

CPI AEROSTRUCTURES INC
Form 10-Q
August 14, 2007
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period
ended June 30, 2007
CPI AEROSTRUCTURES, INC.

Commission File Number 1-11398

(Exact name of registrant as specified in its charter)

New York
(State or other jurisdiction
of incorporation or organization)
60 Heartland Blvd., Edgewood, NY
(Address of principal executive offices)
(631) 586-5200

11-2520310
(IRS Employer Identification Number)

11717
(zip code)

(Registrant's telephone number including area code)

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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 10, 2007, the number of shares of common stock, par value \$.001 per share, outstanding was 5,750,273.

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Part I: Financial Information:

Item 1 — Financial Statements:

CPI AEROSTRUCTURES, INC.

CONDENSED BALANCE SHEETS

| | June 30, 2007 (Unaudited) | December 31, 2006 (Note 1) |
|---|---------------------------------|----------------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash | \$ 1,041,745 | \$ 38,564 |
| Accounts receivable, net | 1,756,599 | 1,422,135 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 29,326,300 | 28,783,708 |

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| | | |
|--|---------------|---------------|
| Prepaid expenses and other current assets | 403,882 | 133,618 |
| Refundable income taxes | 528,470 | 628,470 |
| Total current assets | 33,056,996 | 31,006,495 |
| Plant and equipment, net | 781,492 | 855,736 |
| Other assets | 229,319 | 297,956 |
| Total Assets | \$ 34,067,807 | \$ 32,160,187 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 4,919,126 | \$ 4,758,763 |
| Accrued expenses | 102,751 | 225,040 |
| Current portion of long-term debt | 14,215 | 42,188 |
| Line of credit | — | 350,000 |
| Deferred income taxes | 508,000 | 508,000 |
| Total current liabilities | 5,544,092 | 5,883,991 |
| Other liabilities | 114,570 | 98,541 |
| Total Liabilities | 5,658,662 | 5,982,532 |
| Shareholders' Equity: | | |
| Common stock – \$.001 par value; authorized 50,000,000 shares, issued 5,793,807 and 5,478,807 shares, respectively, and outstanding 5,730,273 and 5,447,792 shares, respectively | 5,794 | 5,479 |
| Additional paid-in capital | 24,656,208 | 23,048,520 |
| Retained earnings | 4,288,149 | 3,444,512 |
| Treasury stock, 63,534 and 32,980 shares (at cost), respectively | (541,006) | (320,856) |
| Total Shareholders' Equity | 28,409,145 | 26,177,655 |
| Total Liabilities and Shareholders' Equity | \$ 34,067,807 | \$ 32,160,187 |
| See Notes to Condensed Financial Statements | | |

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CPI AEROSTRUCTURES, INC.

CONDENSED STATEMENTS OF OPERATIONS

| | For the Three | | For the Six | |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | Months Ended June 30, 2007 | Months Ended June 30, 2006 | Months Ended June 30, 2007 | Months Ended June 30, 2006 |
| | (Unaudited) | | (Unaudited) | |
| Revenue | \$ 7,490,669 | \$ 2,457,016 | \$ 12,962,637 | \$ 7,487,210 |
| Cost of sales | 5,302,049 | 3,361,506 | 9,415,336 | 7,426,508 |
| Gross profit (loss) | 2,188,620 | (904,490) | 3,547,301 | 60,702 |
| Selling, general and administrative expenses | 1,262,172 | 1,133,844 | 2,185,664 | 1,982,142 |
| Income (loss) before provision for (benefit from) | 926,448 | (2,038,334) | 1,361,637 | (1,921,440) |

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| | | | | |
|--|------------|----------------|------------|----------------|
| income taxes | | | | |
| Provision for (benefit from) income taxes | 351,000 | (705,000) | 518,000 | (657,000) |
| Net income (loss) | \$ 575,448 | \$ (1,333,334) | \$ 843,637 | \$ (1,264,440) |
| Income (loss) per common share – basic | \$ 0.10 | \$ (0.24) | \$ 0.15 | \$ (0.23) |
| Income (loss) per common share – diluted | \$ 0.10 | \$ (0.24) | \$ 0.14 | \$ (0.23) |
| Shares used in computing income (loss) per common share: | | | | |
| Basic | 5,691,811 | 5,447,042 | 5,596,963 | 5,446,263 |
| Diluted | 6,026,829 | 5,447,042 | 5,908,891 | 5,446,263 |
| See Notes to Condensed Financial Statements | | | | |

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CPI AEROSTRUCTURES, INC.

