CPI INTERNATIONAL, INC.
Form 10-K/A
December 16, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K/A
Amendment No. 1

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended October 1, 2010

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: 000-51928

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Yes ¨ No x

Rule 405 of the Securities Act.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.	Yes ¨ No x
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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).	Yes ¨ No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.	x

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 the definitions of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
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 Act).	Yes ¨ No x

The aggregate market value of common stock held by non-affiliates of the registrant as of April 1, 2010 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately $96 million, based on the closing sale price of $13.09 per share of common stock as reported on the Nasdaq Stock Market.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 16,820,741 shares of the registrant's common stock, par value $0.01 per share, were outstanding at December 1, 2010.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the registrant's definitive 2011 proxy statement, anticipated to be filed with the Securities and Exchange Commission within 120 days after the close of the registrant's fiscal year, are incorporated by reference into Part III of this Form 10-K.

EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-K/A ("Amendment") to correct a typographical error in our Annual Report on Form 10-K for the fiscal year ended October 1, 2010, which was filed with the Securities and Exchange Commission on December 10, 2010 (the "Original Filing").

In the Original Filing, the Report of Independent Registered Public Accounting Firm issued by KPMG LLP ("Accountant's Report") was erroneously shown as December 9, 2010. The correct date should have been December 10, 2010, the date of the Original Filing.

This Amendment contains our financial statements (Part IV, Item 15 (a) (1)), with the correct date on the Accountant's Report. Except for changing the date of the Accountant's Report from December 9, 2010 to December 10, 2010, no other changes have been made to the Original Filing.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) (1) Financial Statements:

The following consolidated financial statements and schedules are filed as a part of this report:

- Report of Independent Registered Public Accounting Firm
- Consolidated Balance Sheets
- Consolidated Statements of Income
- Consolidated Statements of Stockholders’ Equity and Comprehensive Income
- Consolidated Statements of Cash Flows
- Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
CPI International, Inc.:

We have audited the accompanying consolidated balance sheets of CPI International, Inc. and subsidiaries (the Company) as of October 1, 2010 and October 2, 2009, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended October 1, 2010. We also have audited the Company's internal control over financial reporting as of October 1, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting (Item 9A). Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CPI International, Inc. and subsidiaries as of October 1, 2010 and October 2, 2009, and the results of its operations and its cash flows for each of the years in the three-year period ended October 1, 2010, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of October 1, 2010, based on criteria established in Internal Control – Integrated Framework issued by the COSO.

Mountain View, California
December 10, 2010

/s/ KPMG LLP

CPI INTERNATIONAL, INC.
and subsidiaries

CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	October 1, 2010	October 2, 2009
Assets		
Current Assets:		
Cash and cash equivalents	$ 42,829	$ 26,152
Restricted cash	1,804	1,561
Accounts receivable, net	45,707	45,145
Inventories	75,208	66,996
Deferred tax assets	11,030	8,652
Prepaid and other current assets	6,459	6,700
Total current assets	183,037	155,206
Property, plant, and equipment, net	54,259	57,912
Deferred debt issue costs, net	1,604	3,609
Intangible assets, net	72,474	75,430
Goodwill	162,225	162,225
Other long-term assets	4,677	3,872
Total assets	$ 478,276	$ 458,254
Liabilities and stockholders' equity		
Current Liabilities:		
Current portion of long-term debt	$ 66,000	$ -
Accounts payable	24,290	22,665
Accrued expenses	23,653	19,015
Product warranty	5,101	3,845
Income taxes payable	5,022	4,305
Advance payments from customers	14,218	12,996
Total current liabilities	138,284	62,826
Deferred income taxes	21,707	24,726
Long-term debt, less current portion	128,934	194,922
Other long-term liabilities	5,411	2,227
Total liabilities	294,336	284,701
Commitments and contingencies		
Stockholders' equity		
Preferred stock ($0.01 par value; 10,000 shares authorized and none issued and outstanding)	-	-
Common stock ($0.01 par value, 90,000 shares authorized; 17,020 and 16,807 shares issued; 16,813 and 16,601 shares outstanding	170	168
Additional paid-in capital	80,015	75,630
Accumulated other comprehensive (loss) income	(141)	598
Retained earnings	106,696	99,957
Treasury stock, at cost (206 shares)	(2,800)	(2,800)

Total stockholders’ equity		183,940		173,553
Total liabilities and stockholders' equity	$	478,276	$	458,254

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

CPI INTERNATIONAL, INC.
and subsidiaries

CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
Sales	$ 360,434	$ 332,876	$ 370,014
Cost of sales	251,987	239,385	261,086
Gross profit	108,447	93,491	108,928
Operating costs and expenses:			
Research and development	12,429	10,520	10,789
Selling and marketing	20,794	19,466	21,144
General and administrative	24,988	20,757	22,951
Amortization of acquisition-related intangible assets	2,749	2,769	3,103
Strategic alternative transaction expenses	19,913	-	-
Total operating costs and expenses	80,873	53,512	57,987
Operating income	27,574	39,979	50,941
Interest expense, net	15,213	16,979	19,055
(Gain) loss on debt extinguishment	-	(248)	633
Income before income taxes	12,361	23,248	31,253
Income tax expense (benefit)	5,622	(218)	10,804
Net income	$ 6,739	$ 23,466	$ 20,449
Earnings per common share - Basic	$ 0.40	$ 1.42	$ 1.24
Earnings per common share - Diluted	$ 0.37	$ 1.33	$ 1.15
Shares used to compute earnings per common share - Basic	16,571	16,343	16,356
Shares used to compute earnings per common share - Diluted	17,837	17,443	17,684

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

CPI INTERNATIONAL, INC.
and subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME

	Common Stock		Additional Paid-in	Accumulated Other Comprehensive Income	Retained	Treasury Stock		
	Shares	Amount	Capital	(Loss)	Earnings	Shares	Amount	Total
Balances, September 28, 2007	16,370	$ 164	$ 68,763	$ 937	$ 56,042	-	$ -	$ 125,906
Comprehensive income:								
Net income	-	-	-	-	20,449	-	-	20,449
Unrealized loss on cash flow hedges, net of tax benefit of $1,652	-	-	-	(2,697)	-	-	-	(2,697)
Unrealized actuarial loss and prior service credit for pension liability, net of tax benefit of $30	-	-	-	(49)	-	-	-	(49)
Total comprehensive income								17,703
Stock-based compensation cost	-	-	2,160	-	-	-	-	2,160
Exercise of stock options	9	-	38	-	-	-	-	38
Tax benefit related to stock option exercises	-	-	5	-	-	-	-	5
Issuance of common stock under employee stock purchase plan	72	1	852	-	-	-	-	853
Issuance of restricted stock awards	89	-	-	-	-	-	-	-
Forfeiture of restricted stock awards	(2)	-	-	-	-	-	-	-
Purchase of treasury stock	-	-	-	-	-	(206)	(2,800)	(2,800)
Balances, October 3, 2008	16,538	165	71,818	(1,809)	76,491	(206)	(2,800)	143,865

Comprehensive income:								
Net income	-	-	-	-	23,466	-	-	23,466
Unrealized gain on cash flow hedges, net of tax expense of $1,471	-	-	-	2,415	-	-	-	2,415
Unrealized actuarial loss and prior service credit for pension liability, net of tax expense of $52	-	-	-	(8)	-	-	-	(8)
Total comprehensive income								25,873
Stock-based compensation cost	-	-	2,729	-	-	-	-	2,729
Exercise of stock options	57	1	83	-	-	-	-	84
Tax benefit related to stock option exercises	-	-	48	-	-	-	-	48
Issuance of common stock under employee stock purchase plan	111	1	952	-	-	-	-	953
Issuance of restricted stock awards	106	1		-	-	-	-	1
Forfeiture of restricted stock awards	(5)	-	-	-	-	-	-	-
Balances, October 2, 2009	16,807	168	75,630	598	99,957	(206)	(2,800)	173,553
Comprehensive income:								
Net income	-	-	-	-	6,739	-	-	6,739
Unrealized loss on cash flow hedges, net of tax benefit of $496	-	-	-	(653)	-	-	-	(653)
Unrealized actuarial loss and prior service credit for pension liability, net of tax benefit of $22	-	-	-	(86)	-	-	-	(86)
Total comprehensive income								6,000
	-	-	3,051	-	-	-	-	3,051

Stock-based compensation cost								
Exercise of stock options	126	1	229	-	-	-	-	230
Tax benefit related to stock option exercises	-	-	526	-	-	-	-	526
Issuance of common stock under employee stock purchase plan	49	1	579	-	-	-	-	580
Issuance of restricted stock awards	38	-	-	-	-	-	-	-
Balances, October 1, 2010	17,020	$ 170	$ 80,015	$ (141)	$ 106,696	(206)	$ (2,800)	$ 183,940

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

CPI INTERNATIONAL, INC.
and subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
Cash flows from operating activities			
Net income	$ 6,739	$ 23,466	$ 20,449
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	8,076	7,773	7,607
Amortization of intangible assets	2,996	3,021	3,356
Write-off of patent application fees	-	83	-
Amortization of deferred debt issue costs	1,353	1,241	1,197
Amortization of discount on floating rate senior notes	12	12	15
Non-cash loss on debt extinguishment	-	144	420
Discount on repayment of debt	-	(392)	-
Non-cash defined benefit pension expense	31	39	55
Stock-based compensation expense	3,040	2,679	2,135
Allowance for doubtful accounts	17	6	-
Deferred income taxes	(5,159)	(1,000)	(1,360)
Net loss on the disposition of assets	82	130	205
Net loss (gain) on derivative contracts	374	343	(838)
Tax benefit from stock option exercises	806	212	50
Excess tax benefit on stock option exercises	(593)	(54)	(18)

Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:

Restricted cash	(243)	(785)	1,479
Accounts receivable	(579)	2,197	5,241
Inventories	(8,200)	(1,495)	1,986
Prepaid and other current assets	(726)	426	(246)
Other long-term assets	(775)	67	(208)
Accounts payable	1,625	1,556	(685)
Accrued expenses	5,588	(4,107)	(4,953)
Product warranty	1,256	(314)	(1,419)
Income tax payable, net	2,516	(5,974)	(1,003)
Advance payments from customers	1,222	661	203
Other long-term liabilities	350	179	213
Net cash provided by operating activities	19,808	30,114	33,881
Cash flows from investing activities			
Capital expenditures	(4,492)	(3,365)	(4,262)
Acquisitions, net of cash acquired	-	-	1,615
Payment of patent application fees	(41)	-	(147)
Net cash used in investing activities	(4,533)	(3,365)	(2,794)
Cash flows from financing activities			
Proceeds from stock purchase plan and exercises of stock options	809	1,037	891
Repayments of debt	-	(30,358)	(21,000)
Purchase of treasury stock	-	-	(2,800)
Excess tax benefit on stock option exercises	593	54	18
Net cash provided by (used in) financing activities	1,402	(29,267)	(22,891)
Net increase (decrease) in cash and cash equivalents	16,677	(2,518)	8,196
Cash and cash equivalents at beginning of year	26,152	28,670	20,474
Cash and cash equivalents at end of year	$ 42,829	$ 26,152	$ 28,670
Supplemental cash flow disclosures			
Cash paid for interest	$ 13,917	$ 16,081	$ 18,720
Cash paid for income taxes, net of refunds	$ 8,437	$ 6,539	$ 13,099

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

CPI INTERNATIONAL, INC.
and subsidiaries

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

1. Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation: 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, antenna systems and various other power supply equipment and devices. The Company has two reportable segments, VED and satcom equipment.

