

CPI HOLDCO INC
Form 10-Q
May 13, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE
COMMISSION
Washington, D.C. 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 April 1, 2005

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: **333-11387-04**

CPI HOLDCO, 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 each 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 an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

APPLICABLE ONLY TO CORPORATE ISSUERS:

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Indicate the number of shares outstanding for each of the Registrant's classes of Common Stock, as of the latest practicable date: 4,275,566 shares of Common Stock, \$.01 par value, at May 13, 2005.

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**CPI Holdco, Inc.
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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 the future financial performance of CPI Holdco, Inc. (collectively, with its subsidiaries, the Company). 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 of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither the Company nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. All written and oral forward-looking statements made in connection with this report that are attributable to the Company or persons acting on the Company's behalf are expressly qualified in their entirety by the risk factors, and other cautionary statements included herein and in the other filings with the Securities and Exchange Commission (SEC) made by the Company and its predecessor, Communications & Power Industries Holding Corporation. The Company is 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 the Company's expectations.

The information in this report is not a complete description of the Company's business or the risks and uncertainties associated with an investment in the Company's securities. You should carefully consider the various risks and uncertainties that impact the Company's business and the other information in this report and the Company's other filings with the SEC before you decide to invest in the Company or to maintain or increase your investment. Such risks and uncertainties include, but are not limited to, the following:

the Company's indebtedness is substantial;

the agreements and instruments governing the Company's debt have restrictions that could limit its flexibility in operating its business;

the Company's ability to generate the significant amount of cash needed to service its debt and to fund capital expenditures or other liquidity needs depends on many factors beyond its control;

the Company has had historical losses;

the Company may be unable to retain and/or recruit key management and other personnel;

the markets in which the Company sells its products are competitive;

the end markets in which the Company operates are subject to technological change;

a significant portion of the Company's sales is, and is expected to continue to be, from contracts with the U.S. Government;

the Company generates sales from contracts with foreign governments;

the Company's international operations subject it to social, political and economic risks of doing business in foreign countries;

the Company may not be successful in obtaining the necessary export licenses and technical assistance agreements to conduct operations abroad and the U.S. Congress may prevent proposed sales to foreign customers;

the Company's results of operations and financial condition may be adversely affected by increased or unexpected costs incurred by it on its contracts and sales orders;

environmental regulation and legislation, liabilities relating to contamination and changes in the Company's ability to recover under Varian Medical Systems Inc.'s indemnity obligations could adversely affect its business;

the Company has only a limited ability to protect its intellectual property rights;

the Company's inability to obtain certain necessary raw materials and key components could disrupt the manufacture of its products and cause its financial condition and results of operations to suffer;

the relocation of the Company's San Carlos, California operating division to Palo Alto, California could result in disruption to the Company's operations;

the Company may not be able to timely comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002; and

the Company is controlled by affiliates of The Cypress Group L.L.C.

Any of the foregoing factors could cause the Company's business, results of operations, or financial condition to suffer, and actual results could differ materially from those expected.

CPI Holdco, Inc.
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CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands-unaudited)

	April 1 2005	October 1, 2004
Assets		
Cash and cash equivalents	\$ 12,481	\$ 40,476
Restricted cash	1,849	2,279
Accounts receivable, net	44,602	35,914
Inventories	47,229	38,074
Deferred tax assets	13,037	12,285
Prepays and other current assets	5,538	3,796
 Total current assets	 124,736	 132,824
Property, plant and equipment, net	74,691	70,127
Debt issue costs, net	11,685	8,910
Intangible assets, net	79,168	78,481
Goodwill	145,822	139,614
Other long-term assets	744	1,251
 Total assets	 \$ 436,846	 \$ 431,207
 Liabilities and stockholders equity		
Current portion of long-term debt	\$	\$ 3,944
Accounts payable	18,550	15,790
Accrued expenses	21,555	20,939
Product warranty	5,666	6,074
Income taxes payable	2,735	1,661
Advance payments from customers	10,975	12,031
 Total current liabilities	 59,481	 60,439
Deferred income taxes	37,692	39,118
Advance payments from sale of San Carlos property	13,450	13,450
Long-term debt	284,205	210,606
 Total liabilities	 394,828	 323,613

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Common stock	43	43
Additional paid-in capital	28,157	103,534
Accumulated other comprehensive income	1,752	1,369
Retained earnings	12,066	2,648
Net stockholders' equity	42,018	107,594
Total liabilities and stockholders' equity	\$ 436,846	\$ 431,207

See accompanying notes to the condensed consolidated financial statements.

