

CPI HOLDCO INC  
Form 10-Q  
May 17, 2004

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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 2, 2004

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: **333-11386-04**

**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:**

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 7, 2004.**

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**CONSOLIDATED CONDENSED BALANCE SHEETS**

(in thousands-unaudited)

	<b>April 2, 2004 (Successor)</b>	<b>October 3, 2003 (Predecessor)</b>
	<u>                    </u>	<u>                    </u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 13,982	\$ 33,751
Accounts receivable, net	43,331	33,128
Inventories	37,218	37,358
Other current assets	3,111	2,210
	<u>                    </u>	<u>                    </u>
Total current assets	97,642	106,447
Property, plant, and equipment, net	69,544	32,551
Goodwill	165,507	19,149
Intangibles, net	27,214	21,536
Debt issue costs, net	9,395	2,285
	<u>                    </u>	<u>                    </u>
Total assets	<u>\$369,302</u>	<u>\$181,968</u>
 <b>LIABILITIES, PREFERRED STOCK AND STOCKHOLDERS EQUITY (DEFICIT)</b>		
<b>Current Liabilities</b>		
Current portion of term loans	\$ 900	\$
Mortgage financing		17,500
Accounts payable	16,723	15,624
Accrued expenses	20,270	21,445
Product warranty	5,889	5,401
Income taxes payable	2,976	3,584
Accrued dividends payable		15,449
Advance payments from customers	7,830	10,203
	<u>                    </u>	<u>                    </u>
Total current liabilities	54,588	89,206
Senior term loans	89,100	
Senior subordinated notes	125,000	100,000

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Deferred income taxes	4,802	_____
Total liabilities	273,490	189,206 _____
<b>Senior Redeemable Preferred Stock of CPI</b>	_____	28,907 _____
<b>Junior Preferred Stock of CPI</b>	_____	29,300 _____
Commitments and contingencies		
<b>Stockholders' Equity (Deficit)</b>		
Common stock	43	50
Additional paid-in capital	102,237	21,519
Deferred compensation		(1,289)
Accumulated deficit	(6,833)	(84,469)
Stockholder loans		(1,256)
Other comprehensive income	365	_____
Net stockholders' equity (deficit)	95,812	(65,445) _____
Total liabilities, preferred stock and stockholders' equity (deficit)	\$369,302	\$181,968 _____

See accompanying notes to the unaudited consolidated condensed financial statements.

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**CONSOLIDATED CONDENSED  
STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME**

(in thousands - unaudited)

	Fiscal Year		
	2004	2004	2003
	January 23, 2004  to April 2, 2004 (Successor)	January 3, 2004  to January 22, 2004 (Predecessor)	13-Week Period Ended April 4, 2003 (Predecessor)
Sales	\$65,641	\$ 11,606	\$ 67,897
Cost of sales	46,027	9,049	47,213
Gross profit	19,614	2,557	20,684
Operating costs and expenses:			
Research and development	1,464	467	1,574
Selling and marketing	3,138	728	3,845
General and administrative	3,512	2,332	5,085
Merger expenses		5,944	
Amortization of acquisition-related intangible assets	3,396		
Acquired in-process research and development	11,500		
Total operating costs and expenses	23,010	9,471	10,504
Operating (loss) income	(3,396)	(6,914)	10,180
Interest expense	2,950	5,343	3,576
(Loss) income before taxes	(6,346)	(12,257)	6,604
Income tax expense (benefit)	487	(2,848)	3,385

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Net (loss) income	(6,833)	(9,409)	3,219
Preferred dividends:			
Senior redeemable preferred stock		2,252	1,452
Junior preferred stock		1,334	945
	<u>          </u>	<u>          </u>	<u>          </u>
Net (loss) income attributable to common stock	\$ (6,833)	\$ (12,995)	\$ 822
	<u>          </u>	<u>          </u>	<u>          </u>
Other comprehensive income, net of tax:			
Unrealized gain on cash flow hedges	365		
	<u>          </u>	<u>          </u>	<u>          </u>
Comprehensive (loss) income	\$ (6,468)	\$ (12,995)	\$ 822
	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to the unaudited consolidated condensed financial statements.