The consolidated financial statements include those of the Company and its subsidiaries. Significant intercompany balances, transactions, and stockholdings have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to current year presentation.

The Company's fiscal year is the 52- or 53-week period that ends on the Friday nearest September 30. Fiscal years 2010 and 2009 comprised the 52-week periods ending October 1, 2010 and October 2, 2009, respectively. Fiscal year 2008 comprised the 53-week period ended October 3, 2008. All period references are to the Company's fiscal periods unless otherwise indicated.

Liquidity: The Company's cash and cash equivalents as of October 1, 2010 of approximately $42.8 million is not sufficient to repay certain long-term debt totaling $66.0 million currently scheduled to mature in August 2011. The Company intends to obtain replacement financing to repay the respective loan within fiscal year 2011 prior to its scheduled maturity date. The Company has historically financed, and intends to continue to finance, its capital and working capital requirements including debt service and internal growth, through a combination of cash flows from its operations and borrowings under its senior credit facilities.

While the Company believes that, based on its cash flow from operations and its past history, it will be successful in obtaining the replacement financing with reasonable terms to repay its maturing debt, there are no assurances that such additional refinancing will be successful. If the Company is unable to refinance its debt facility, the Company may need to implement other alternatives such as issuing common stock or securities convertible into common stock to repay its indebtedness. If implemented, these actions could negatively impact its business or dilute its existing stockholders.

CPI INTERNATIONAL, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(All tabular amounts in thousands except share and per share amounts)

Foreign Currency Translation: The functional currency of the Company's foreign subsidiaries is the U.S. dollar. Gains or losses resulting from the translation into U.S. dollars of amounts denominated in foreign currencies are included in the determination of net income or loss. Foreign currency translation gains and losses are generally reported on a net basis in the caption "general and administrative" in the consolidated statements of income, except for translation gains or losses on income tax-related assets and liabilities, which are reported in "income tax expense" in the consolidated statements of income.

Use of Estimates: 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 revenue recognition; inventory valuation; provision for product warranty; business combinations; recoverability and valuation of recorded amounts of long-lived assets and identifiable intangible assets, including goodwill; recognition and measurement of share-based compensation; and recognition and 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.

Revenues from contracts that contain multiple elements are accounted for in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic FASB ASC 605-25 "Revenue Recognition — Multiple Element Arrangements." Through October 1, 2010, revenue from these contracts was allocated to each respective element or unit of accounting, based on each element's relative fair value using vendor-specific objective evidence ("VSOE") or third-party evidence ("TPE"), if determinable, and was recognized when the respective revenue recognition criteria for each element was met. Effective October 2, 2010, the Company is required to adopt the provisions of FASB Accounting Standards Update ("ASU") 2009-13, "Revenue Recognition (Topic 605): Multiple Deliverable Revenue Arrangements – A Consensus of the FASB Emerging Issues Task Force," which, among other things, requires revenue to be allocated to each element based on the relative selling price method in the absence of VSOE or TPE. See Note 2.

CPI INTERNATIONAL, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(All tabular amounts in thousands except share and per share amounts)

The Company has commercial and U.S. Government fixed-price contracts that are accounted for under FASB ASC 605, “Revenue Recognition,” Subtopic 35, “Construction-Type and Production-Type Contracts.” These contracts have represented not more than 4% of the Company’s sales during fiscal years 2010, 2009 and 2008, and are for contracts that generally are greater than one year in duration and that include a significant 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.

Sales under cost-reimbursement contracts, which are primarily for research and development, are recorded as costs are incurred and include estimated earned fees in the proportion that costs incurred to date bear to total estimated costs. The fees under certain commercial and U.S. Government contracts may be increased or decreased in accordance with cost or performance incentive provisions that measure actual performance against established targets or other criteria. Such incentive fee awards or penalties are included in revenue at the time the amounts can be reasonably determined.

Revenue is recorded net of taxes collected from customers that are remitted to governmental authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Cash and Cash Equivalents: The Company considers all highly liquid short-term investments with original maturities of three months or less, readily convertible to known amounts of cash to be cash equivalents.

Restricted Cash: Restricted cash consists 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.

Inventories: Inventories are stated at the lower of average cost or market value, primarily using the average cost method. Costs include labor, material and overhead costs. Overhead costs are based on indirect costs allocated among cost of sales, work-in-process inventory and finished goods inventory. Inventories also include costs and earnings in excess of progress billings for contracts using the percentage-of-completion method of accounting. Progress billings in excess of costs and earnings for contracts using the percentage-of-completion method of accounting are reported in Advance Payments from Customers.

The Company assesses the valuation of inventory and periodically writes down the value for estimated excess and obsolete inventory based upon actual usage and estimates about future demand. The excess balance determined by this analysis becomes the basis for the Company’s excess inventory charge. Management personnel play a key role in the excess inventory review process by providing updated sales forecasts, managing product rollovers and working with manufacturing to maximize recovery of excess inventory. If actual market conditions are less favorable than those projected by management, additional write-downs may be required. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold, resulting in lower cost of sales and higher income from operations than expected in that period.

CPI INTERNATIONAL, INC.
and subsidiaries

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

Management also reviews the carrying value of inventory for lower of cost or market on an individual product or contract basis. A loss is charged to cost of sales when known if estimated product or contract cost at completion is in excess of net realizable value (selling price less estimated cost of disposal). If actual product or contract cost at completion is different than originally estimated, then a loss or gain provision adjustment is recorded that would have an impact on the Company’s operating results.

Property, Plant and Equipment: Property, plant and equipment are stated at cost. Major improvements are capitalized, while maintenance and repairs are expensed as incurred. Plant and equipment are depreciated over their estimated useful lives using the straight-line method. Building, land improvements and process equipment are depreciated generally over 25, 20 and 12 years, respectively. Machinery and equipment are depreciated generally over 7 to 12 years. Office furniture and equipment are depreciated generally over 5 to 10 years. Leasehold improvements are amortized using the straight-line method over their estimated useful lives, or the remaining term of the lease, whichever is shorter.

Goodwill and Other Intangible Assets: The Company accounts for business combinations using the purchase method of accounting in which intangible assets acquired are recognized and reported apart from goodwill.

The values assigned to acquired identifiable intangible assets for technology were determined based on the excess earnings method of the income approach. This method determines fair market value using estimates and judgments regarding the expectations of future after-tax cash flows from those assets over their lives, including the probability of expected future contract renewals and sales, all of which are discounted to their present value.

The Company accounts for goodwill and other intangible assets in accordance with FASB ASC 350, “Intangibles-Goodwill and Other.” ASC 350 requires that goodwill and identifiable intangible assets with indefinite useful lives be tested for impairment at least annually. ASC 350 also requires that intangible assets subject to amortization be amortized over their respective estimated useful lives and reviewed for impairment. Identifiable intangible assets are amortized on a straight-line basis over their useful lives of up to 50 years. The Company tests goodwill for impairment annually or more frequently if events and circumstances warrant. The Company’s annual testing resulted in no impairment of goodwill in fiscal years 2010, 2009 and 2008.

Long-Lived Assets: The Company accounts for long-lived assets in accordance with FASB ASC 360, “Property, Plant and Equipment,” and ASC 350, which requires that long-lived and finite-lived intangible assets, including property, equipment and leasehold improvements, be evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value.

There were no triggering events identified that would indicate a need to review for impairment of long-lived assets during fiscal years 2010, 2009 and 2008.

CPI INTERNATIONAL, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(All tabular amounts in thousands except share and per share amounts)

Deferred Debt Issue Costs: Costs incurred related to the issuance of the Company's long-term debt and other credit facilities are capitalized and amortized over the estimated time the obligations are expected to be outstanding using the effective interest method. Deferred debt issue costs for CPI's revolving credit facility and term loan, CPI's 8% Senior Subordinated Notes due 2012 and CPI International's Floating Rate Senior Notes due 2015 are amortized over the term to maturity of the respective debt of four years, eight years and ten years, respectively. As a result of the Company's debt repurchase or prepayment as discussed in Note 5, $0.2 million and $0.3 million of unamortized deferred debt issue costs were written off and charged to (gain) loss on debt extinguishment in the consolidated statement of income for fiscal years 2009 and 2008, respectively. As the outstanding balance of CPI's term loan is expected to be repaid within the next 12 months, the Company has classified $0.7 million of the related unamortized deferred debt issue costs as current (prepaid and other current assets) in the consolidated balance sheet as of October 1, 2010. As of October 1, 2010, and October 2, 2009, gross long-term deferred debt issue costs were $6.4 million and $7.9 million and related accumulated amortization was $4.8 million and $4.3 million, respectively.

Product Warranty: The Company's products typically carry warranty periods of one to three years or warranties over a predetermined product usage life. The Company estimates the costs that may be incurred under its warranty plans and records a liability in the amount of such estimated costs at the time revenue is recognized. The determination of product warranty reserves requires the Company to make estimates of product return rates and expected cost to repair or replace the products under warranty. The Company assesses the adequacy of its preexisting warranty liabilities and adjusts the balance based on actual experience and changes in future expectations.

Business Risks and Credit Concentrations: Defense-related applications, such as certain radar, electronic countermeasures and military communications applications, constitute a significant portion of the Company's sales. Companies engaged in supplying defense-related equipment and services to government agencies are subject to certain business risks unique to that industry. Sales to the government may be affected by changes in procurement policies, budget considerations, changing concepts of national defense, political developments abroad and other factors.

Research and Development: Company-sponsored research and development costs related to both present and future products are expensed as incurred. Customer-sponsored research and development costs are charged to cost of sales to match revenue recognized. Total expenditures incurred by the Company on research and development are summarized as follows:

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
CPI Sponsored	$ 12,429	$ 10,520	$ 10,789
Customer Sponsored	16,106	17,526	12,028
	$ 28,535	$ 28,046	$ 22,817

Advertising Expenses: Costs related to advertising are recognized in selling and marketing expenses as incurred. Advertising expenses were not material in any of the periods presented.

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Income Taxes: The Company records income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In addition, the calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations. In accordance with FASB ASC 740, "Income Taxes," the Company recognizes liabilities for uncertain tax positions based on the two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires the Company to estimate and measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires the Company to determine the probability of various possible outcomes. The Company reevaluates these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

Income tax-related interest expense and income tax-related penalties are reported as a component of the provision for income taxes in the consolidated statement of income.

See Note 11 for further discussion on income taxes.

