

**CPI INTERNATIONAL HOLDING CORP.**  
**SECOND QUARTER 2012 FINANCIAL RESULTS CONFERENCE CALL**  
**May 10, 2012**  
**11:00 a.m. ET**

Operator: Good day everyone and welcome to the CPI International second quarter fiscal 2012 financial results conference call.

My name is Latoya and I will be your coordinator for today's call.

At this time, all participants are in a listen-only mode.

We will be facilitating a question and answer session at the end of today's conference. If you require assistance at any time, please press star followed by zero and a conference coordinator will be happy to assist you.

As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the call over to Amanda Mogin, director of investor relations for CPI International.

Please proceed.

Amanda Mogin: Thank you, Latoya.

Good morning and welcome to CPI International's conference call for the second quarter of fiscal year 2012. Our speakers and topics for today's call will be the following.

First, Joe Caldarelli, CPI's chief executive officer will discuss our performance in our significant end markets and our expectations for those markets this fiscal year. Next, Joel Littman, our chief financial officer, will discuss some of our key financial metrics for the year – excuse me, for the quarter.

Then, Joe will discuss our financial projections for the remainder of fiscal 2012, and, finally, Bob Fickett, our president and chief operating officer, will join Joe and Joel for the question and answer session.

Before this morning's call gets underway, however, there are some administrative details to which I'd like to attend.

Please bear in mind that today's presentation includes forward-looking statements within the meaning of the Securities and Exchange Act of 1934. These statements are based on our best view of our markets in our business as we see them today and actual results can 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 as well as measures that combined results before and after the February 11, 2011 acquisition of the company by Veritas Capital.

A presentation of the most directly comparable GAAP measures and a reconciliation of each of these non-GAAP financial measures to most directly comparable GAAP measures are available in yesterday's press release which has been posted on our Web site. Interested parties can access the press release by going to [www.cpii.com](http://www.cpii.com) and opening the press release entitled CPI International Announces Second Quarter 2012 Financial Results.

And now here's Joe Caldarelli.

Joe Caldarelli: Thank you, Amanda.

Good morning and welcome to our call.

CPI's good second quarter operational performance was largely a continuation of our solid first quarter performance. Like Q1 the most recent quarter was characterized by well-performing core programs with a stable foundation of recurring bases

business. Demand for our products has remained strong within our defense, medical, and communications markets.

At 255 million, our backlog remains high and has risen slightly from last quarter. Our year-to-date book-to-bill ratio stands at the 1.03.

Our Q2 sales totaled 96.5 million, increasing 2 percent from the year-ago quarter.

Our largest markets contributed to our total sales in the following ways. The defense market maintained the same robust level of sales as in last year's Q2, the medical market enjoyed double digit growth, and the end of our involvement in WIN-T Increment One resulted in a decrease in our communication sales.

I'm going to go into the results in each of these markets in more detail in a minute.

In the first half of fiscal '12 we booked total orders of 196 million. Unlike this year, the same six-month period last year included 18.1 million in orders for a one-time counter-IED program.

While indications are that this program has been highly successful in the field, we have no expectations for it recurring this fiscal year. If we exclude this non-recurring program from last year's results our orders in the first six months of fiscal '12 were in fact 3 percent higher than in the year-ago period.

Let's now look at our specific markets.

The defense market, which encompasses our business in radar and electronic warfare applications, has been a strong performer for CPI in fiscal '12. Several of the larger long-term radar programs that we support, such as the Aegis weapons system and the radars on certain missile systems, are enjoying excellent demand right now.

There are a number of factors driving demand that are largely program specific, including the building of new ships utilizing the Aegis weapons system, the addition of new countries for foreign military sales for certain missile systems on which we support the radar system, the timing of inventory restocking for spare components, and the timing and size of repair programs. We believe these factors will continue to drive strong demand for our defense products for the rest of the year.

For the first six months of fiscal '12, orders in our defense market decreased 10 percent to 79.6 million. This decrease is entirely attributable to the presence in last year's results of a non-recurring counter-IED program I already mentioned and the absence of that program in this year's result.

If we exclude the 18.1 million in counter-IED orders from last year's results, CPI's core defense orders actually increased 12 percent in the first six months of fiscal '12. This increase was driven by higher demand for products that support the Aegis weapons system and the radar systems on certain missiles.

