CPI INTERNATIONAL HOLDING CORP.

SECOND QUARTER 2013 FINANCIAL RESULTS CONFERENCE CALL
May 8, 2013
10:00 a.m. ET

Operator: Good day, everyone, and welcome to the CPI International Second Quarter Fiscal 2013 Financial Results Conference Call. My name is Charlotte and I will be your conference coordinator for today's call. At this time, all participants are in a listen-only mode. I will be facilitating a question-and-answer session on today's call. If you require assistance at any time during the call, please press star followed by zero and the coordinator will be happy to assist you. As a reminder, this conference is being recorded for replay purposes.

I would now like to introduce your conference coordinator – your leader Amanda Mogin, director of investor relations for CPI International. Ms. Mogin, you may proceed.

Amanda Mogin: Thank you, Charlotte. Good morning and welcome to CPI International Conference Call for the second quarter of fiscal 2013. Our speakers and topics for this morning's call will be the following. First Joe Caldarelli, CPI's chief executive officer, will discuss our recent sales and order performance in our major end markets and our expectations for those markets in the second half of the year.

Next Joel Littman, our chief financial officer, will review CPI's performance in the second quarter with respect to several of our key financial metrics. Then Joe will discuss our financial projections for the remainder of the fiscal year. And lastly, Joe and Joel will be joined by Bob Fickett, our president and chief operating officer, for the question-and-answer portion of today's call.

Before this morning's call gets underway, however, there are some administrative details which I like to attend. Please bear in mind that today's presentation includes forward-looking statements within the meeting of the Securities and Exchange Act of

1934. These statements are based on our best view of our markets and our business as we see them today and actual results may change as market conditions change. Please interpret these statements in that light. Additional information regarding risks and uncertainties related to our business are included in the safe harbor statement in yesterday's press release and in our filings with the Securities and Exchange Commission.

Today's presentation under Securities and Exchange Commission rules also includes non-GAAP financial measures related to EBITDA and cash flow. A presentation of the most directly comparable GAAP measures and a reconciliation of each of these non-GAAP financial measures to the most directly comparable GAAP measures are available in yesterday's press release, which has been posted to our Web site. Interested parties can access the press release by going to www.cpii.com and opening the press release entitled, "CPI International Announces Second Quarter 2013 Financial Results."

Now I would like to turn the call over to Joe Caldarelli.

Joe Caldarelli: Good morning and welcome to our call. Q2 was another good quarter for CPI and a continuation of the solid operational performance that we enjoyed in Q1. In comparison to last year's quarter, we grew our revenue and profitability and orders in all of our key markets increased. And in addition we achieved our highest second quarter sales ever and closed the quarter with our highest backlog ever.

In the just concluded quarter, we also completed much of the physical relocation and integration of the Australian Codan Satcom business operations into our existing manufacturing facilities in the U.S. and Canada. As you'll recall, we acquired this business in Q4 of 2012. The integration of those operations at the CPI has largely been completed and has gone smoothly and according to plan.

Let's now turn to our sales and orders results for the quarter. At $102 million CPI's total sales in Q2 were 6 percent higher than last year's quarter This is the highest second quarter sales level that we have ever achieved and represents the continuation of the healthy sales trends that we've seen in recent quarters. In comparison to the year ago quarter, sales in our defense and communication markets grew by double digit percentages.

Our orders results, which we report on a year-to-date basis, were also very positive in the most recent period. For the first six months of fiscal ‘13 we recorded $264 million in orders, an increase of 35 percent from the same period last year. This is the highest orders amount that we have ever booked in the first six months of any fiscal year, demonstrating the stable and ongoing demand for CPI’s products.

At the end of Q2, our backlog totaled $307 million, setting another company record.

We continued to see healthy activity levels in our defense markets in the most recent period. Demand for spare and the repair product to support established radar and electronic warfare programs has held up well in the recent months, notwithstanding the ongoing defense budget discussions and the start of sequestration. To date, in fact, we have seen no measurable impact from sequestration.

While we have noticed the bit of a slowdown in the process in some orders by certain government agencies and primes, defense orders on the whole have continued to be placed with us at healthy levels. The push-outs and delays that certain defense programs have experienced continue to be more than offset by pull-ins and higher level demand in other programs. We therefore expect our defense business to hold steady over the short to medium term.

In the first six month of fiscal ’13, orders for our defense markets increase 17 percent to 93 million. This increase was due to higher demand for products to support a number of radar systems for the U.S. and foreign militaries as well as to support certain U.S. military electronic warfare systems.