Comprehensive Income: The Company follows the accounting treatment prescribed by FASB ASC 220, "Comprehensive Income." Comprehensive income is defined as a change in equity of a company during a period from transactions and other events and circumstances, excluding transactions resulting from investments by owners and distributions to owners. The difference between net income and comprehensive income for the Company arises from unrealized gains and losses on cash flow hedge contracts, net of tax, and unrealized actuarial loss and prior service credit for pension liability, net of tax.

2. Recently Issued Accounting Standards

In the first quarter of fiscal year 2010, the Company adopted provisions of FASB ASC 820, "Fair Value Measurements and Disclosures," that specified the way in which fair value measurements should be made for non-financial assets and non-financial liabilities that are not measured and recorded at fair value on a recurring basis, and specified additional disclosures related to these fair value measurements. The adoption of this new standard did not have an impact on the Company's consolidated results of operations, financial position or cash flows.

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In June 2008, the FASB issued an update to ASC 260, "Earnings Per Share," which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method. The update to ASC 260 requires unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) to be treated as participating securities and to be included in the computation of earnings per share pursuant to the two-class method. This guidance under ASC 260 was effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. All prior-period earnings per share data presented shall be adjusted retrospectively. The Company adopted the provisions of this guidance under ASC 260 effective October 3, 2009 and has included the required disclosures in Note 12 to the consolidated financial statements. The adoption of this guidance did not have a material impact on the Company's computation of earnings per share.

In October 2008, the FASB issued guidance codified under ASC 715, "Compensation—Retirement Benefits," which requires that an employer disclose the following information about the fair value of plan assets: (1) the level within the fair value hierarchy in which fair value measurements of plan assets fall; (2) information about the inputs and valuation techniques used to measure the fair value of plan assets; and (3) a reconciliation of beginning and ending balances for fair value measurements of plan assets using significant unobservable inputs. At initial adoption, application of this guidance would not be required for earlier periods that are presented for comparative purposes. The Company adopted the provisions of this guidance under ASC 715 effective October 3, 2009. The adoption did not have an impact on the Company's consolidated results of operations, financial position or cash flows.

In April 2009, the FASB released an amendment to ASC 805, "Business Combinations," which requires an acquirer to recognize at fair value, at the acquisition date, an asset acquired or a liability assumed that arises from a contingency if the acquisition date fair value of that asset or liability can be determined during the measurement period. If the acquisition date fair value cannot be determined during the measurement period, an asset or liability shall be recognized at the acquisition date if (1) information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date, and (2) the amount of the asset or liability can be reasonably estimated. The Company adopted the provisions of the guidance under ASC 805 and its amendment effective October 3, 2009. The impact of the adoption will depend on the nature of acquisitions completed in the future.

In August 2009, the FASB issued ASU 2009-05, "Measuring Liabilities at Fair Value," an update to ASC 820. This update provides amendments to reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. Among other provisions, this update provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the valuation techniques described in ASU 2009-05. The Company adopted the provisions of this guidance under ASU 2009-05 effective October 3, 2009. The adoption did not have an impact on the Company's consolidated results of operations, financial position or cash flows.

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In October 2009, the FASB issued ASU 2009-13, “Revenue Recognition (Topic 605): Multiple Deliverable Revenue Arrangements – A Consensus of the FASB Emerging Issues Task Force.” This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update eliminates the residual method of allocation for multiple-deliverable revenue arrangements, and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The selling price used for each deliverable will be based on VSOE, if available, TPE if VSOE is not available, or estimated selling price if neither VSOE or TPE is available. Additionally, ASU 2009-13 expands the disclosure requirements related to a vendor’s multiple-deliverable revenue arrangements. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and early adoption is permitted. The Company will adopt the provisions of this update under ASU 2009-13 effective October 2, 2010. The Company does not expect ASU 2009-13 to have a material impact on its consolidated results of operations, financial position or cash flows.

In September 2009, the FASB issued ASU 2009-14, “Certain Revenue Arrangements That Include Software Elements,” which is included in the ASC 985, “Software.” ASU 2009-14 amends previous software revenue recognition to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product’s essential functionality. ASU 2009-14 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and shall be applied on a prospective basis. Earlier application is permitted as of the beginning of an entity’s fiscal year. The Company will adopt the provisions of this update under ASU 2009-14 effective October 2, 2010. The Company does not expect ASU 2009-14 to have a material impact on its consolidated results of operations, financial position or cash flows.

In December 2009, the FASB issued ASU 2009-17, “Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities,” as a further clarification to ASC 810-10, “Consolidation of Variable Interest Entities.” ASU 2009-17, upon adoption, requires the use of a qualitative analysis to determine the primary beneficiary of a variable interest entity (“VIE”), amends the guidance for determining if an entity is a VIE and enhances the disclosure requirements regarding an enterprise’s involvement with a VIE. ASU 2009-17 is effective as of the beginning of a company’s first fiscal year beginning after November 15, 2009. The Company will adopt the provisions of this update under ASU 2009-17 effective October 2, 2010. Since the Company does not currently have variable interest entities, this update is expected to have no impact on its consolidated results of operations, financial position or cash flows.

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In January 2010, the FASB issued ASU 2010-06, “Fair Value Measurements and Disclosures: Improving Disclosures About Fair Value Measurements.” This update requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-06 was effective for interim and annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The Company adopted the provisions of this guidance under ASU 2009-06, except for Level 3 reconciliation disclosures, effective January 2, 2010. As this guidance is disclosure-related, it did not have an impact on the Company’s consolidated results of operations, financial position or cash flows.

In February 2010, the FASB issued ASU 2010-08, "Technical Corrections to Various Topics." This update eliminates inconsistencies and outdated provisions in U.S. generally accepted accounting principles (“GAAP”) and provides needed clarification on others. Amendments within ASU 2010-08 that may be applicable to the Company are effective as of the first reporting period beginning after February 2, 2010, the date this ASU was issued. The Company adopted the provisions of this guidance under ASU 2010-08 effective April 3, 2010 with no material impact on its consolidated results of operations, financial position or cash flows.

In April 2010, the FASB issued ASU 2010-17, “Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition.” ASU 2010-17 provides guidance on applying the milestone method to milestone payments for achieving specified performance measures when those payments are related to uncertain future events. The scope of ASU 2010-17 is limited to transactions involving research or development. This update further states that the milestone method is not the only acceptable method of revenue recognition for milestone payments. Accordingly, entities can make an accounting policy election to recognize arrangement consideration received for achieving specified performance measures during the period in which the milestones are achieved, provided certain criteria are met. An entity’s policy for recognizing deliverable consideration or unit of accounting consideration contingent upon achievement of a milestone shall be applied consistently to similar deliverables or units of accounting. ASU 2010-17 is effective on a prospective basis for milestones achieved in interim and fiscal years beginning after June 15, 2010. Early adoption is permitted. The Company will adopt the provisions of this update under ASU 2010-17 effective October 2, 2010. The Company does not expect ASU 2010-17 to have a material impact on its consolidated results of operations, financial position or cash flows.

3. Supplemental Balance Sheet Information

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

	October 1, 2010	October 2, 2009
Accounts receivable	$ 45,819	$ 45,240
Less: Allowance for doubtful accounts	(112)	(95)
	$ 45,707	$ 45,145

Accounts receivable, net

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The following table sets forth the changes in allowance for doubtful account during fiscal years 2010, 2009 and 2008:

	Year Ended October 1, 2010	October 2, 2009	October 3, 2008
Balance at beginning of period	$ 95	$ 89	$ 89
Provision for doubtful accounts charged to general and administrative expense	54	17	19
Write-offs against allowance	(37)	(11)	(19)
Balance at end of period	$ 112	$ 95	$ 89

Inventories: The following table provides details of inventories:

	October 1, 2010	October 2, 2009
Raw material and parts	$ 42,167	$ 38,205
Work in process	24,531	20,542
Finished goods	8,510	8,249
	$ 75,208	$ 66,996

Reserve for loss contracts: The following table summarizes the activity related to reserves for loss contracts during fiscal years 2010 and 2009:

	Year Ended October 1, 2010	October 2, 2009
Balance at beginning of period	$ 4,068	$ 1,928
Provision for loss contracts, charged to cost of sales	4,157	4,173
Credit to cost of sales upon revenue recognition	(4,488)	(2,033)
Balance at end of period	$ 3,737	$ 4,068

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

	October 1, 2010	October 2, 2009
Inventories	$ 3,343	$ 3,967
Accrued expenses	394	101
	$ 3,737	$ 4,068

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Property, Plant and Equipment, Net: The following table provides details of property, plant and equipment, net:

	October 1, 2010	October 2, 2009
Land	$ 2,947	$ 2,947
Land improvements	1,861	1,851
Buildings	41,424	40,630
Machinery and equipment	48,610	45,935
Construction in progress	1,023	640
	95,865	92,003
Less: accumulated depreciation and amortization	(41,606)	(34,091)
Property, plant and equipment, net	$ 54,259	$ 57,912

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

	Weighted Average Useful Life (in years)	October 1, 2010			October 2, 2009		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
VED Core Technology	50	$ 30,700	$ (4,115)	$ 26,585	$ 30,700	$ (3,501)	$ 27,199
VED Application Technology	25	19,800	(5,297)	14,503	19,800	(4,505)	15,295
X-ray Generator and Satcom Application Technology	15	8,000	(3,574)	4,426	8,000	(3,042)	4,958
Antenna and Telemetry Technology	25	5,300	(665)	4,635	5,300	(453)	4,847
Customer backlog	1	580	(580)	-	580	(580)	-
Land lease	46	11,810	(1,687)	10,123	11,810	(1,434)	10,376

Tradename	20 - Indefinite	7,600	(495)	7,105	7,600	(275)	7,325
Customer list and programs	24	6,280	(1,485)	4,795	6,280	(1,218)	5,062
Noncompete agreement	5	530	(332)	198	640	(336)	304
Patent application fees	-	104	-	104	64	-	64
		$ 90,704	$ (18,230)	$ 72,474	$ 90,774	$ (15,344)	$ 75,430

Intangible assets, net as of October 1, 2010 and October 2, 2009 include a total of approximately $0.1 million of application costs and associated legal costs incurred to obtain certain patents. Once obtained, these patents 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 $3.0 million, $3.0 million and $3.4 million for fiscal years 2010, 2009 and 2008, respectively.

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

Fiscal Year	Amount
2011	3,003
2012	3,003
2013	2,883
2014	2,897
2015	2,897
Thereafter	54,591
	$ 69,274

Goodwill: The following table sets forth the changes in goodwill by reportable segment during fiscal years 2010 and 2009:

	October 1, 2010	October 2, 2009
VED	$ 132,621	$ 132,621
Satcom equipment	13,720	13,720
Other	15,884	15,884
	$ 162,225	$ 162,225

Accrued Expenses: The following table provides details of accrued expenses:

	October 1, 2010	October 2, 2009
Payroll and employee benefits	$ 14,254	$ 11,015
Accrued interest	1,735	1,786
Strategic alternative transaction expenses (Note 10)	1,495	-
Other accruals	6,169	6,214
	$ 23,653	$ 19,015

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Product Warranty: The following table summarizes the activity related to product warranty during fiscal years 2010 and 2009:

	Year Ended	
	October 1, 2010	October 2, 2009
Beginning accrued warranty	$ 3,845	$ 4,159
Actual costs of warranty claims	(5,451)	(4,524)
Estimates for product warranty, charged to cost of sales	6,707	4,210
Ending accrued warranty	$ 5,101	$ 3,845

4. Financial Instruments

FASB ASC 825 establishes a framework for measuring fair value and expands disclosures about fair value measurements by establishing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy under ASC 825 are described as follows:

Level 1	Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2	Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or the liability; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3	Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk, including the Company's own credit risk.