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

	Fiscal Year		
	2004	2003	2003
	January 23, 2004 to April 2, 2004 (Successor)	October 4, 2003 to January 22, 2004 (Predecessor)	27-Week Period Ended April 4, 2003 (Predecessor)
Sales	\$65,641	\$ 79,919	\$129,523
Cost of sales	46,027	56,189	92,149
Gross profit	19,614	23,730	37,374
Operating costs and expenses:			
Research and development	1,464	2,200	3,019
Selling and marketing	3,138	4,352	7,769
General and administrative	3,512	6,033	8,963
Merger expenses		6,374	
Amortization of acquisition related intangible assets	3,396		
Acquired in-process research and development	11,500		
Total operating costs and expenses	23,010	18,959	19,751
Operating (loss) income	(3,396)	4,771	17,623
Other income			(267)
Interest expense	2,950	8,902	7,246
(Loss) income before taxes	(6,346)	(4,131)	10,644
Income tax expense	487	439	4,889



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Net (loss) income	(6,833)	(4,570)	5,755
Preferred dividends:			
Senior redeemable preferred stock		3,861	2,854
Junior preferred stock		2,382	1,859
	<u>          </u>	<u>          </u>	<u>          </u>
Net (loss) income attributable to common stock	\$ (6,833)	\$ (10,813)	\$ 1,042
	<u>          </u>	<u>          </u>	<u>          </u>
Other comprehensive income, net of tax:			
Unrealized gain on cash flow hedges	365		
	<u>          </u>	<u>          </u>	<u>          </u>
Comprehensive (loss) income	\$ (6,468)	\$ (10,813)	\$ 1,042
	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to the unaudited consolidated condensed financial statements.

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

	Fiscal Year		
	2004	2003	2003
	January 23, 2004  to April 2, 2004 (Successor)	October 4, 2003  to January 22, 2004 (Predecessor)	27-Week period ended April 4, 2003 (Predecessor)
<b>OPERATING ACTIVITIES</b>			
Net cash (used in) provided by operating activities	\$ (5,750)	\$ 7,166	\$ 18,812
<b>INVESTING ACTIVITIES</b>			
Purchase of Predecessor net assets, net of cash acquired	(113,760)		
Proceeds from the sale of SSPD division			136
Purchase of property, plant and equipment, net	(298)	(459)	(918)
Net cash used in investing activities	(114,058)	(459)	(782)
<b>FINANCING ACTIVITIES</b>			
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:			
Senior subordinated notes	125,000		
Senior term loans	90,000		
Debt issue costs	(9,577)		
	1,266		

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Proceeds from the repayment of Predecessor management loans			
Net proceeds from the issuance of common stock	98,075		110
Repayments on capital leases			(45)
Repayment of mortgage financing			(250)
Payment of debt issue refinancing costs			(295)
Net repayment from bank overdraft	1,907	(1,639)	(1,007)
	<u>          </u>	<u>          </u>	<u>          </u>
Net cash provided by (used in) financing activities	133,790	(27,639)	(1,487)
	<u>          </u>	<u>          </u>	<u>          </u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	13,982	(20,932)	16,543
Cash and cash equivalents at beginning of period		33,751	2,724
	<u>          </u>	<u>          </u>	<u>          </u>
Cash and cash equivalents at end of period	\$ 13,982	\$ 12,819	\$ 19,267
	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to the unaudited consolidated condensed financial statements.

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**NOTES TO CONSOLIDATED  
CONDENSED FINANCIAL STATEMENTS**  
(unaudited)

***1. Basis of Presentation***

For periods prior to January 22, 2004, the accompanying consolidated condensed 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 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 (the Merger ). 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 consolidated condensed 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 which end on the Friday nearest September 30. The Successor's fiscal year did not change from that of the Predecessor. Fiscal year 2004 will be comprised of the 52-week period ending October 1, 2004, and fiscal year 2003 was comprised of the 53-week period ended October 3, 2003. Both the second quarter of fiscal year 2004 and the second quarter of fiscal year 2003 were comprised of 13 weeks.

Management believes that these unaudited interim condensed 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 2004. 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 year ended October 3, 2003.