We have supported these radar systems for many years and they have provided and are expected to continue to provide stable and recurring business to CPI for the foreseeable future.

Our Q2 defense sales of 35.2 million were effectively unchanged from the year-ago quarter. This is a very healthy sales level for defense business. During the most recent quarter we had increased sales of radar products to support the Aegis weapons system and certain missile systems as well as increased sales of electronic warfare products to support an airborne electronic countermeasure program.

For the remainder of fiscal '12 we anticipate steady ongoing demand for our core defense products.

Let's now move on to our medical market. As we've discussed in previous calls, our medical business has been slower to recover from the global economic downturn than our business in other large markets.

Hospitals and clinics, who are the end customers for our x-ray imaging products, have been slower to embark on large projects to upgrade their existing equipment or to expand their facilities in the face of this sluggish economy and tight credit markets. Customers in this market is still being cautious and so demand for some of our medical products have been somewhat softer than usual over the past couple of years.

Based on feedbacks from our customers, we believe medical market conditions are improving, but slowly. As a result demand has increased for our radiation therapy and x-ray imaging products for fiscal '12 but remains lumpy for our MRI products.

Medical orders in the first half of the year were essentially the same as last year at 39.3 million. Our Q2 medical sales, however, increased 22 percent, to 20 million.

During fiscal year '12 orders and sales for x-ray imaging products have increased particularly from customers who are participating in the 2011 installment of the Russian tender programs for imaging systems. Our involvement in the latest Russian imaging program has now been completed, but similar periodic tender programs are expected to occur again in the next year.

Orders and sales to support radiation therapy applications were strong in the recent period. Radiation therapy application remain a very solid, secure, and long-term business for CPI. We may not discuss this business as much as some of our other medical businesses because it does not typically experience large swings in demand in any one period, but it is a steady foundational program for us and we expect it to continue to perform well to the foreseeable future.

In contrast, as we discussed previously, our MRI business tends to be uneven and lumpy. Our MRI orders decreased in the first half of this year and our Q2 MRI sales were down as well. We expect to see continued lumpiness in this business for the remainder of the fiscal year.

Let's now turn to the last major market that we'll be discussing in our prepared remarks this morning, the communications market.

As you know, we break down our communication market into two types of applications – commercial communications and military communications, or milcom. Within commercial communications, demand was strong and stable and conditions have remained favorable. In military communications, as we've discussed on previous calls, we had been participating in one very large program in the past five years while building a portfolio of additional milcom business that contains a number of smaller milcom programs.

CPI's participation in that large program, Increment One of the Warfighter Information Network-Tactical, or WIN-T, and its related programs, has resulted in approximately 55 million in sales for the company over the past several years.

We have now substantially completed our involvement in that program. Offsetting the effects of this conclusion, our participation in other smaller milcom programs remain sound and is growing.

Year-to-date our orders in the communication market total 60.6 million in fiscal '12, decreasing 3 percent from the same period of last year. This decrease was due to lower orders for certain commercial communication applications.

In particular, a couple of our commercial communications customers delayed orders because they are currently and, we believe, temporarily overstocked, in part because they are working to complete certain administrative steps before their programs can commence.

We do not believe that these delays will result in anything more than a timing issue, and they do not reflect the level of underlying demand that we are currently enjoying without their commercial communication customers and programs. Partially offsetting the impact of these delays, orders for various core military communications applications excluding WIN-T have actually increased in the first six months of fiscal '12.

In Q2 of this fiscal year our communications sales totaled 30.2 million, decreasing 13 percent from the year-ago quarter. This decrease was driven by lower sales as expected in support of the WIN-T program that I mentioned a moment ago.

We believe that conditions within the communications market are favorable and that demand is stable and steady.

Overall, we are pleased with our orders and sales results for the quarter. Demand remained stable in our largest markets and our core programs are performing well.

Now, I'll turn the call over to Joel to discuss our financial quarter during Q2.

Joel Littman: Thanks, Joe.

In my comments today I will focus on CPI's profitability and liquidity metrics for the second quarter of fiscal year 2012 including net income, adjusted EBITDA, cash, free cash flow, and adjusted free cash flow.

The financial tables in the press release we issued yesterday afternoon contained definitions and reconciliations of the non-GAAP metrics that I will be discussing this morning.