The Company's non-financial assets (including goodwill, intangible assets, inventories and long-lived assets) and liabilities are measured at fair value on a non-recurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances such as when they are deemed to be other-than-temporarily impaired. The fair values of these non-financial assets and liabilities are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. During fiscal year 2010, no fair value adjustments or material fair value measurements were required for the Company's non-financial assets or liabilities.

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The Company measures certain financial assets and liabilities at fair value on a recurring basis, including cash equivalents, restricted cash, available-for-sale securities and derivative instruments. As of October 1, 2010, financial assets utilizing Level 1 inputs included cash equivalents, such as money market and overnight U.S. Government securities and available-for-sale securities, such as mutual funds. Financial assets and liabilities utilizing Level 2 inputs included foreign currency derivatives and interest rate swap derivatives. The Company does not have any financial assets or liabilities requiring the use of Level 3 inputs.

The following tables set forth financial instruments carried at fair value within the ASC 825 hierarchy:

		Fair Value Measurements at October 1, 2010 Using		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market and overnight U.S. Government securities1	$ 36,420	$ 36,420	$ -	$ -
Mutual funds2	171	171	-	-
Foreign exchange forward derivatives3	437	-	437	-
Total assets at fair value	$ 37,028	$ 36,591	$ 437	-
Liabilities:				
Interest rate swap derivative4	$ 816	$ -	$ 816	$ -
Total liabilities at fair value	$ 816	$ -	$ 816	$ -

1 The money market and overnight U.S. Government securities are classified as part of cash and cash equivalents and restricted cash in the consolidated balance sheet.
2 The mutual funds are classified as part of other long-term assets in the consolidated balance sheet.
3 The foreign currency derivatives are classified as part of prepaid and other current assets in the consolidated balance sheet.
4 The interest rate swap derivatives are classified as part of accrued expenses in the consolidated balance sheet.

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		Fair Value Measurements at October 2, 2009 Using		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market and overnight U.S. Government securities1	$ 22,464	$ 22,464	$ -	$ -
Mutual funds2	152	152	-	-
Foreign exchange forward derivatives3	3,467	-	3,467	-
Total assets at fair value	$ 26,083	$ 22,616	$ 3,467	-
Liabilities:				
Interest rate swap derivative4	$ 2,323	$ -	$ 2,323	$ -
Total liabilities at fair value	$ 2,323	$ -	$ 2,323	$ -

1 The money market and overnight U.S. Government securities are classified as part of cash and cash equivalents and restricted cash in the consolidated balance sheet.

2 The mutual funds are classified as part of other long-term assets in the consolidated balance sheet.

3 The foreign currency derivatives are classified as part of prepaid and other current assets in the consolidated balance sheet.

4 The interest rate swap derivatives are classified as part of accrued expenses and other long-term liabilities in the consolidated balance sheet.

Investments Other Than Derivatives

In general and where applicable, the Company uses quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology applies to the Company’s Level 1 investments, such as money market, U.S. Government securities and mutual funds.

If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then the Company would use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. These investments would be included in Level 2.

Derivatives

The Company executes foreign exchange forward contracts to purchase Canadian dollars and holds a pay-fixed receive-variable interest rate swap contract, all executed in the retail market with its relationship banks. To determine the most appropriate value, the Company uses an in-exchange valuation premise which considers the assumptions that market participants would use in pricing the derivatives. The Company has elected to use the income approach and uses observable (Level 2) market expectations at the measurement date and standard valuation techniques to convert future amounts to a single present amount. Level 2 inputs for derivative valuations are midmarket quoted prices for similar assets or liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability.

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Key inputs for currency derivatives are spot rates, forward rates, interest rates and credit derivative rates. The spot rate for the Canadian dollar is the same spot rate used for all balance sheet translations at the measurement date. Forward premiums/discounts and interest rates are interpolated from commonly quoted intervals. Once valued, each forward is identified as either an asset or liability. Assets are further discounted using counterparty annual credit default rates, and liabilities are valued using the Company's credit as reflected in the spread paid over LIBOR on the term loan under the Company's senior credit facilities.

Key inputs for valuing the interest rate swap are the cash rates used for the short term (under 3 months), futures rates for up to three years and LIBOR swap rates for periods beyond. These inputs are used to derive variable resets for the swap as well as to discount future fixed and variable cash flows to present value at the measurement date. A credit spread is used to further discount each net cash flow using, for assets, counterparty credit default rates and, for liabilities, the Company's credit spread over LIBOR on the term loan under the Company's senior credit facilities.

See Note 7 for further information regarding the Company's derivative instruments.

Other Financial Instruments

The Company's other financial instruments include cash, restricted cash, accounts receivable, accounts payable and long-term debt. Except for long-term debt, the carrying value of these financial instruments approximates fair values because of their relatively short maturity.

The fair values of the Company's long-term debt were estimated using quoted market prices where available. For long-term debt not actively traded, fair values were estimated using discounted cash flow analyses, based on the Company's current estimated incremental borrowing rates for similar types of borrowing arrangements. The estimated fair value of the Company's long-term debt was $192.6 million and $188.5 million as of October 1, 2010 and October 2, 2009, respectively. See Note 5 for the carrying value of the long-term debt.

5. Long-Term Debt

Long-term debt comprises the following:

	October 1, 2010	October 2, 2009
Term loan	$ 66,000	$ 66,000
8% Senior subordinated notes due 2012	117,000	117,000
Floating rate senior notes due 2015, net of issue discount of $66 and $78	11,934	11,922
	194,934	194,922
Less: Current portion	66,000	-
Long-term portion	$ 128,934	$ 194,922

Standby letters of credit	$ 4,544	$ 5,544

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Senior Credit Facilities: CPI's senior credit facilities ("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.

Both the Term Loan and the Revolver will mature on August 1, 2011 if, prior to August 1, 2011, CPI has not repaid or refinanced its 8% Senior Subordinated Notes due 2012. If CPI repays or refinances its 8% Senior Subordinated Notes due 2012 prior to August 1, 2011, then the Term Loan would mature on August 1, 2014 and the Revolver would mature on August 1, 2013.

In August 2007, 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 is 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 varies depending on CPI's leverage ratio, as defined in the Senior Credit Facilities and ranges from 0.25% to 0.50%.

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.

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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 no payments on the Term Loan during fiscal year 2010. During fiscal years 2009 and 2008, CPI made repayments on the Term Loan of $22.8 million and $11.0 million, respectively. As of October 1, 2010, the principal balance of the Term Loan was $66.0 million.

At October 1, 2010, the amount available for borrowing under the Revolver, after taking into account the Company's outstanding letters of credit of $4.5 million, was approximately $55.5 million.

8% Senior Subordinated Notes due 2012 of CPI: As of October 1, 2010, CPI had $117.0 million in aggregate principal amount of its 8% Senior Subordinated Notes due 2012 (the "8% Notes"). CPI made no repurchase of any of the outstanding 8% Notes during fiscal year 2010. During fiscal year 2009, CPI repurchased a total of $8.0 million. CPI repurchased $3.0 million aggregate principal amount of the 8% Notes in January 2009 at a discount of 8.5% to par value. CPI paid approximately $2.9 million, including accrued interest of $0.1 million, for the repurchase and realized a net gain of approximately $0.2 million. CPI also repurchased $5.0 million aggregate principal amount of the 8% Notes in June 2009 at a discount of 2.75% to par value. CPI paid approximately $5.0 million, including accrued interest of $0.2 million, for the repurchase and realized a net gain of approximately $0.1 million. The 8% Notes have no sinking fund requirements.

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, CPI, at its option, may redeem the 8% Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount) thereof, 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 any given year. For year 2010 and thereafter, the optional redemption price is 100% of the principal amount of the 8% Notes.

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.

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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 October 1, 2010, $12.0 million of aggregate principal amount remained outstanding under CPI International's Floating Rate Senior Notes due 2015 (the "FR Notes"). CPI International redeemed none of its outstanding FR Notes during fiscal years 2010 and 2009. During fiscal year 2008, CPI International redeemed $10.0 million aggregate principal amount of the FR Notes. The FR Notes were originally issued at a 1% discount and 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 February 1, 2011 is 6.43% per annum. 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, 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) thereof, 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 any given year. For year 2010 and thereafter, the optional redemption price is 100% of the principal amount of the FR Notes.

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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.

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 October 1, 2010, maturities on long-term debt were as follows:

Fiscal Year	Term Loan	8% Senior Subordinated Notes	Floating Rate Senior Notes	Total
2011	$ 66,000	$ -	$ -	$ 66,000
2012	-	117,000	-	117,000
2013	-	-	-	-
2014	-	-	-	-
2015	-	-	12,000	12,000
	$ 66,000	$ 117,000	$ 12,000	$ 195,000

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 above table also excludes any optional prepayments.

As of October 1, 2010, 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.

(Gain) loss on debt extinguishment: The repurchase of $8.0 million of the 8% Notes during fiscal year 2009, as discussed above, resulted in a gain on debt extinguishment of $0.2 million which was comprised of a discount of $0.4 million, partially offset by a non-cash write-off of $0.2 million deferred debt issue costs. The redemption of $10.0 million of the FR Notes in fiscal year 2008 resulted in a loss on debt extinguishment of approximately $0.6 million, including non-cash write-offs of $0.4 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 7 for information on the interest rate swap agreements entered into by the Company to hedge the interest rate exposure associated with the Term Loan.

6. Employee Benefit Plans

Retirement Plans: The Company provides a qualified 401(k) investment plan covering substantially all of its domestic employees and a pension contribution plan covering substantially all of its Canadian employees. Discontinued as of end of fiscal year 2008, a profit sharing plan had also been provided by the Company, covering substantially all of its Econco employees. These plans provided for the Company to contribute an amount based on a percentage of each participant's base pay. The Company also has a Non-Qualified Deferred Compensation Plan (the "Non-Qualified Plan") that allows a select group of management and highly compensated employees to defer a portion of their compensation. The Non-Qualified Plan liability recorded by the Company amounted to approximately $0.4 million and $0.3 million as of October 1, 2010 and October 2, 2009, respectively. For all of the Company's current retirement plans, all participant contributions and Company matching contributions are 100% vested. Total CPI contributions to these retirement plans were $2.7 million, $2.6 million and $3.7 million for fiscal years 2010, 2009 and 2008, respectively. The Company's contributions were lower in fiscal years 2010 and 2009 as the Company reduced its contributions to the retirement plans as a cost savings measure, which was restored to prior levels during fiscal year 2010.