There is currently no public market for the Company's common stock. The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, pursuant to Section 15(d) thereof, because it, along with Communications & Power Industries, Inc. ( CPI ) and certain of its subsidiaries, filed a registration statement on Form S-4 to register CPI's 8% Senior Subordinated Notes due 2012 ( 8% Notes ). The registration statement became effective April 20, 2004 pursuant to the Securities Act of 1933, as amended.

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. During fiscal year 2003, the Company issued stock options to employees which 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 under the caption General and administrative in the Consolidated Condensed Statement of Operations on a straight-line basis over the four year vesting period until they became fully vested at the time of the merger.

If compensation cost for the Company's stock-based compensation plan had been determined consistent

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with SFAS No. 123, the Company's net income would have changed to the pro forma amounts indicated below:

<b>(In thousands)</b>	<b>Fiscal Year</b>		
	<b>2004</b>	<b>2003</b>	
	<b>January 23, 2004 to April 2, 2004 (Successor)</b>	<b>January 3, 2004 to January 22, 2004 (Predecessor)</b>	<b>13-Week Period ended April 4, 2003 (Predecessor)</b>
Net (loss) income as reported	\$(6,833)	\$ (9,409)	\$ 3,219
Add:			
Stock-based compensation included in net income determined under intrinsic value method, net of tax		1,195	821
Deduct:			
Stock-based compensation determined under fair value based method, net of tax	43	24	160
Pro forma net (loss) income	<u>\$(6,876)</u>	<u>\$ (8,238)</u>	<u>\$ 3,880</u>

<b>(In thousands)</b>	<b>Fiscal Year</b>		
	<b>2004</b>	<b>2003</b>	
	<b>January 23, 2004 to April 2, 2004 (Successor)</b>	<b>October 4, 2003 to January 22, 2004 (Predecessor)</b>	<b>27-Week Period ended April 4, 2003 (Predecessor)</b>
Net (loss) income as reported	\$(6,833)	\$ (4,570)	\$ 5,755
Add:			
Stock-based compensation included in net income determined under intrinsic		1,289	821

value method, net of tax			
Deduct:			
Stock-based compensation determined under fair value based method, net of tax	43	227	128
	<u>          </u>	<u>          </u>	<u>          </u>
Pro forma net (loss) income	\$(6,876)	\$ (3,508)	\$ 6,448
	<u>          </u>	<u>          </u>	<u>          </u>

## 2. Mergers

### *Merger*

On January 23, 2004, CPI Holdco's wholly-owned subsidiary, Merger Sub, merged with and into Holding pursuant to the terms of the Agreement and Plan of Merger (the Merger Agreement), dated as of November 17, 2003, by and among Holding, CPI Holdco, Merger Sub and Green Equity Investors II, L.P., as the representative of the security holders of Holding, under which CPI Holdco, Merger Sub's parent corporation and a corporation controlled by affiliates of Cypress, agreed to acquire Holding. In the Merger, each share of Holding's common stock and stock options outstanding immediately prior to the Merger, other than a portion of stock options held by certain members of management (which were converted into options to purchase shares of CPI Holdco) and other than any shares of common stock owned by Holding or CPI Holdco, were converted into the right to receive a

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pro rata portion of the aggregate merger consideration of \$130.3 million. In connection with the Merger, CPI Holdco received an equity contribution of \$100.0 million before expenses from affiliates of Cypress in exchange for 4,251,122 shares of common stock of CPI Holdco. Members of management of Holding, as a result of rolling over their options to purchase common stock of Holding, received stock options to purchase 168,998 shares of common stock of CPI Holdco. In connection with the Merger, Holding and CPI refinanced all of their outstanding indebtedness. As part of the refinancing, CPI effected a covenant defeasance of its 12% Senior Subordinated Notes ( 12% Notes ) and elected to redeem in full the remaining \$74.0 million outstanding aggregate principal amount of the 12% Notes pursuant to the terms of the Indenture governing the 12% Notes (the 12% Indenture ). In addition, CPI terminated its credit facility, and Holding paid off all amounts owing under, and terminated, the loan agreement related to its San Carlos Property. CPI also redeemed all of the outstanding shares of its 14% Junior Cumulative Preferred Stock and its Series B 14% Senior Redeemable Exchangeable Cumulative Preferred Stock.

