

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

CSP Inc. (CSPI)



ALEXANDER R. LUPINETTI is the Chairman of the Board, President and CEO of CSP Inc. and has more than 30 years of management experience in the information technology industry. Since his appointment as CEO in 1996, Mr. Lupinetti's achievements include the implementation of a new strategic plan that increased revenues from approximately \$19 million in fiscal 1997 to more than \$69 million in fiscal 2006. Under his leadership, CSP Inc. acquired Ft. Lauderdale, Florida-based Modcomp Inc. and Technisource Hardware as part of his strategic plan. Prior to his position at CSP Inc., Mr. Lupinetti spent nine years at Stratus Computer Inc. where he was President of three software companies named Softcom Systems, Inc., Shared Systems Corp., and TCAM System Inc. He also held senior sales and marketing positions at Stratus and IBM Corporation. He has a Bachelor of Arts degree from St. John Fisher College in Rochester, New York.

TWST: Please begin with a brief historical sketch of the company and a picture of the things you are doing right now.

Mr. Lupinetti: CSP Inc. was incorporated in 1968. We develop and market best of breed IT Solutions, system integration services and high performance computer systems. CSPI's System Segment includes the MultiComputer Division, which supplies high-performance Linux cluster computer systems for a broad array of defense applications, including radar, sonar and surveillance signal processing. The company's MODCOMP Inc. subsidiary, part of our service and system integration segment, was founded in 1970, and is a leading supplier of cutting-edge IT solutions and systems integration services for complex IT environments. MODCOMP also works with third parties to develop customized solutions in the global IT market, and has offices in the US, UK and Germany.

TWST: What is the competitive landscape like? What are your competitive advantages?

Mr. Lupinetti: The competitive landscape is very formidable in both of our markets. In the systems market, which is where we

build systems for military applications, we compete with several companies. Our main competitor is Mercury Computer Systems. They are significantly larger than we are, with over a \$100 million in sales from defense applications. Curtiss Wright, which is a \$1 billion company, has bought several of our small competitors and GE Fanuc has done the same in terms of buying several smaller defense-oriented companies. They are both trying to be a large player in the embedded computer segment. We actually differentiate ourselves by using the fact it is an advantage that we are a small company. Last year we won an \$18 million contract with Raytheon by convincing them that because we are a smaller company we are more flexible and more willing to work directly with their engineers on their unique requirements. We believe that our larger competitors have a much more difficult time doing this. Therefore, since we have demonstrated our ability to work shoulder-to-shoulder with our customer's engineers, we use this to differentiate ourselves in the market place.

On the systems integration side, MODCOMP faces a totally different type of competition. They go up against very large

companies like EDS and IBM Global Services. They also compete with the hundreds and thousands of other value-added resellers and IT integration companies in the marketplace. There are literally thousands of companies, ranging from one or two person operations to very large companies like EDS. Last year, we were ranked as the 314th largest VAR/Integrator with our \$60 million sales. Again, we use our technical expertise to differentiate ourselves in this market. We focus on advanced storage and network security consulting services to add value to the industry-leading products and software that we sell with our solutions.

TWST: What are the main opportunities that lie ahead for the company over the next few years? What are the strategies that you will be employing?

Mr. Lupinetti: The opportunities are very significant. Again, on the defense side, we see opportunities in the embedded computer market segment, which has been sized at approximately \$14 billion. The sub segment that we compete in is about 5% or \$700 million, which leaves us plenty of room to grow in the future. We think there is plenty of opportunity here because of the global threat from terrorism and the wars in Afghanistan and Iraq. There is certainly reason to believe that the Defense Department will continue to invest in strategic programs to maintain our worldwide military leadership.

On the systems integration side, the market is very large. The global IT market is \$1.5 trillion growing to \$2 trillion over the next few years. Systems integrators like us serve a big part of this market. We see a tremendous opportunity to grow. The gating factor here is our ability to hire excellent technical and sales people.

TWST: What do you do to recruit, train and develop good people?

Mr. Lupinetti: Again, it depends on what business we are talking about. In our systems business, we go to the local universities and actually bring in engineers on a co-op program. They work with us while they are still in school and then we hire the best ones. Having been in business for close to 40 years, we have employees in both divisions of the company who have 20 or 25 years of service and are very experienced. They form the foundation of the company. In the integration side of the business, what we tend to do is bring in young talent. To build a competitive sales force and technical staff, we first leverage the company's history, stability and reputation to attract people. Then we rely on the experienced people within the company to train them and integrate them into the business.

TWST: Are there any challenges or problems that might arise for you?

Mr. Lupinetti: In the defense segment there are always challenges due to changes in the global environment that often

lead to a shift in military spending priorities. As I have said, I think that the opportunities will continue to grow, albeit they will be uneven. The current DoD budgets are constantly being reshuffled a bit because of the tactical needs of the military. However, we will continue to leverage our new technology for strategic programs like the \$18 million contract we won with Raytheon last year and the E-2D (Global Hawkeye) contract we won a few years before that.

On the integration side of our business, barring a global meltdown, we see the IT industry continuing to grow at the same rate it has been growing. There are plenty of opportunities there for us to increase our market share and grow our business in the future.

TWST: What are your feelings about mergers and acquisitions?

Mr. Lupinetti: We have a two-pronged growth strategy that includes growing both organically and through acquisition. Internally we fund new product development to grow organically, and then we use our cash to grow through acquisitions. Over my tenure, we have made several acquisitions, like MODCOMP. MODCOMP was a \$60 million business last year. It works out well for us to have a commercial business that is not subject to the lumpy nature of our defense business. We continue to look for acquisition candidates that would complement and be compatible with one of our two businesses. We look for profitable companies that will be a good cultural fit and that would be accretive immediately.