Defined Benefit Pension Plan: The Company maintains a defined benefit pension plan for its Chief Executive Officer ("CEO"). The plan's benefits are based on the CEO's compensation earnings and are limited by statutory requirements of the Canadian Income Tax Act. All costs of the plan are borne by the Company.

At October 1, 2010 and October 2, 2009, the Company recorded a liability of $0.4 million and $0.3 million, respectively, which approximates the excess of the projected benefit obligation over plan assets of $0.9 million and $0.8 million, respectively. Additionally, the Company recorded an unrealized loss of $0.3 million, net of tax of $0.1 million, as of October 1, 2010; an unrealized loss of $0.2 million, net of tax of $0.1 million, as of October 2, 2009; and an unrealized loss of $0.2 million, net of tax of $0.1 million, as of October 3, 2008 to accumulated other comprehensive (loss) income in the consolidated balance sheets..

The Company's defined benefit pension plan is managed by an insurance company consistent with regulations or market practice in Canada, where the plan assets are invested. Net pension expense was not material for any period. Contributions to the plan are not expected to be significant to the financial position of the Company.

7. Derivative Instruments and Hedging Activities

Foreign Exchange Forward Contracts: Although the majority of the Company's revenue and expense activities are transacted in U.S. dollars, the Company does transact business in foreign countries. The Company's primary foreign currency cash flows are in Canada and several European countries. In an effort to reduce its foreign currency exposure to Canadian dollar denominated expenses, the Company enters into Canadian dollar forward contracts to hedge the Canadian dollar denominated costs for its manufacturing operation in Canada. The Company does not engage in currency speculation.

The Company's Canadian dollar forward contracts in effect as of October 1, 2010 have durations of 7 to 11 months. These contracts are designated as cash flow hedges and are considered highly effective, as defined by FASB ASC 815. Unrealized gains and losses from foreign exchange forward contracts are included in accumulated other comprehensive (loss) income in the consolidated balance sheets. At October 1, 2010, the unrealized gain, net of tax of $0.3 million, was $0.7 million. The Company anticipates recognizing the entire unrealized gain or loss in operating earnings within the next four fiscal quarters. 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 expenses in the consolidated statements of income. The time value was not material for fiscal years 2010, 2009 and 2008. If the transaction being hedged fails to occur, or if a portion of any derivative is ineffective, then the Company immediately recognizes the gain or loss on the associated financial instrument in general and administrative expenses in the consolidated statements of income. The gain recognized in general and administrative expenses due to hedge ineffectiveness for fiscal year 2010 was $0.1 million. No ineffective amounts were recognized due to anticipated transactions failing to occur in fiscal years 2009 and 2008.

As of October 1, 2010, the Company had entered into Canadian dollar forward contracts for approximately $14.1 million (Canadian dollars), or approximately 39% of estimated Canadian dollar denominated expenses for October 2010 through June 2011, at an average rate of approximately 0.94 U.S. dollars to Canadian dollars.

Interest Rate Contracts: The Company also uses derivative instruments in order to manage interest costs and risk associated with its long-term debt. During fiscal year 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 such that it is less than the balance of its Term Loan under the Senior Credit Facilities discussed in Note 5. The notional value of the 2007 Swap was $30.0 million at October 1, 2010 and represented approximately 45% of the aggregate Term Loan balance. The Swap agreement is effective through June 30, 2011. Under the provisions of ASC 815, 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 (loss) income in the consolidated balance sheets. At October 1, 2010, the unrealized loss, net of tax of $0.3 million, was $0.5 million. The interest rate swap gain or loss is included in the assessment of hedge effectiveness. Gains and losses representing hedge ineffectiveness are immediately recognized in interest expense, net, in the consolidated statements of income.

See Note 4, Financial Instruments, for further information regarding the Company's derivative instruments.

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The following table summarizes the fair value of derivative instruments designated as cash flow hedges at October 1, 2010 and October 2, 2009:

	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
	Balance Sheet Location	October 1, 2010	October 2, 2009	Balance Sheet Location	October 1, 2010	October 2, 2009
Derivatives designated as hedging instruments						
Interest rate contracts				Accrued expenses	$ 816	$ 1,766
Interest rate contracts				Other long-term liabilities	-	557
Forward contracts	Prepaid and other current assets	$ 437	$ 3,467			
Total derivatives designated as hedging instruments		$ 437	$ 3,467		$ 816	$ 2,323

As of October 1, 2010 and October 2, 2009, all of the Company’s derivative instruments were classified as hedging instruments under ASC 815.

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The following table summarizes the effect of derivative instruments on the consolidated statements of income and comprehensive income for fiscal years 2010 and 2009:

Derivatives in Cash Flow Hedging Relationships	Amount of (Loss) Gain Recognized in OCI on Derivative (Effective Portion) Year Ended October 1, 2010	October 2, 2009	Location of (Loss) Gain Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of (Loss) Gain Reclassified from Accumulated OCI into Income (Effective Portion) Year Ended October 1, 2010	October 2, 2009	Location of (Loss) Gain Recognized in Income on Derivative (Ineffective and Excluded Portion)	Amount of (Loss) Gain Recognized in Income on Derivative (Ineffective and Excluded Portion) Year Ended October 1, 2010	October 2, 2009
Interest rate contracts	$ (355)	$ (2,173)	Interest expense, net	$ (1,862)	$ (1,797)	Interest expense, net	$ (36)	$ (51)
Forward contracts	1,236	(315)	Cost of sales	3,150	(3,963)	General and administrative	45 (a)	(321)
			Research and development	365	(192)			
			Selling and marketing	158	(106)			
			General and administrative	219	(317)			
Total	$ 881	$ (2,488)		$ 2,030	$ (6,375)		$ 9	$ (372)

(a) The amount of gain recognized in income during fiscal year 2010 represents a $62 gain related to the ineffective portion of the hedging relationships, net of $17 loss related to the amount excluded from the assessment of hedge effectiveness. The amount of loss recognized in income during fiscal year 2009 represents a $323 loss related to the amount excluded from the assessment of hedge effectiveness, net of a $2 gain related to the ineffective portion of the hedging relationships.

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As a result of the use of derivative instruments, the Company is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. The Company does not hold collateral or other security from its counterparties supporting its derivative instruments. To mitigate the counterparty credit risk, the Company has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors. The Company regularly reviews its credit exposure balances as well as the creditworthiness of its counterparties.

When the Company’s derivatives are in a net asset position, such as the case with the Company’s forward foreign exchange contract derivatives at October 1, 2010, the Company is exposed to credit loss from nonperformance by the counterparty. If the counterparty fails to perform, credit risk with such counterparty is equal to the extent of the fair value gain in the derivative. At October 1, 2010, the Company’s interest rate contract derivatives were in a net liability position, and the Company, therefore, was not exposed to the interest rate contract counterparty credit risk.

8. 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 October 1, 2010 were as follows:

Fiscal Year	Operating Leases
2011	$ 1,409
2012	1,128
2013	699
2014	422
2015	219
Thereafter	2,443
	$ 6,320

Real estate taxes, insurance, and maintenance are also obligations of the Company. Rental expense under non-cancelable operating leases amounted to $2.5 million for each of fiscal years 2010, 2009 and 2008. Assets subject to capital leases at October 1, 2010 and October 2, 2009 were not material.

Guarantees: The Company has restricted cash of $1.8 million and $1.6 million as of October 1, 2010 and October 2, 2009, 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.

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Purchase commitments: As of October 1, 2010, 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
2011	$ 28,519
2012	326
2013	5
2014	-
2015	-
	$ 28,850

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 the Company’s 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. Management believes that the likelihood of loss under these agreements is remote.

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

Contingencies: From time to time, the Company may be subject to claims that arise in the ordinary course of business. Except as noted below, 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.

On July 1, 2010, a putative stockholder class action complaint was filed against the Company, the members of the Company's board of directors, and Comtech Telecommunications Corporation ("Comtech"). The lawsuit concerns the proposed merger between the Company and Comtech, and generally asserts claims alleging, among other things, that each member of the Company's board of directors breached his fiduciary duties by agreeing to the terms of the previously proposed merger and by failing to provide stockholders with allegedly material information related to the proposed merger, and that Comtech aided and abetted the breaches of fiduciary duty allegedly committed by the members of the Company's board of directors. The lawsuit seeks, among other things, class action certification and monetary relief. On July 28, 2010, the plaintiff filed an amended complaint, making generally the same claims against the same defendants, and seeking the same relief. In addition, the amended complaint generally alleges that the consideration that would have been paid to the Company's stockholders under the terms of the proposed merger was inadequate. On September 7, 2010, the Company terminated the Comtech sale agreement. On November 24, 2010, the Company entered in an agreement and plan of merger with Catalyst Holdings, Inc. and Catalyst Acquisition, Inc. which are affiliates of The Veritas Capital Fund IV, L.P. ("Veritas"). On December 9, 2010, the plaintiff filed a motion for leave to file a second amended complaint which, among other things, amends its breach of fiduciary duty claims to allege that the Company and its board of directors, as well as Cypress Associates II LLC, breached fiduciary duties in connection with the proposed merger of the Company with a Veritas affiliate, adds a claim for attorneys' fees for the benefit the plaintiff purportedly obtained as a result of its previous prosecution of this action, and adds claims against Veritas and its affiliates for aiding and abetting the aforementioned breaches of fiduciary duties. The action continues to seek, among other things, class action certification and monetary relief. The Company believes all claims asserted in the lawsuit to be without merit.

During fiscal year 2009, the Company received a notice from a customer purporting to terminate a sales contract due to alleged nonperformance. In April and June 2010, the Company received notices from the customer claiming additional cost incurred due to the alleged nonperformance. The customer has filed a claim for damages of approximately $2.1 million and the Company has filed a counterclaim for damages of approximately $0.9 million. The Company plans to contest this matter vigorously. At this time, the Company believes that any loss or gain with respect to this matter will not have a material effect on the Company's consolidated results of operations and cash flows.

All legal costs are expensed as incurred.

9. Stockholders' Equity

Common and Preferred Stock: The Company has 90,000,000 authorized shares of Common Stock, par value $0.01 per share, and 10,000,000 authorized shares of Preferred Stock, par value $0.01 per share. The holder of each share of Common Stock has the right to one vote. The board of directors has the authority to issue the undesignated Preferred Stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof. At October 1, 2010 and October 2, 2009, there were no shares of Preferred Stock outstanding.

Treasury Stock: Pursuant to its May 2008 publicly announced share repurchase program, the Company repurchased 206,243 shares at an average per share price of $13.54, plus average brokerage commissions of $0.04 per share, for an aggregate cost of $2.8 million during fiscal year 2008. Repurchased shares have been recorded as treasury shares and will be held until the Company’s board of directors designates that these shares be retired or used for other purposes.

Stock-Based Compensation Plans: The Company has two active stock plans: the 2006 Equity and Performance Incentive Plan (the “2006 Plan”) and the 2006 Employee Stock Purchase Plan (the “2006 ESPP”).