Before I get started, I'd like to note that we completed a small acquisition in February. We paid approximately \$400,000 to acquire the assets of a Louisiana-based company that repairs and rebuilds vacuum electronic devices for a number of end markets, much like our Econco division.

That business has been folded into our Econco division. While it was a positive transaction that we believe will benefit our business, the acquisition had no material impact on our financial results during the quarter.

Now let's look in our profitability in the most recent quarter.

In order to do so we need to revisit an event that took place in the middle of the second quarter of last year, namely the acquisition of CPI by Veritas Capital in February 2011.

We reported a number of significant expenses related to that acquisition in our financial results for the year-ago quarter including 10.8 million in non-recurring transaction cost for expenses such as fees to investment bankers, attorneys and others. We did not have similar expenses in this year's quarter.

In the second quarter of fiscal 2012 we recorded a small net loss of \$300,000. This is a significant improvement from the 14.1 million net loss we reported a year ago primarily because last year's quarter included the 10.8 million in non-recurring transaction cost that I mentioned a moment ago.

Nonetheless, some of our costs have increased in the most recent period as a result of the acquisition and the related refinancing of the company. In particular, our depreciation and amortization expenses increased by 1.5 million in the second quarter of fiscal 2012 as compared to the same quarter last year primarily as a result of the reevaluation of our assets in connection with the acquisition.

Our interest expense also increased \$600,000 as a result of the refinancing. Both of these increases have a negative impact on our net income in the second quarter of fiscal 2012.

There was also an operational factor that was partially responsible for the net loss in the most recent quarter. Our gross profit during this quarter was impacted negatively by several development programs with high cost. Over time as these new and development programs settle into standard production, their profit margins are expected to increase.

Our adjusted EBITDA in the second quarter of fiscal 2012 totaled 14.2 million, or 15 percent of sales. This is a decrease from our adjusted EBITDA of 15.5 million, or 16 percent of sales, in the year-ago quarter. The decrease is due primarily to the aforementioned high costs for several development programs.

As you know we consider adjusted EBITDA to be one of our most important measures of our financial performance. Our standing guidance for adjusted EBITDA margin is in the mid to high teens. Our 15 percent adjusted EBITDA margin in the most recent quarter is in line with this guidance and we expect these margins to continue to improve in the second half of fiscal 2012.

Before we move on to our liquidity measures I'd like to take a moment to discuss our effective tax rate.

Our second quarter rate of 264 percent clearly diverged from our typical rate. This high rate was primarily the result of a discrete tax change relating to the true-up of previous year's tax returns and interest on tax contingencies compounded by low pretax income in their current quarter. Together these factors resulted in an abnormally high quarterly tax rate. Our stated guidance and continued expectations are for an effective tax rate of approximately 39 percent.

Let's turn now to liquidity.

As of the second quarter of fiscal 2012 our cash and cash equivalents totaled 33.4 million. This is a 5.5 million decrease from the end of the previous quarter driven by 10.6 million in cash interest payments that we made during the most recent quarter.

For the 12 months ended March 30, 2012 we generated cash flow from operating activities totaling 22.3 million and free cash flow totaling 14 million.

Adjusted free cash flow totaled 13.6 million, which was an improvement from 11 million for the 12 months ended December 30, 2011. For fiscal 2012 we continue to

expect to generate adjusted free cash flow of more than 17 million on an annual basis.

Overall, CPI's financial position remains stable and secure. Our adjusted EBITDA margins are in line with our expectations and we are generating positive cash flow while continuing to make cash interest payments on our outstanding debt.

We remain confident in our ability to achieve our financial goals from fiscal 2012 and beyond.

With that I'd like to turn the call back over to Joe for a recap of our financial projections for the remainder of the year.

Joe Caldarelli: Thank you, Joel.

In December we issued financial guidance for fiscal 2012. Now, halfway through the year, we have not encountered anything that impacts our overall financial expectations for the year. Conditions in our major markets remain stable, we continue to operate efficiently and productively, our core programs are performing well, and indications for future orders and sales growth are encouraging. Therefore, we are reconfirming our previously-issued guidance for the year.

We expect to generate sales up to 380 million to 395 million, adjusted EBITDA of 63 million to 65 million, and adjusted free cash flow of more than 17 million.