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CPI Holdco, Inc.
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**CONDENSED CONSOLIDATED
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**
(in thousands - unaudited)

	2005	Fiscal Year 2004	
	13-Week Period Ended April 1, 2005	January 23, 2004 to April 2, 2004	January 3, 2004 to January 22, 2004
	(Successor)	(Successor)	(Predecessor)
Sales	\$ 84,463	\$ 65,641	\$ 11,606
Cost of sales	55,386	41,807	9,049
Amortization of acquisition-related inventory write-up		4,220	
Gross profit	29,077	19,614	2,557
Operating costs and expenses:			
Research and development	1,858	1,464	467
Selling and marketing	4,585	3,138	728
General and administrative	5,850	3,512	2,332
Merger expenses			5,944
Amortization of acquisition-related intangible assets	1,486	3,396	
Acquired in-process research and development		11,500	
Total operating costs and expenses	13,779	23,010	9,471
Operating income (loss)	15,298	(3,396)	(6,914)
Interest expense, net	4,732	2,950	5,343
Income (loss) before income taxes	10,566	(6,346)	(12,257)
Income tax expense (benefit)	4,246	487	(2,848)
Net income (loss)	6,320	(6,833)	(9,409)
Preferred dividends:			
Senior redeemable preferred stock			2,252
Junior preferred stock			1,334
Net income (loss) attributable to common stock	\$ 6,320	\$ (6,833)	\$ (12,995)

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Other comprehensive income, net of tax:				
Unrealized (loss) gain on cash flow hedges	(433)	365		
Comprehensive income (loss)	\$ 5,887	\$ (6,468)	\$	(12,995)

See accompanying notes to the condensed consolidated financial statements.

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**CONDENSED CONSOLIDATED
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**
(in thousands - unaudited)

	2005	Fiscal Year 2004	
	26-Week Period Ended April 1, 2005 (Successor)	January 23, 2004 to April 2, 2004 (Successor)	October 4, 2003 to January 22, 2004 (Predecessor)
Sales	\$ 158,196	\$ 65,641	\$ 79,919
Cost of sales	105,064	41,807	56,189
Amortization of acquisition-related inventory write-up	351	4,220	
Gross profit	52,781	19,614	23,730
Operating costs and expenses:			
Research and development	3,306	1,464	2,200
Selling and marketing	8,653	3,138	4,352
General and administrative	9,875	3,512	6,033
Merger expenses			6,374
Amortization of acquisition-related intangible assets	6,392	3,396	
Acquired in-process research and development		11,500	
Total operating costs and expenses	28,226	23,010	18,959
Operating income (loss)	24,555	(3,396)	4,771
Interest expense, net	8,812	2,950	8,902
Income (loss) before income taxes	15,743	(6,346)	(4,131)
Income tax expense	6,325	487	439
Net income (loss)	9,418	(6,833)	(4,570)
Preferred dividends:			
Senior redeemable preferred stock			3,861
Junior preferred stock			2,382
Net income (loss) attributable to common stock	\$ 9,418	\$ (6,833)	\$ (10,813)

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Other comprehensive income, net of tax:

Unrealized gain on cash flow hedges

383

365

Comprehensive income (loss)

\$ 9,801

\$ (6,468) \$

(10,813)

See accompanying notes to the condensed consolidated financial statements.

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**CONDENSED CONSOLIDATED
STATEMENTS OF CASH FLOWS**
(in thousands - unaudited)

	2005	Fiscal Year	
	26-Week	2004	
	period	January	October 4,
	ended	23, 2004	2003
	April 1,	to	to
	2005	April 2,	January 22,
	(Successor)	2004	2004
	(Successor)	(Successor)	(Predecessor)
OPERATING ACTIVITIES			
Net cash provided by (used in) operating activities	\$ 5,247	\$ (5,750)	\$ 8,213
INVESTING ACTIVITIES			
Expenses relating to sale of San Carlos property	(203)		
Purchase of Predecessor's net assets, net of cash acquired		(113,760)	
Purchase of Econco's net assets, net of cash acquired	(18,685)		
Purchases of property, plant and equipment	(4,428)	(298)	(459)
Net cash used in investing activities	(23,316)	(114,058)	(459)
FINANCING ACTIVITIES			
Retirement of debt and preferred stock:			
Senior subordinated notes		(74,000)	(26,000)
Senior redeemable preferred stock		(29,735)	
Junior preferred stock		(32,336)	
Dividends on senior preferred stock		(19,310)	
Mortgage financing		(17,500)	
Proceeds from/(payments for) the issuance of debt:			
Floating rate senior notes	79,200		
Senior subordinated notes		125,000	
Senior term loans		90,000	
Debt issue costs	(3,375)	(9,577)	
Repayments on senior term loans	(9,550)		
Proceeds from the repayment of Predecessor management loans		1,266	
Net proceeds from the issuance of common stock		98,075	
Stockholder distribution payments	(75,809)		
Repayments on capital leases	(20)		

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Net (repayments) proceeds from bank overdraft	(372)	1,907	(1,639)
Net cash (used in) provided by financing activities	(9,926)	133,790	(27,639)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(27,995)	13,982	(19,885)
Cash and cash equivalents at beginning of period	40,476		33,751
Cash and cash equivalents at end of period	\$ 12,481	\$ 13,982	\$ 13,866