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2006 Plan: The 2006 Plan provides for an aggregate of up to 2,800,000 shares of CPI International's common stock to be available for awards, plus the number of shares subject to awards granted under the 2004 Stock Incentive Plan (the "2004 Plan") and the 2000 Stock Option Plan (the "2000 Plan") that are forfeited, expire or are cancelled after the effective date of the 2006 Plan. All of the Company's employees (including officers), directors, and consultants are eligible for awards under the 2006 Plan. The 2006 Plan is administered by the Compensation Committee of the Company's board of directors ("Compensation Committee") and awards may consist of options, stock appreciation rights, restricted stock, other stock unit awards, performance awards, dividend equivalents or any combination of the foregoing. The exercise price for stock options generally cannot be less than 100% of the fair market value of the shares on the date of grant. Effective February 2009, future share-based awards (other than option and stock appreciation right awards) made under the 2006 Plan will count as two shares for purposes of determining whether the cap on the total number of shares issuable under the 2006 Plan has been exceeded. Approximately 1,285,000 shares were available for grant as of October 1, 2010.

2006 ESPP: The 2006 ESPP permits eligible employees to purchase common stock at a discounted price. An aggregate of 760,000 shares of common stock is reserved for issuance under this plan. The stock purchase plan is administered by the Compensation Committee. Employees participating in the plan may purchase stock for their accounts according to a price formula set by the Compensation Committee, as administrator, before the applicable offering period, which cannot exceed 24 months. The price per share will equal either a fixed percentage (which may not be lower than 85%) of the fair market value of a share of common stock on the last day of the purchase period in the offering, or the lower of (1) a fixed percentage (not to be less than 85%) of the fair market value of a share of common stock on the date of commencement of participation in the offering and (2) a fixed percentage (not to be less than 85%) of the fair market value of a share of common stock on the date of purchase as determined by the Compensation Committee. Under the 2006 ESPP, approximately 477,000 shares of common stock were available for issuance as of October 1, 2010.

The Company has two other stock plans, the 2004 Plan and the 2000 Plan mentioned above, that were terminated as to future grants. Although these plans have been terminated as to future grants, they continue to govern all awards granted under them.

Stock Options: Options outstanding that have vested and are expected to vest as of October 1, 2010 are as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Vested	2,915,483	$ 5.61	3.8	$ 25,930
Expected to vest	430,539	13.29	7.5	871
Total	3,346,022	6.60	4.2	$ 26,801

Options outstanding that are expected to vest are net of estimated future option forfeitures in accordance with the provisions of FASB ASC 718, "Compensation—Stock Compensation."

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Additional information with respect to stock option activity is as follows:

	Oustanding Options				Exercisable Options			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic 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	(8,906)	4.32						
Forfeited or cancelled	(21,631)	17.75						
Balance at October 3, 2008	3,349,294	$ 6.23	5.77	$ 24,363	2,556,762	$ 3.83	5.16	$ 23,052
Granted	108,000	10.00						
Exercised	(57,382)	1.44						
Forfeited or cancelled	(17,149)	16.85						
Balance at October 2, 2009	3,382,763	$ 6.38	4.95	$ 20,362	2,845,996	$ 4.73	4.43	$ 20,227
Granted	108,000	9.66						
Exercised	(126,446)	1.83						
Forfeited or cancelled	(17,125)	16.42						
Balance at October 1, 2010	3,347,192	$ 6.60	4.24	$ 26,801	2,915,483	$ 5.61	3.76	$ 25,930

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value of in-the-money options that would have been received by the option holders had all option holders exercised their options at the Company's closing stock price on the date indicated. As of October 1, 2010, approximately 2.4 million exercisable options were in-the-money.

During fiscal years 2010, 2009 and 2008, cash received from option exercises was approximately $0.2 million, $0.1 million and $38,000, and the total intrinsic value of options exercised was approximately $1.5 million, $0.4 million and $0.1 million, respectively. As of October 1, 2010, there was approximately $1.5 million of total unrecognized compensation costs related to nonvested stock options, which is expected to be recognized over a weighted-average vesting period of 1.3 years.

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Outstanding and exercisable options presented by exercise price at October 1, 2010 are as follows:

	Options Outstanding		Exercisable Options	
Exercise Price	Number of Options Outstanding	Weighted-Average Remaining Contractual Term (Years)	Number of Options Exercisable	Weighted-Average Remaining Contractual Term (Years)
$ 0.20	618,364	2.4	618,364	2.4
$ 0.74	23,153	1.1	23,153	1.1
$ 1.08	8,000	3.3	8,000	3.3
$ 4.32	1,666,531	3.5	1,666,531	3.5
$ 6.61	49,032	4.0	49,032	4.0
$ 6.98	21,412	4.5	21,412	4.5
$ 9.66	108,000	9.2	-	-
$ 10.00	108,000	8.2	13,500	8.2
$ 14.22	270,375	6.2	202,500	6.2
$ 16.79	192,325	7.2	96,741	7.2
$ 16.94	1,500	7.2	750	7.2
$ 17.09	6,000	6.4	6,000	6.4
$ 18.00	263,500	5.6	199,500	5.6
$ 19.53	7,000	7.0	7,000	7.0
$ 19.80	4,000	6.6	3,000	6.6
Total	3,347,192	4.2	2,915,483	3.8

Stock Purchase Plan: Employees purchased approximately 49,000 shares, 111,000 shares, and 72,000 shares in fiscal years 2010, 2009 and 2008, respectively, for $0.6 million, $1.0 million and $0.9 million, respectively, under the 2006 ESPP. As of October 1, 2010, there were no unrecognized compensation costs related to rights to acquire stock under the 2006 ESPP.

Restricted Stock and Restricted Stock Units: As of October 1, 2010, October 2, 2009 and October 3, 2008, there were outstanding 310,341, 218,298 and 117,154, respectively, of nonvested restricted stock and restricted stock units, in each case, granted to directors and employees. The restricted stock and restricted stock units generally vest over periods of one to four years. Upon vesting, each restricted stock unit will automatically convert into one share of common stock of CPI International.

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Additional information with respect to outstanding restricted stock and restricted stock unit activity is as follows:

	Number of Shares	Weighted-Average Grant-Date Fair Value Per Share	Aggregate Fair Value*
Nonvested at September 28, 2007	11,466	$ 17.44	
Granted	114,461	$ 15.22	
Vested	(5,848)	$ 17.60	$ 62
Forfeited	(2,925)	$ 16.79	
Nonvested at October 3, 2008	117,154	$ 15.28	
Granted	142,721	$ 8.87	
Vested	(36,377)	$ 14.81	$ 233
Forfeited	(5,200)	$ 10.85	
Nonvested at October 2, 2009	218,298	$ 11.27	
Granted	163,307	$ 10.04	
Vested	(65,914)	$ 11.87	$ 778
Forfeited	(5,350)	$ 10.44	
Nonvested at October 1, 2010	310,341	$ 10.51	

* Based on the value of the Company's stock on the date that the restricted stock units vest.

During the first quarter of fiscal year 2010, the Company granted 104,800 restricted stock units with time vesting criteria to certain of its non-executive employees and 36,000 restricted stock units with performance vesting criteria to its officers.

During the second quarter of fiscal year 2010, the Company granted certain members of its board of directors a total of 22,507 shares of restricted stock which will vest within the following three years.

Aggregate intrinsic value of the nonvested restricted stock and restricted stock unit awards at October 1, 2010 and October 2, 2009 was $4.4 million and $2.5 million, respectively. As of October 1, 2010, there was $2.3 million of unrecognized compensation costs related to restricted stock and restricted stock unit awards. The unrecognized compensation cost is expected to be recognized over a weighted average period of 1.7 years.

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

Valuation and Expense Information

The fair value of the Company’s time-based option awards is estimated on the date of grant using the Black-Scholes model. The fair value of each market performance-based (or combination of market performance- and time-based) option, restricted stock and restricted stock unit award is estimated on the date of grant using the Monte Carlo simulation technique in a risk-neutral framework.

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The Black-Scholes and the Monte Carlo simulation valuation models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable and require the input of subjective assumptions, including the expected stock price volatility and estimated option life. The Company currently does not intend to pay dividends and, accordingly, no dividends have been assumed in its Black-Scholes calculation and Monte Carlo simulation. Since the Company's common stock has not been publicly traded for a sufficient time period, the expected volatility is based on a blend of expected volatilities of similar companies and that of the Company based on its available historical data. 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 time-based options granted is based on integrating historical data with the simplified method for plain vanilla options in accordance with ASC 718. The integration of historical data with the simplified method is done by using the actual life for options that have been settled, and a uniform distribution assumption for the options still outstanding. The Company will continue to use historical data with the simplified method until it has enough historical experience to provide a reasonable estimate of expected term.

Stock Options. Assumptions used in the Black-Scholes model to estimate the fair value of time-based option grants are presented below.

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
Expected term (in years)	7.79	-	6.25
Expected volatility	60.50 %	- %	41.20 %
Dividend yield	0.00 %	- %	0.0 %
Risk-free rate	3.0 %	- %	3.8 %

There were no time-based options granted during fiscal year 2009.

Assumptions used in the Monte Carlo simulation model to estimate the fair value of time- and market performance-based options first granted during fiscal year 2009 are presented below.

Contractual term (in years)	10.00
Expected volatility	51.50 %
Risk-free rate	3.5 %
Dividend yield	0 %

There were no time-based and market performance-based options granted during fiscal years 2010 and 2008.

The weighted-average grant-date fair value of all the options granted during fiscal years 2010, 2009 and 2008 was $6.25, $5.61 and $7.83 per share, respectively.

Stock Purchase Plan. Based on the 15% discount received by the employees, the weighted-average fair value of shares issued under the 2006 ESPP was $2.08, $1.51 and $2.08 per share during fiscal years 2010, 2009 and 2008, respectively.

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Restricted Stock and Restricted Stock Units. The fair value of each time-based restricted stock and restricted stock unit award and of each performance-based restricted stock unit award is calculated using the market price of the Company's common stock on the date of grant. The fair value of each performance-based restricted stock unit award assumes that the relevant performance criteria will be met and the target payout level will be achieved. Compensation cost is adjusted for subsequent changes in the outcome of performance-related conditions until the award vests.

Assumptions used in the Monte Carlo simulation model to estimate the fair value of time- and market performance-based restricted stock and restricted stock units first granted during fiscal year 2009 are presented below.

Expected volatility	51.50	%
Risk-free rate	3.5	%
Dividend yield	0	%

There were no time- and market performance-based restricted stock and restricted stock units granted during fiscal years 2010 and 2008.

The weighted-average estimated fair value of restricted stock and restricted stock units granted was $10.04, $8.87 and $15.22 per share during fiscal years 2010, 2009 and 2008, respectively.