In summary, we expect a satisfactory busy year for CPI due to the steady demand in our core programs in our largest markets. The completion of the counter-IED program and the WIN-T Increment One last year provides some unfavorable comparisons on the surface, but dipping down into our deep and broad portfolio of standard defense, medical, and communication programs reveals a firm foundation of long-term recurring programs with solid demand for our products.

Our sales have increased, our backlog remains high, our book-to-bill ratio points to ongoing sales growth, and we are well-positioned for a good year.

That concludes my prepared remarks for today.

Thank you for your time and attention.

Latoya, let's begin the question and answer session.

Operator: Thank you.

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

Once again, if you have a question, please press star then one.

Our first question is from Dan Colonna of UBS.

Your line is open.

Dan Colonna: Hi. Thanks for hosting the call and thanks for taking my question.

First, my first question, free cash flow. I think the implied free cash flow in the back half of the year about 20 million or more and you implied EBITDA guidance should grow 10 million second half versus first half.

Can you help us bridge what else is going to drive the higher free cash flow in the quarter? I'm assuming it's working capital, but any color on that would be helpful.

Joel Littman: Hi, Dan, this is Joel.

It is working capital and our inventory - we expect to drive that down over the second half of the year and that's the primary working capital change item.

Dan Colonna: Is there any way to quantify that? How much that should drive if that's the full \$8 million to \$10 million?

Joel Littman: That's a big chunk of it.

Dan Colonna: OK.

Joel Littman: It's not all of it.

Dan Colonna: OK.

And then, secondly, any update or color on, you know, defense orders? I know, you know, WIN-T phase one is rolling down, but anything potential for phase two or anything that you're working on similar to the IED program that occurred last year?

Joe Caldarelli: There are not any of similar magnitude to either WIN-T or the counter-IED, but as I mentioned the defense business for us in both in the radar electronic warfare and in mil communications continue to do remarkably well, frankly counter intuitively so, and all indications are that will continue and we think it's just simply that the type of programs that we're on and the sockets that we're in will just need to be maintained.

So, if you exclude WIN-T, our remaining mil communications business actually grew in the first six months of the year and while there are no \$50 million on the horizon there are a number of \$1 million, \$2 million, \$3 million, \$5 million programs that we're working on that will certainly help us to continue to grow that.

Dan Colonna: That's very helpful.

And then just lastly for me. You cited the development cost of the – the launch cost of a new programs. Can you quantify for that – that for us and with that all centered in the quarter end we shouldn't have any of those impacts in the second half of the year? Thanks.

Joe Caldarelli: Yes. The contribution from that is in the sort of, you know, 1.5 percent of sales and it's in multiple divisions that we're doing work on things that will become production programs, some of them certainly in the second half of the year, some of them, perhaps, taking a bit longer.

But, yes, we expect the second half of the year to have less expense associated with some of these new programs because a number of them did transition into more regular production by the end of the quarter.

Dan Colonna: OK. Great. Thanks, again.

Joe Caldarelli: Thank you.

Operator: Thank you.

Once again, if you have a question, please press star then one.

Our next question is from Clark Orsky of Standish Mellon Assessment.

Your line is open.

Clark Orsky: Yes, hi. Any thoughts on sequestration if it happens, et cetera, and what programs that you're on that you see might be affected?

Joe Caldarelli: It is very difficult to predict of course because it's hard to say how that's going to flow down to the various purchasing agencies. For quite a significant period of time now we've been seeing things getting pushed out to the right as the agency side have been low on funds or have been asked to delay expenditures so our guess is that much of the disruption is already worked into the system and we're operating in a continuing delayed or displacement mode already.

And as I mentioned earlier, much to our surprise in the particular applications that we're on we've done remarkably well in all three of our defense oriented areas – radar, electronic warfare, and communications. So, our expectation would be that the impact would be nominal, but, you know, frankly until it happens and people see the details of how it flowed down to the agencies and what directives they're given, it's very difficult to plan, quantify them, and predict it.

Clark Orsky: OK. Thank you.

Joe Caldarelli: OK.

Operator: Thank you. There are no further questions at this time. I'll turn the call back over to Joe Caldarelli for closing remarks.

Joe Caldarelli: Well, thank you very much, folks, for listening in and we'll look forward to talking to you all again next quarter.

Thank you.

**END**