Supplemental Disclosures of Cash Flow Information

Cash paid for interest	\$ 7,066	\$ 5,662	\$ 1,637
Cash paid for taxes, net of refunds	\$ 7,699	\$ 168	\$ 2,376

Supplemental Disclosures of Non-cash Investing and Financing Activities

Dividends on senior preferred stock	\$	\$	\$ 3,861
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See accompanying notes to the condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

For periods ending prior to January 23, 2004, the accompanying condensed consolidated financial statements represent the consolidated results and financial position of Communications & Power Industries Holding Corporation (Holding or the Predecessor). On January 23, 2004, the Predecessor merged (the Merger) with CPI Merger Sub Corp. (Merger Sub), a wholly-owned subsidiary of CPI Holdco, Inc. (CPI Holdco or the Successor), a Delaware corporation formerly known as CPI Acquisition Corp., controlled by affiliates of The Cypress Group L.L.C. (Cypress) as more fully described in Note 2. As a result of the Merger, the Predecessor became a wholly-owned subsidiary of CPI Holdco. The financial statements for periods subsequent to January 22, 2004 represent the condensed consolidated financial statements of CPI Holdco after giving effect to the Merger. References to the Company refer to the Predecessor prior to the Merger and the Successor post-Merger.

CPI Holdco's fiscal years are the 52- or 53-week periods that end on the Friday nearest September 30. The Successor's fiscal year did not change from that of the Predecessor. Fiscal year 2005 comprises the 52-week period ending September 30, 2005, and fiscal year 2004 comprised the 52-week period ended October 1, 2004.

Management believes that these unaudited interim condensed consolidated financial statements contain all adjustments, all of which are of a normal, recurring nature, necessary to present fairly the financial position of the Company and its results of operations and cash flows for the interim periods presented. The results for the interim periods reported are not necessarily indicative of the results for the complete fiscal year 2005. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted and, accordingly, these financial statements should be read in conjunction with the financial statements and the notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended October 1, 2004.

There is currently no public market for CPI Holdco's common stock.

Stock-based Compensation

As allowed by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, the Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under this method, compensation expense is recorded only if the current market price of the underlying stock exceeded the exercise price at the measurement date. All stock options issued by the Successor were issued at, or above, the current market price of the underlying stock. The Company charges stock-based compensation expense against income under the caption General and administrative in the Condensed Consolidated Statements of Operations and Comprehensive Income.

In fiscal year 2005, stock-based compensation determined under the intrinsic value-based method was recorded for performance stock options that vest in fiscal years 2005 through 2008. Stock-based compensation expense is charged to income over the stock option vesting period that corresponds with the performance measurement period. Stock-based compensation expense is determined based on an estimate of the number of performance stock options expected to vest multiplied by the difference between a) the estimated stock price at the performance measurement

date and b) the option exercise price. The estimated stock price at the performance measurement date was based on the fair value of CPI Holdco's common stock at the end of the most recent quarter. The Company expects to meet the performance targets for all outstanding performance stock options.

During fiscal year 2003, the Company issued stock options to employees that were subsequently determined to have been issued below the fair value of the stock on the date of grant. The compensation cost associated with the 2003 stock options was amortized as a charge against income on a straight-line basis over the four-year vesting period until the stock options became fully vested at the time of the Merger.

If compensation cost for the Company's stock-based compensation plan had been determined using the fair value-based method of accounting, then the Company's net income (loss) would have changed to the pro forma amounts indicated below (in thousands):

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and SubsidiariesNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, continued
(unaudited)

	2005	Fiscal Year 2004	
	13-Week Period ended April 1, 2005 (Successor)	January 23, 2004 to April 2, 2004 (Successor)	January 3, 2004 to January 22, 2004 (Predecessor)
Net income (loss) as reported	\$ 6,320	\$ (6,833)	\$ (9,409)
Add: Stock-based compensation included in net income (loss) determined under intrinsic value-based method, net of tax	387		1,195
Deduct: Stock-based compensation determined under fair value-based method, net of tax	(187)	(43)	(24)
Pro forma net income (loss)	\$ 6,520	\$ (6,876)	\$ (8,238)

	2005	Fiscal Year 2004	
	26-Week Period ended April 1, 2005 (Successor)	January 23, 2004 to April 2, 2004 (Successor)	October 4, 2003 to January 22, 2004 (Predecessor)
Net income (loss) as reported	\$ 9,418	\$ (6,833)	\$ (4,570)
Add: Stock-based compensation included in net income (loss) determined under intrinsic value-based method, net of tax	432		1,289
Deduct: Stock-based compensation determined under fair value-based method, net of tax	(405)	(43)	(227)
Pro forma net income (loss)	\$ 9,445	\$ (6,876)	\$ (3,508)

2. Issuance of Floating Rate Senior Notes

As more fully described in Note 6 Long-term Debt , on February 22, 2005, the Company issued \$80.0 million of Floating Rate Senior Notes due 2015 (the FR Notes). The FR Notes were issued at a 1%