Q2 sales in defense markets increased 18 percent to $41.7 million. The increase was the result of higher sales to support a number of U.S. and foreign radar systems in a specific U.S. military electronic warfare system.

Before I discuss the details of our orders in sales in the medical markets, I’d like to spend a few moments examining geographic trends in this market. In North America and Europe, conditions continue to show signs of moderate improvement. Customers in these regions are showing higher levels of confidence in medium term business than they have in recent years.

In Russia and China, CPI's medical imaging business has grown nicely over the past several years, and demand for our x-ray imaging products continues to be healthy. Activity levels are more cyclical and seasonal in these two countries than in other markets, and our medical imaging business in Russia and China is frequently tied to annual or periodic programs or tenders.

In Russia, we typically see the highest demand for imaging products toward the end of our fiscal year, and shipments generally overflow into the first part of our next fiscal year. In China, we tend to see a notable slowdown in business in the weeks surrounding the Chinese New Year holiday in February. This now expected seasonality has impacted the timing but not the overall level of demand for CPI medical imaging products in Russia and China.

Turning now to our recent results, in the first six months of fiscal '13, CPI's orders in the medical market increased 4 percent of $40.7 million. This increase was due to higher demand from customers in Europe and North America for x-ray imaging products as well as higher demand for products used in radiation therapy applications for the treatment of cancer.

In Q2, medical sales decreased 11 percent to $17.9 million. This decrease was primarily the result of lower sales of x-ray imaging products to customers in China and Russia due to the seasonal nature of the demand in those two countries that I mentioned a moment ago. In particular, we saw greater temporary slowdown in China around the Chinese New Year holiday this year than we have seen in some previous years.

Our communication market business has remained healthy in fiscal '13. We are seeing solid demand for CPI's products to support both commercial and military communications applications. In the first six months of the year, orders in this market increased 84 percent to $112 million. A key contributor to these increases was a multi-year order totally more than 20 million for our tactical common data link antenna products to support intelligence, surveillance and reconnaissance capabilities on unmanned aerial vehicles. Shipments for this military communications program will begin later this year and continue into fiscal '15.

In addition to this program, we had higher orders to support other milcom and commercial satellite service applications in the first six months of fiscal '13. The most recent period also included an order for Codan Satcom products that are primarily used in maritime commercial communications applications. There were no such orders in the year-ago period because we acquired the Codan Satcom business in Q4 of fiscal ’12.

In the most recent quarter, our communication sales increased 13 percent to $34.8 million. This increase was primarily due to the inclusion of sales of the Codan Satcom products in Q2 of fiscal ’13. Sales of products for commercial communications applications including direct-to-home broadcast and satellite services also increased during the quarter.

As you can see from our orders and sales results, CPI had a very good second quarter. Demand in our defense, medical and communications markets remains healthy.

Our book to bill ratio for the last 12 months was favorable at 1.13 and we have record backlog of 307 million, which we expect to convert into continued solid sales levels in coming quarters. I’ll address our expectations for the remainder of fiscal ’13 in more detail toward the end of this morning’s prepared remarks.

Now, here’s Joel Littman to discuss our financial performance during the quarter.

Joel Littman: Thank you, Joe. My comments on today’s conference call will focus on CPI’s key profitability and liquidity metrics, namely, net income, adjusted EBITDA, cash, free cash flow and adjusted free cash flow. The definitions and reconciliation of the non-GAAP financial metrics I will discuss are available in the financial tables of the press release that CPI issued yesterday afternoon.

During the second quarter of fiscal 2013, in comparison to the same quarter of the previous year, all of our key profitability and liquidity metrics increased. Net income totaled $1.3 million in the second quarter. In comparison, we recorded a net loss of $317,000 in the same quarter of fiscal 2012. The improvement in our net income results was primarily due to our higher sales volume in the most recent quarter.

The second positive factor in our improved net income results was that the amortization of acquisition-related intangibles related to the February 2011 acquisition of CPI decreased by $1.4 million from last year of second quarter. These positive factors were partially offset by the inclusion of 1.3 million in expenses related to the negotiation, closing and integration of acquisitions of which the majority of cost in the second quarter of fiscal 2013 were for the integration of the Codan Satcom business into CPI. We recorded no such expenses in the year-ago quarter.

In the second quarter of fiscal 2013, our adjusted EBITDA totaled 16.2 million or 15.9 percent of sales representing, an improvement from the $14.2 million or 14.7 percent of sales that we generated in the same quarter of the previous year. Similar to our net income results, the primary reason for the increase in adjusted EBITDA in the most recent quarter was our higher sales volume in comparison to last year. CPI continues to maintain healthy levels of cash and excellent liquidity.