The transaction described above is being accounted for using the purchase method of accounting as required by the Financial Accounting Standards Board ( FASB ) Statement No. 141, Business Combinations. Accordingly, the assets and liabilities of Holding will be adjusted to their fair values and the excess of the purchase price over the fair value of the assets acquired will be recorded as goodwill. The allocation of the purchase price to specific assets and liabilities is based, in part, upon independent appraisals and internal estimates of cash flow and recoverability. The allocation of purchase price has been completed for inventory, property, plant and equipment, and certain intangibles, such as backlog, in-process research and development and land leases. An independent appraisal of additional identifiable intangibles is in process and is expected to be completed in the quarter ended July 2, 2004. It is probable that additional adjustments to this allocation will be made in future periods, which could adversely affect the Company's results of operations. Based on the preliminary purchase price allocation, the following table summarizes the fair values of the assets acquired and liabilities assumed at January 23, 2004:

Inventory	\$ 43,608
Accounts receivable	29,587
Other current assets	16,060
Property, plant and equipment	70,145
Identifiable intangible assets	30,733
Acquired in-process research and development	11,500
Goodwill	165,507
Debt and preferred stock	(172,881)
Other liabilities	(63,938)
	<hr/>
Total	\$ 130,321
	<hr/>

The acquired in-process research and development of \$11.5 million represents the estimated fair value of acquired in-process research and development projects that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was written off at the Merger date. The value assigned to in-process technology relates to ten projects involving development of VEDs for communications, scientific and military applications and development of power supplies, x-ray generators and transmitters for industrial, medical and military applications. See Note 12 for description of identifiable intangible assets acquired.





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The following unaudited pro forma summary presents information as if the Merger had taken place at the beginning of each period presented. The pro forma amounts include certain adjustments, including depreciation based on the allocated purchase price of property and equipment, amortization of finite lived intangible assets acquired, interest expense and taxes. One-time charges for the inventory write-up, merger expenses, acquired in-process research and development and backlog amortization are excluded from the adjustments to the pro forma amounts.

	<b>Fiscal Year</b>	
	<b>2004</b>	<b>2003</b>
	<b>13-Week Period ended April 2, 2004</b>	<b>13-Week Period ended April 4, 2003</b>
<b>(In thousands)</b>		
Sales	\$77,247	\$67,897
Pro forma net income	\$ 6,594	\$ 3,280

	<b>Fiscal Year</b>	
	<b>2004</b>	<b>2003</b>
	<b>26-Week Period ended April 2, 2004</b>	<b>27-Week Period ended April 4, 2003</b>
<b>(In thousands)</b>		
Sales	\$145,560	\$129,523
Pro forma net income	\$ 11,420	\$ 5,792

*Intercompany Merger*

On March 12, 2004, Holding was merged with and into its wholly-owned subsidiary, CPI, with CPI as the surviving corporation (the Intercompany Merger). As a result of the Intercompany Merger, the corporate structure of the Company and its subsidiaries consists of one parent holding corporation, CPI Holdco, and all of the obligations of Holding existing prior to the Intercompany Merger became obligations of CPI.

**3. Inventories**

Inventories are stated at the lower of average cost or market (net realizable value). The main components of inventories are as follows:

	<b>April 2, 2004</b>	<b>October 3, 2003</b>
<b>(In thousands)</b>		

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Raw materials and parts	\$24,781	\$26,330
Work in process	9,868	8,786
Finished goods	2,569	2,242
	<u>          </u>	<u>          </u>
Inventories	\$37,218	\$37,358
	<u>          </u>	<u>          </u>

**4. Accrued Warranty**

The Company's products are generally warranted for a variety of periods, typically one to three years or a predetermined product usage life. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the balance based on actual experience and changes in future expectations. The following table reconciles the changes in the Company's accrued warranty:

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<b>(In thousands)</b>	<b>Fiscal Year</b>		
	<b>2004</b>		<b>2003</b>
	<b>January 23, 2004  to April 2, 2004  (Successor)</b>	<b>January 3, 2004  to January 22, 2004  (Predecessor)</b>	<b>13-Week Period ended April 4, 2003  (Predecessor)</b>
Beginning accrued warranty	\$5,839	\$ 6,086	\$ 5,081
Cost of warranty claims	(826)	(269)	(1,428)
Accruals for product warranty	876	22	1,420
Ending accrued warranty	\$5,889	\$ 5,839	\$ 5,073

<b>(In thousands)</b>	<b>Fiscal Year</b>		
	<b>2004</b>		<b>2003</b>
	<b>January 23, 2004  to April 2, 2004  (Successor)</b>	<b>October 4, 2003  to January 22, 2004  (Predecessor)</b>	<b>27-Week Period ended April 4, 2003  (Predecessor)</b>
Beginning accrued warranty	\$5,839	\$ 5,401	\$ 4,823
Cost of warranty claims	(826)	(1,241)	(2,728)
Accruals for product warranty	876	1,679	2,978
Ending accrued warranty	\$5,889	\$ 5,839	\$ 5,073

**5. Senior Credit Facility**

In connection with the Merger, CPI entered into a \$130.0 million credit agreement ( Senior Credit Facility ). This Senior Credit Facility consists of a \$40.0 million revolving commitment, with a sub-facility of \$15.0 million for letters of credit and \$5.0 million for swingline loans ( Revolver ), which expires on January 23, 2010, and a \$90.0 million term loan ( Term Loan ), which expires on July 23, 2010. The Term Loan requires 1.0% of the loan amount to be repaid

annually in quarterly installments of 0.25% beginning June 30, 2004 and continuing for five years with the remainder due in equal quarterly installments thereafter. The Senior Credit Facility is guaranteed by CPI Holdco and all of CPI's domestic subsidiaries and collateralized with a security agreement, which includes a security interest in certain property and fixtures.

The Revolver and Term Loan borrowings will initially bear interest at a rate equal to LIBOR plus 3.00% per annum (the 3.00% being referred to as the Applicable LIBOR Margin), or the Alternate Base Rate (ABR) plus 2.0% per annum; the ABR is the greater of (a) the Prime Rate and (b) the Federal Funds Rate plus 0.50%. In addition to customary fronting and administrative fees under the Senior Credit Facility, CPI will pay Letter of Credit Participation fees equal to the Applicable LIBOR Margin per annum on the average daily amount of letter of credit exposure, and a commitment fee of 0.50% per annum on the average daily unused amount of revolving commitment.

The Senior Credit Facility contains a number of covenants that, among other things, restrict the ability of CPI Holdco, CPI and certain of its 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; change their business or ownership; amend agreements or make prepayments relating to subordinated indebtedness; amend

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or waive provisions of charter documents, agreements with respect to capital stock or any other document related to the Merger Agreement or related transaction documents in a manner that is materially adverse to the lenders; and change their fiscal year. These covenants are subject to certain exceptions.

In addition, the Senior Credit Facility requires CPI and its subsidiaries to maintain the following financial covenants: a minimum interest coverage ratio; a maximum total leverage ratio; a minimum fixed charge coverage ratio; and a maximum capital expenditures limitation.

***6. 8% Senior Subordinated Notes***

In connection with the Merger, CPI issued an aggregate principal amount of \$125.0 million of 8% Notes which will mature on February 1, 2012. CPI is required to pay interest on the 8% Notes semiannually, beginning on August 1, 2004. The indenture governing the terms of the 8% Notes (the 8% Indenture ) contains restrictive provisions which, among other things, limit CPI and certain of its subsidiaries from incurring certain indebtedness, selling assets or consolidating or merging with or into other companies, paying dividends or repurchasing or redeeming capital stock, making certain investments and entering into certain types of transactions with their affiliates. The payment of principal, premium and interest on, and other obligations evidenced by the 8% Notes is subordinated in right of payment, as set forth in the 8% Indenture, to the prior payment in full of all senior debt (as defined in the 8% Indenture), including indebtedness under the Senior Credit Facility, whether outstanding on the date of the 8% I