As stock-based compensation expense recognized in the consolidated statement of income for all fiscal years presented is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FASB ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The following table summarizes stock-based compensation expense for fiscal years 2010, 2009, and 2008, which was allocated as follows:

	Year Ended October 1, 2010		October 2, 2009		October 3, 2008	
Share-based compensation cost recognized in the statement of income by caption:						
Cost of sales	$	575	$	506	$	425
Research and development		200		174		153
Selling and marketing		284		262		229
General and administrative		1,981		1,737		1,328
	$	3,040	$	2,679	$	2,135
Share-based compensation cost capitalized in inventory	$	586	$	516	$	453
Share-based compensation cost remaining in inventory at end of	$	97	$	86	$	76

period						
Share-based compensation expense by type of award:						
Stock options	$	1,831	$	1,746	$	1,544
Restricted stock and restricted stock units		1,105		804		438
Stock purchase plan		104		129		153
	$	3,040	$	2,679	$	2,135

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The tax benefit realized from option exercises and restricted stock vesting totaled approximately $0.8 million, $0.2 million and $50,000 during fiscal years 2010, 2009 and 2008, respectively.

10. Termination of Merger Agreement with Comtech

On September 7, 2010, the Company and Comtech entered into a Termination and Release Agreement, by which the Company and Comtech terminated a previously announced merger agreement, dated May 8, 2010. The termination was by mutual agreement of the companies and was unanimously approved by the Company's board of directors and the board of directors of Comtech. As part of the termination, the Company has paid Comtech a termination fee of $15.0 million. In addition, the Company has incurred during fiscal year 2010 transaction expenses relating to the proposed merger in the amount of $4.9 million. Such transaction expenses comprised fees for investment bankers, attorneys and other professional services rendered in connection with the proposed merger, as well as with the related stockholder class lawsuit described in Note 8 above. The total expenses of $19.9 million is presented as "strategic alternative transaction expenses" in the consolidated statement of income for fiscal year 2010.

11. Income Taxes

Income (loss) before income taxes consisted of the following:

	Year Ended October 1, 2010	Year Ended October 2, 2009	Year Ended October 3, 2008
U.S.	$ (2,914)	$ 15,206	$ 20,405
Foreign	15,275	8,042	10,848
	$ 12,361	$ 23,248	$ 31,253

Income tax expense (benefit) consisted of the following:

	Year Ended October 1, 2010	Year Ended October 2, 2009	Year Ended October 3, 2008
Current			
Federal	$ 5,879	$ 1,263	$ 6,904
State	857	1,083	1,980
Foreign	3,751	(1,201)	3,035
	10,487	1,145	11,919
Deferred			
Federal	(4,230)	(99)	(934)
State	(268)	(738)	(208)
Foreign	(367)	(526)	27
	(4,865)	(1,363)	(1,115)

Income tax expense	$ 5,622	$ (218)	$ 10,804

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The differences between the effective income tax rate and the federal statutory income tax rate were as follows:

	Year Ended October 1, 2010		October 2, 2009		October 3, 2008	
Statutory federal income tax rate	35.0	%	35.0	%	35.0	%
Domestic manufacturing deduction	(3.2	)	(1.7	)	(1.5	)
Foreign tax rate differential	(10.0	)	(2.8	)	(2.3	)
State taxes	2.8		4.3		3.7	
Research and development credit	(3.1	)	(1.3	)	-	
Tax contingency reserve accrual (reversal)	23.9		(14.6	)	0.5	
Correction of error from prior year	-		(7.2	)	(1.4	)
New state legislation	-		(2.9	)	-	
Tax treaty benefits	-		(12.1	)	-	
Other differences	0.1		2.4		0.6	
Effective tax rate	45.5	%	(0.9	) %	34.6	%

The effective tax rate for fiscal year 2010 was 45.5% and diverged from the federal and state statutory rate primarily due to a $3.1 million discrete tax expense on an uncertain tax position for strategic alternative transaction expenses.

Deferred income taxes reflect the net tax effects of temporary differences between the basis of assets and liabilities for financial reporting and income tax purposes. The Company’s deferred tax assets (liabilities) were as follows:

		October 1, 2010			October 2, 2009	
Deferred tax assets:						
Inventory and other reserves	$	6,699		$	6,539	
Accrued vacation		1,758			1,607	
Deferred compensation and other accruals		6,448			5,338	
Tax credit carryforward		2,241			-	
Other		1,695			2,001	
Gross deferred tax assets		18,841			15,485	
Valuation allowance		-			-	
Total deferred tax assets	$	18,841		$	15,485	
Deferred tax liabilities:						
Accelerated depreciation	$	(6,084	)	$	(7,122	)
Acquisition-related intangibles		(23,022	)		(23,659	)

Other comprehensive income		-		(432)
Unremitted foreign earnings		(92)		(63)
Other long-term deferred tax liabilities		(320)		(283)
Total deferred tax liabilities	$	(29,518)	$	(31,559)
Net deferred tax liabilities	$	(10,677)	$	(16,074)

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Realization of the Company's net deferred tax assets is based upon the weight of available evidence, including such factors as recent earnings history and expected future taxable income. The Company believes it is more likely than not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. As of October 1, 2010, the Company had federal tax credit carryforwards of $2.2 million. If not utilized, the federal tax credit carryforwards will begin to expire in 2019.

The net deferred tax assets (liabilities) were classified in the consolidated balance sheet as follows:

	October 1, 2010	October 2, 2009
Deferred tax assets (Current asset)	$ 11,030	$ 8,652
Deferred income taxes (Long-term liability)	(21,707)	(24,726)
Net deferred tax liabilities	$ (10,677)	$ (16,074)

The Company has not provided deferred taxes on approximately $21.8 million of the Company's undistributed earnings in its Canadian operations which are intended to be permanently reinvested. The amount of unrecognized deferred tax liability related to this temporary difference is estimated to be approximately $2.7 million.

The total unrecognized tax benefits, excluding any related interest accrual, are reported in the consolidated balance sheet in the following accounts:

	October 1, 2010	October 2, 2009
Income taxes payable	$ 2,744	$ 2,713
Other long-term liabilities	3,841	615
	$ 6,585	$ 3,328

Of the total unrecognized tax benefit balance, $6.3 million and $2.4 million would reduce the effective tax rate if recognized as of October 1, 2010 and October 2, 2009, respectively. The Company believes that it is reasonably possible that, in the next 12 months, the amount of unrecognized tax benefits related to the resolution of federal, state and foreign matters could be reduced by $2.7 million as audits close, statutes expire and amended tax returns are filed.

As of October 1, 2010 and October 2, 2009, the Company had $0.8 million and $0.6 million of accrued income tax related interest and penalties on unrecognized tax benefits, respectively. Interest included in the Company's provision for income taxes was an expense of $0.2 million for fiscal year 2010 and a benefit of $1.2 million for fiscal year 2009. If the accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced in the period that such determination is made, and reflected as a reduction of the income tax provision.

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A reconciliation of the beginning and ending balances of the total amount of unrecognized tax benefits, excluding accrued interest and penalties is as follows:

	Year Ended October 1, 2010	Year Ended October 2, 2009
Unrecognized tax benefits - beginning of year	$ 3,328	$ 5,609
Settlements and effective settlements with tax authorities and related remeasurements	-	(75)
Decrease in balances related to expiration of statute of limitations	(82)	-
Increase in balances related to tax positions taken in current year	3,312	228
Decrease in balances related to tax positions taken in prior years	(86)	(2,964)
Increase in balances related to tax positions taken in prior years	31	512
Changes due to translation of foreign currency	82	18
Unrecognized tax benefits - end of year	$ 6,585	$ 3,328

The Company files U.S. federal, California and other U.S. states, Canada and other foreign jurisdictions income tax returns. Generally, fiscal years 2006 to 2009 remain open to examination by the various taxing jurisdictions and 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 international jurisdictions in which it operates. The years under examination by the Canadian taxing authorities are 2001 to 2002.

Based on the outcome of examinations of the Company and 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 Company has provided for amounts of anticipated tax audit adjustments in various jurisdictions based on its reasonable estimate of additional taxes and interest that do not meet the more likely than not standard under the accounting guidance for uncertainty in income taxes.

The Canada Revenue Agency (“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. The Company believes that adequate accruals have been provided for any adjustments that may result from the CRA examination.

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12. Earnings Per Share

As discussed in Note 2, the Company adopted ASC 260 effective October 3, 2009. Under ASC 260, earnings per share is computed using the two-class method, which is an earnings allocation method for computing earnings per share that treats a participating security as having rights to earnings that would otherwise have been available to common stockholders. Certain of the Company's stock-based compensation awards pay nonforfeitable dividends to the participants during the vesting period and, as such, are deemed participating securities. Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding that are increased for additional shares that would be outstanding if potentially dilutive non-participating securities were converted to common shares, pursuant to the treasury stock method.

Earnings per share for the respective periods were calculated as follows:

	Year Ended		
	October 1, 2010	October 2, 2009 1	October 3, 2008 1
Basic Earnings per Share			
Net income	$ 6,739	$ 23,466	$ 20,449
Income allocated to participating securities	(116)	(286)	(118)
Net income available to common shareholders	$ 6,623	$ 23,180	$ 20,331
Basic weighted average common shares outstanding	16,571	16,343	16,356
Net income per common share - Basic	$ 0.40	$ 1.42	$ 1.24
Diluted Earnings per Share			
Net income	$ 6,739	$ 23,466	$ 20,449
Income allocated to participating securities	(108)	(268)	(110)
Net income available to common shareholders	$ 6,631	$ 23,198	$ 20,339
Basic weighted average common shares outstanding	16,571	16,343	16,356
Effect of dilutive stock options	1,266	1,100	1,328
Diluted weighted average common shares outstanding	17,837	17,443	17,684
	$ 0.37	$ 1.33	$ 1.15

Net income per common share - Diluted

1 Restated in accordance with ASC 260.

The calculation of diluted net income per share excludes all anti-dilutive shares from stock options. For fiscal years 2010, 2009 and 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 743,000, 864,000 and 731,000 shares, respectively.

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13. 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.

The Company's reportable segments, VED and satcom equipment, are differentiated based on their underlying profitability and economic performance. The VED segment is made up of four divisions, that have been aggregated based on the similarity of their economic characteristics as measured by EBITDA, and the similarity of their products and services, production processes, types of customers and distribution methods, and nature of regulatory environments. The satcom equipment segment consists of one division. The Company's analysis of the similarity of economic characteristics was based on both a historical and anticipated future analysis of performance.

The VED segment develops, manufactures and distributes high power/high frequency microwave and radio frequency signal components. Its products include linear beam, cavity, power grid, crossed field and magnetron devices. These products are used in the communication, radar, electronic countermeasures, industrial, medical and scientific markets depending on the specific power and frequency requirements of the end-user and the physical operating conditions of the environment in which the VED will be located. These products are distributed through the Company's direct sales force, independent sales representatives and distributors.

The satcom equipment segment manufactures and supplies high power amplifiers and networks for satellite communication uplink and industrial applications. This segment also provides spares, service and other post sales support. Its products are distributed through the Company's direct sales force and independent sales representatives.

Amounts not reported as VED or satcom equipment are reported as Other. In accordance with quantitative and qualitative guidelines established by FASB ASC 280, "Segment Reporting." Other includes the activities of the Company's 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, unmanned aerial vehicles ("UAVs") and shipboard systems.

Sales and marketing, and certain administration expenses, are allocated to the divisions and are included in the results reported. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment product transfers are recorded at cost.