TWST: What would you reasonably expect the company to look like in a broad way, in about three years?

Mr. Lupinetti: We did \$69 million in sales last year. Through the first three quarters of this year, we have achieved 65.9 million in revenue. We made \$0.52 per share last year and already through three quarters this year we have made \$0.54 per share. We are on our way to a record year this year. It should be the largest year in the history of our systems division, because of that \$18 million contract with Raytheon. Over the next few years, we see the company growing to exceed \$100 million in sales. We continue to strive to increase our bottom line by 10% on an average annualized basis. We see those as our goals over the next few years.

TWST: As CEO, what occupies your own attention most on a day-by-day basis?

Mr. Lupinetti: My primary focus is our growth strategy. I am confident that we have a competitive strategy that when executed properly will achieve our goals. I am always looking at the management team to make sure that we have the right people in the right places and I am continually looking for areas to grow our shareholder value. That is what occupies most of my time

TWST: Do you see any need to improve the company's capital structure?

Mr. Lupinetti: Right now, we are in great shape. We had \$14 million in cash as of the last quarter. We have always used our cash for acquisition. We have no debt, so the capital structure and our balance sheet right now are in excellent condition.

TWST: Are there any areas within the company that you feel you should be strengthening?

Mr. Lupinetti: We always are looking to strengthen our products by making them the most competitive, architecturally superior products in the marketplace. We have recently started shipping our new 3000 SERIES and we are confident that product line puts us in a technology leadership position.

industry's leading suppliers. We sell the leading hardware and software products in the market from companies like Hewlett-Packard, IBM, Cisco Systems, Sun Microsystems and EMC Corporation and integrate them for our customers so they can upgrade their IT departments seamlessly.

They may need to upgrade their servers, for example, using the latest technology called virtualization. We provide the software and integration services for products from companies like VMware and Virtual Iron. The reason this is a hot technology is that over the last several years, data centers have become very complex because of the large number of different types of servers that have been installed for new applications. What the virtualization allows you to do is to consolidate all the servers regardless of what operating systems

“We build very high performance computers that take very little space. They go on airplanes and boats for radar and sonar signal processing applications, where they have very little space with virtually no air conditioning, but need super-computing type of performance. In the integration segment, we provide cutting edge IT infrastructure solutions for complex IT environments.”

TWST: Would you expand on the services and products that you sell?

Mr. Lupinetti: In the system segment, we sell almost exclusively to prime contractors who sell to the defense department. For example, this year we were able to grow the systems business, primarily because of the \$18 million contract we sold to Raytheon. We also do business with Lockheed Martin and other suppliers to the Defense Department for applications like radar, sonar and surveillance. In this segment we provide high performance rugged cluster computer systems based on open system technology for military applications. In layman's terms, we build very high performance computers that take very little space. They go on airplanes and boats for radar and sonar signal processing applications, where they have very little space with virtually no air conditioning, but need super-computing type of performance.

In the integration segment, we provide cutting edge IT infrastructure solutions for complex IT environments. These include advanced storage systems and security consulting services, along with the best of breed hardware and software available from the in-

they are running. On one large server, you can consolidate many servers that might be running Microsoft Windows on one server and Unix on another server and Linux on another; put them all on one server, saving space, power and complexity. The same can be done for storage systems. These services add value to the products that we resell and integrate.

TWST: What about investor relations? Do you feel that the company is well understood by the investment community?

Mr. Lupinetti: We have a long-term investor relations program. We have our story out there, but it could be improved. We are always trying to figure out a better way to get our story understood. I believe the main difficulty investors have understanding us is that we have two very different business segments. Nevertheless, our investors have placed their confidence in us because they see a small, diversified company not dependent on one market or product line. We have a stable management team and a very strong balance sheet. That is what they look for; they are looking for companies with a low debt profile. We have no debt and we have over \$14 million in cash.

We've been in this situation for many years and we have a track record of strong financial management. We have shown the ability to take risks to go into new markets and buy other companies. We are also global, which is a big advantage right now because of the currency valuation difference in Europe. That is really helping fuel our growth. We are not dependent on one geography or market. Investors may miss this when they initially look at the company. However, we are trying to get this message across through our investor relations program.

TWST: What would be the two or three best reasons for the long-term investor to look very closely at CSPI?

Mr. Lupinetti: I think that the "past is prologue." We have a history of very strong financial management and we are very stable. We have a strong balance sheet, and we have been growing for five consecutive quarters. We have been growing year-over-year for the last several years. Therefore I think that is really the message: look at what we have done. Look at how this company is managed and the growth that we have been experiencing; those would be the reasons to take a closer look at CSPI.

TWST: Is there anything that you would like to add, especially regarding strategies, long-term objectives and reasons for an investor to look at the company?

Mr. Lupinetti: I would say the main message is that we have a strong management team and are very focused on our growth strategy. We have a competitive strategy and we will continue to execute our strategy to achieve our goals.

TWST: The company was founded in 1968 and you came aboard 11 years ago. What changes did you make at that time? What have been the main drivers of the company's success in your time?

Mr. Lupinetti: The number one change I made was developing a new growth strategy and we have updated this strategy every year using a "bottom up" approach, working with my general management staff and then taking it to the Board of Directors for their input and review. This approach led to our decision to diversify and grow not only organically but grow through acquisitions. Our acquisitions have brought in new people and really increased our pool of talent. The organization has changed dramatically through the implementation of our growth strategy.

TWST: Thank you.

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