As of the end of the second quarter, CPI's cash and cash equivalents totaled $47 million, an increase of $4 million from our balance as of the end of the fiscal year 2012.

For the 12 month period that ended on March 29, 2013, CPI's cash flow from operating activities was $31.1 million. During that same period, adjusted free cash flow equaled $27.5 million, easily beating our guidance for adjusted free cash flow in excess of 17 million annually.

CPI remains in healthy shape financially. Our second quarter of fiscal 2013 contributed positive financial results, and all our most significant and profitability and liquidity measures were favorable in the most recent quarter and LTM period. Much like in the first quarter, our net income and adjusted EBITDA increased. We maintained solid cash balances and we generated positive cash flow. We have the resources, stability and flexibility necessary to run our business and meet our commitments.

That concludes my remarks this morning. I'll turn the call back over to Joe to discuss our financial projection for the second half of the fiscal year.

Joe Caldarelli: Thanks, Joel. As we indicated in yesterday's press release and our discussion this morning, CPI has continued to benefit from stable market conditions, leading to solid financial performance in the first half of fiscal '13. Demand for our products has remained healthy and our excellent backlog and book-to-bill ratio demonstrate that we have sufficient business and momentum to have an equally successful back half for the year. We expect that our top and bottom-line results in Q3 and Q4 will be comparable to or slightly better than they were in Q1 and Q2. At this time we expect no significant change in demand and conditions in our end markets in fiscal ’13.

In particular, we do not anticipate that sequestration will have any notable impact on CPI’s near-term financial results. Therefore, we are largely reconfirming our financial projections for fiscal ’13 that we first announced in December. We have tightened our sales guidance, raising the bottom of our guidance range by $5 million. For fiscal ’13, we currently expect total sales of $415 million to $425 million, adjusted EBITDA of $66 million to $68 million, and adjusted free cash flow of more than $17 million.

We have now finished our prepared remarks for today’s call. We would like to thank you for your time and attention. Let’s begin the question-and-answer portion of the call, please.

Operator: Certainly. Ladies and gentlemen, if you have a question, please press star then the number one key on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the pound key.

Our first question comes from the line of Tim Secontine from Northern Trust. Your line is open and you proceed with your question.

Pardon me. Tim Secontine, if your line is muted, please unmute it.

Tim Secontine: Sorry about that. It was. Good morning. I have one question. You made a comment in your prepared remarks about orders in defense maybe seeing a little bit of a more delay in some, I guess, some orders, and it was sort of offset by pull forward of others. I was just curious about the pull forward. Are you guys sensing or seeing any, I don’t know, ordering that is being done for a fear that, you know, they might not get the budget next year? In other words, you know, what it – do you think, are you seeing anything that might cause you to be more cautious maybe not for the second half of this year but going into next fiscal year?

Joe Caldarelli: Yes. Good question. Much of the pull in that we have seen appears to be related to items that they drew down excessively and were running out of stock in the depots. In fact, in many cases, the government has us expedite to try and get materials to get as quickly as possible. So we don’t think it’s too much of a situation of trying to grab stuff while there’s budget available, although that wouldn’t surprise us.

Now secondly, the orders we have gotten do tend to carry us for a reasonable period of time, often a year or so out. So unless there was actually – an actual slowdown to current firm contracts or a pull back on those, we will probably going to be in pretty decent shape on the defense side for now for the best part of the year or longer in some cases.

The slowdowns we are seeing are more through orders that we get through primes and integrators where they seem to be having – seeing delays in the placement of orders to them for the entire systems. And those are the ones that are trickling down to us often a few months later than originally programmed.

Tim Secontine: OK. That's great call and just to follow on to that, are you seeing any change in the mix of orders or can you give any color about any particular, you know, systems where there might be variability that you've seen in the past whether it's positive or negative?

Joe Caldarelli: No, we're not. We're, you know, we have a handful of systems that are strongest sockets as we call them and those continue to be the strong ones. I don't think – I don't we've seen any significant change in this.

Tim Secontine: OK. Thanks a lot.

Joe Caldarelli: Yes. Thank you.

Operator: Thank you. Once again, ladies and gentlemen, if you do have a question at this time, please press the star then the number one key on your touchtone telephone. We'll give it a moment.

All right. I am not showing any further questions at this time. I would like to turn the call back over to Joe Caldarelli for closing remarks.

Joe Caldarelli: All right. Well, I hope we were exceptionally clear this morning so we don't need too many questions. So thank you all for joining us and we'll talk again in a quarter from now. Thank you.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a great day.

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