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

	Year Ended October 1, 2010	Year Ended October 2, 2009	Year Ended October 3, 2008
Sales from external customers			
VED	$ 259,141	$ 246,717	$ 279,364
Satcom equipment	85,984	69,534	74,264
Other	15,309	16,625	16,386
	$ 360,434	$ 332,876	$ 370,014
Intersegment product transfers			
VED	$ 24,033	$ 18,070	$ 27,462
Satcom equipment	96	9	116
	$ 24,129	$ 18,079	$ 27,578
Capital expenditures			
VED	$ 3,294	$ 2,536	$ 2,659
Satcom equipment	426	141	692
Other	772	688	911
	$ 4,492	$ 3,365	$ 4,262
EBITDA			
VED	$ 65,787	$ 54,791	$ 69,923
Satcom equipment	9,451	5,598	5,997
Other	(36,592)	(9,368)	(14,649)
	$ 38,646	$ 51,021	$ 61,271

	October 1, 2010	October 2, 2009
Total assets		
VED	$ 326,117	$ 324,490
Satcom equipment	48,355	46,720
Other	103,804	87,044
	$ 478,276	$ 458,254

EBITDA is the measure used by the CODM to evaluate segment profit or loss. EBITDA represents earnings before net interest expense, provision for income taxes and depreciation and amortization. The Company believes that EBITDA is a more meaningful representation of segment operating performance for leveraged businesses like its own and therefore uses this metric as its internal measure of profitability. For the reasons listed below, the Company believes EBITDA provides investors better understanding of 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;

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- the Company's 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;

- 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 or superior to, operating income, net income, cash flows from operating activities or other statements of income or statements of cash flows data prepared in accordance with U.S. GAAP. Operating income by the Company's reportable segments was as follows:

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
Operating income			
VED	$ 59,765	$ 49,006	$ 64,431
Satcom equipment	8,726	4,861	5,327
Other	(40,917)	(13,888)	(18,817)
	$ 27,574	$ 39,979	$ 50,941

The following table reconciles net income to EBITDA:

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
Net income	$ 6,739	$ 23,466	$ 20,449
Depreciation and amortization	11,072	10,794	10,963
Interest expense, net	15,213	16,979	19,055
Income tax expense (benefit)	5,622	(218)	10,804
EBITDA	$ 38,646	$ 51,021	$ 61,271

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Net property, plant and equipment by geographic area were as follows:

	October 1, 2010	October 2, 2009
United States	$ 41,746	$ 45,028
Canada	12,290	12,831
Other	223	53
Total	$ 54,259	$ 57,912

With the exception of goodwill, the Company does not identify or allocate assets by operating segment, nor does its CODM evaluate operating segments using discrete asset information.

Goodwill by geographic area was as follows:

	October 1, 2010	October 2, 2009
United States	$ 114,252	$ 114,252
Canada	47,973	47,973
	$ 162,225	$ 162,225

Geographic sales by customer location were as follows for external customers:

	Year Ended		
	October 1, 2010	October 2, 2009	October 3, 2008
United States	$ 230,888	$ 210,590	$ 237,909
All foreign countries	129,546	122,286	132,105
Total sales	$ 360,434	$ 332,876	$ 370,014

There were no individual foreign countries with sales greater than 10% of total sales for the periods presented.

The United States Government is the only customer that accounted for 10% or more of the Company’s consolidated sales in fiscal years 2010, 2009 and 2008. Direct sales to the United States Government were $48.5 million, $49.2 million and $68.6 million for fiscal years 2010, 2009 and 2008, respectively. Accounts receivable from this customer represented 12% and 11% of consolidated accounts receivable at October 1, 2010 and October 2, 2009, respectively.

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14. Selected Quarterly Financial Data (Unaudited)

In management's opinion, the unaudited data has been prepared on the same basis as the audited information and includes all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the data for the periods presented. The Company's results of operations have varied and may continue to fluctuate significantly from quarter to quarter. The results of operations in any period should not be considered indicative of the results to be expected from any future period.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended October 1, 2010				
Sales	$ 82,767	$ 88,352	$ 93,876	$ 95,439
Gross profit	23,440	26,722	28,923	29,362
Net income (loss)	3,841	4,492	4,211	(5,805)
Basic earnings per share	$ 0.23	$ 0.27	$ 0.25	$ (0.34)
Diluted earnings per share	$ 0.21	$ 0.25	$ 0.23	$ (0.34)
Year ended October 2, 2009				
Sales	$ 77,146	$ 81,903	$ 82,520	$ 91,307
Gross profit	19,916	21,766	24,284	27,525
Net income	7,655	3,689	3,870	8,252
Basic earnings per share1	$ 0.47	$ 0.22	$ 0.23	$ 0.50
Diluted earnings per share1	$ 0.44	$ 0.21	$ 0.22	$ 0.46

1 Restated in accordance with ASC 260.

Net income for the third quarter of fiscal year 2010 includes after-tax transaction expenses of $2.2 million relating to the previously announced merger agreement with Comtech.

Net loss for the fourth quarter of fiscal year 2010 reflects after-tax termination fee and transaction expenses totaling $12.9 million relating to the merger agreement with Comtech.

Net income for the first quarter of fiscal year 2009 includes two significant discrete tax benefits: (1) $5.1 million related to the Company's position with regard to an outstanding audit by the Canada Revenue Agency, and (2) $0.6 million for an adjustment to Canadian tax accounts.

Net income for the second quarter of fiscal year 2009 includes a significant discrete tax benefit of $0.7 million related to certain provisions of the California Budget Act of 2008 signed in February 2009.

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15. Subsequent Event

The Company entered into an Agreement and Plan of Merger dated as of November 24, 2010 ("Merger Agreement") with Catalyst Holdings, Inc., a Delaware corporation (“Parent”) and Catalyst Acquisition, Inc., a wholly-owned subsidiary of Parent ("Merger Sub"). Parent and Merger Sub are affiliates of The Veritas Capital Fund IV ("Veritas").

The Merger Agreement contemplates that Merger Sub will be merged with and into the Company, with the Company surviving as a wholly-owned subsidiary of Parent (the "Merger"), and each outstanding share of the Company's common stock will be converted in the Merger into the right to receive $19.50 per share in cash.

The Company has made customary representations, warranties and covenants in the Merger Agreement, including (i) its agreement, subject to certain exceptions, to conduct business in the ordinary course and not to engage in certain activities between the execution of the Merger Agreement and the consummation of the merger and (ii) its agreement to not solicit or knowingly encourage alternative transactions or, subject to certain exceptions, enter into discussions concerning, or provide information in connection with, alternative transactions.

The completion of the Merger is subject to certain conditions, including, among others, (i) the adoption of the Merger Agreement by the Company's stockholders, (ii) the absence of certain legal impediments to the consummation of the merger, (iii) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and certain approvals under foreign anti-competition laws, (iv) subject to certain materiality exceptions, the accuracy of the representations and warranties made by Parent and the Company, respectively, and (v) compliance by Parent and the Company with the respective obligations under the Merger Agreement. The completion of the Merger is not subject to a financing condition. However, generally, Parent will not be required to close the merger until completion of a marketing period set forth in the Merger Agreement.

The Merger Agreement contains typical mutual termination rights, including termination by mutual agreement of the parties, for any final and nonappealable order or law enjoining or prohibiting or making illegal the Merger or for failure to obtain the Company’s stockholder approval. In addition, either party may terminate the Merger Agreement if the Merger is not consummated by April 15, 2011. In addition, the Merger Agreement may be terminated by Parent in the event that the Company's board of directors changes its recommendation. The Company may terminate the Merger Agreement in order to enter into a superior acquisition proposal. The Company may also terminate the Merger agreement if all of the conditions precedent to Parent’s obligation to close have been satisfied or waived (other than conditions that by their terms are to be satisfied at the closing) and Parent does not complete the closing by the required date.

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The Company has agreed to pay a termination fee upon termination of the merger agreement if, among other things, (i) Parent terminates the merger agreement due to a recommendation change by the Company's board of directors, (ii) either party terminates the merger agreement because of the failure to obtain stockholder approval and before termination, the Company's board of directors changes its recommendation, or (iii) the Company terminates the merger agreement to enter into a superior acquisition proposal. If the merger agreement is terminated in connection with a superior acquisition proposal, then the termination fee payable by the Company is $13 million. A termination by Parent following a change of recommendation resulting from certain events, circumstances or developments unknown or not understood as of the date of the merger agreement results in a termination fee of $15 million. In addition, if the termination by Parent following a change in recommendation resulting from certain events, circumstances or developments unknown or not understood as of the date of the merger agreement occurs after the stockholder meeting to approve the merger agreement and the stockholders fail to approve the merger agreement, the Company will also be required to reimburse up to $2.5 million of Parent's fees and expenses.

If the Company terminates the merger agreement under certain circumstances (including Parent's failure to consummate the merger by the required date following satisfaction or waiver of all conditions precedent to Parent's obligation to close (other than conditions that by their terms are to be satisfied at the closing)), Parent must pay the Company a termination fee of $22.5 million; provided that this termination fee will be increased to $27.5 million if Parent has committed willful breach of the merger agreement.

16. Supplemental Guarantors Condensed Consolidating Financial Information

Issued on January 23, 2004, CPI’s 8% Notes, the current balance of which is $117.0 million, are guaranteed by CPI International and all of CPI’s domestic subsidiaries. Separate financial statements of the guarantors are not presented because (i) the guarantors are wholly owned and have fully and unconditionally guaranteed the 8% Notes on a joint and several basis and (ii) the Company’s management has determined that such separate financial statements are not material to investors. Instead, presented below are the consolidating financial statements of: (a) the parent, CPI International, (b) the issuer, CPI, (c) the guarantor subsidiaries (all of the domestic subsidiaries), (d) the non-guarantor subsidiaries, (e) the consolidating elimination entries, and (f) the consolidated totals. The accompanying consolidating financial information should be read in connection with the consolidated financial statements of CPI International.

Investments in subsidiaries are accounted for based on the equity method. The principal elimination entries eliminate investments in subsidiaries, intercompany balances, intercompany transactions and intercompany sales.

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CONDENSED CONSOLIDATING BALANCE SHEET
As of October 1, 2010

	Parent (CPI Int'l)	Issuer (CPI)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Consolidated Total
Assets						
Cash and cash equivalents	$34	$29,397	$905	$ 12,493	$ -	$ 42,829
Restricted cash	-	-	1,710	94	-	1,804
Accounts receivable, net	-	20,107	10,225	15,375	-	45,707
Inventories	-	43,502	11,312	21,070	(676)	75,208
Deferred tax assets	-	10,945	2	83	-	11,030
Intercompany receivable	-	1,261	8,399	16,677	(26,337)	-
Prepaid and other current assets	-	4,666	466	1,327	-	6,459
Total current assets	34	109,878	33,019	67,119	(27,013)	183,037
Property, plant and equipment, net	-	38,877	2,901	12,481	-	54,259
Deferred debt issue costs, net	288	1,316	-	-	-	1,604
Intangible assets, net	-	53,082				