company's management to facilitate internal comparisons to competitors' results and the Company's industry in general; and

the payment of management bonuses is contingent upon, among other things, the satisfaction by the Company of certain targets that contain EBITDA as a component.

Other companies may define EBITDA differently and, as a result, the Company's measure of EBITDA may not be directly comparable to EBITDA of other companies. Although the Company uses EBITDA as a financial measure to assess the performance of its business, the use of EBITDA is limited because it does not include certain material costs, such as interest and taxes, necessary to operate the Company's business. When analyzing the Company's performance, EBITDA should be considered in addition to, and not as a substitute for, net income, cash flows from operating activities or other statements of operations or statements of cash flows data prepared in accordance with GAAP.

The following table reconciles net income to EBITDA:

	Three Months Ended		Nine Months Ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Net income	\$ 5,824	\$ 8,131	\$ 14,488	\$ 19,726
Depreciation and amortization	2,779	2,225	8,171	6,607
Interest expense, net	4,627	5,143	14,244	15,757
Income tax expense	2,836	1,835	6,928	8,639
EBITDA				