CONDENSED STATEMENTS OF CASH FLOWS

| | For the Six Months Ended June 30, 2007 | | 2006 (Unaudited) | |
|--|--|-----------|---------------------|-------------|
| Cash flows from operating activities: | | | | |
| Net income (loss) | \$ | 843,637 | \$ | (1,264,440) |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | |
| Depreciation and amortization | | 110,506 | | 103,249 |
| Other liabilities | | 16,029 | | 21,825 |
| Stock compensation expense | | 360,252 | | 252,425 |
| Tax benefit from stock option exercise | | (538,000) | | (4,600) |
| Deferred portion of provision for income taxes | | 57,000 | | (48,000) |
| Changes in operating assets and liabilities: | | | | |
| Increase in accounts receivable | | (334,464) | | (368,616) |
| (Increase) decrease in costs and estimated earnings in excess of billings on uncompleted contracts | | (542,592) | | 3,171,318 |
| Decrease in prepaid expenses and other assets | | 279,374 | | 195,663 |
| (Increase) decrease in refundable income taxes | | 100,000 | | (890,281) |
| Increase (decrease) in accounts payable and accrued expenses | | 38,074 | | (1,415,273) |
| Decrease in income taxes payable | | — | | (133,110) |
| Net cash provided by (used in) operating activities | | 389,816 | | (379,840) |
| Cash used in investing activities – purchase of plant and equipment | | (36,262) | | (51,093) |
| Cash flows from financing activities: | | | | |
| Payment of long-term debt | | (27,973) | | (47,749) |

| | | |
|---|--------------|------------|
| Repayment of line of credit | (350,000) | — |
| Proceeds from exercise of stock options | 489,600 | 19,050 |
| Tax benefit from stock option exercise | 538,000 | 4,600 |
| Net cash provided by (used in) financing activities | 649,627 | (24,099) |
| Net increase (decrease) in cash | 1,003,181 | (455,032) |
| Cash at beginning of period | 38,564 | 877,182 |
| Cash at end of period | \$ 1,041,745 | \$ 422,150 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | \$ 18,284 | \$ 6,117 |
| Income taxes | \$ 100,000 | \$ 403,093 |
| See Notes to Condensed Financial Statements | | |

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CPI Aerostructures, Inc.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1. Interim Financial Statements:

The financial statements of CPI Aerostructures, Inc. (the “Company”) as of June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 are unaudited, however, in the opinion of the management of the Company, these financial statements reflect all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position of the Company and its results of operations and cash flows. The results of operations for such interim periods are not necessarily indicative of the results to be obtained for a full year.

The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date; but does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. For further information, refer to the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2006.

2. stock-based compensation:

The Company accounts for compensation expense associated with stock options in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Share-Based Payment.”

The Company’s net income for the three and six months ended June 30, 2007 includes approximately \$251,000 and \$360,000, respectively, of non-cash compensation expense related to the Company’s stock options. The Company’s net loss for the three and six months ended June 30, 2006 includes approximately \$154,000 and \$252,000, respectively, of non-cash compensation expense related to the Company’s stock options. The non-cash compensation expense related to all of the Company’s stock-based compensation arrangements is recorded as a component of selling, general and administrative expenses.

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The estimated fair value of each option award granted was determined on the date of grant using the Black-Scholes option valuation model. The following weighted-average assumptions were used for option grants during the six month period ended June 30, 2007:

| | |
|-------------------------------|---------------|
| Risk-free interest rate | 4.50% - 5.25% |
| Expected volatility | 61% - 73% |
| Dividend yield | 0% |
| Expected option term-in years | 5 |
| 6 | |

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CPI Aerostructures, Inc.

NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

A summary of the status of the Company's stock option plans as of June 30, 2007 and changes during the period is as follows:

| | Options | Weighted average Exercise Price | Weighted average remaining contractual term (in years) | Aggregate Intrinsic Value |
|------------------------------------|-----------|---------------------------------------|--|---------------------------------|
| Fixed Options | | | | |
| Outstanding at beginning of period | 1,240,418 | \$ 5.17 | | |
| Granted during period | 80,000 | 7.01 | | |
| Exercised | (315,000) | 2.25 | | |
| Outstanding at end of period | 1,005,418 | \$ 6.24 | 4.46 | \$ 2,530,326 |
| Vested at end of period | 980,418 | \$ 6.23 | 4.33 | \$ 2,491,576 |

As of June 30, 2007, there was \$76,105 of unrecognized compensation cost related to non-vested stock option awards which will be amortized through December 2008.

During the six months ended June 30, 2007, 230,000 stock options were exercised for cash resulting in proceeds to the Company of \$489,600. In addition, 85,000 stock options were exercised on a cashless basis, pursuant to provisions of the stock option plans. The Company received 30,554 shares of its common stock in exchange for the 85,000 shares issued in the exercise. The 30,554 shares that the Company received were valued at \$220,150, the fair market value of the shares on the date of exercise, and were added to treasury stock.

During the six months ended June 30, 2007, the company earned a tax benefit of approximately \$538,000 resulting from the exercise of stock options. The amount has been credited to paid in capital and applied to the current tax liability with the balance of \$277,000 reflected in prepaid expenses and other current assets.

3. costs and estimated earnings in excess of billings on uncompleted contracts:

Costs and estimated earnings in excess of billings on uncompleted contracts consist of:

| | June 30, 2007 | | |
|---|---------------|---------------|---------------|
| | U.S. | | |
| | Government | Commercial | Total |
| Costs incurred on uncompleted contracts | \$ 51,105,784 | \$ 15,622,461 | \$ 66,728,245 |
| Estimated earnings | 31,880,494 | 6,853,813 | 38,734,307 |
| Sub-total | 82,986,278 | 22,476,274 | 105,462,552 |
| Less billings to date | 55,388,261 | 20,747,991 | 76,136,252 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 27,598,017 | \$ 1,728,283 | \$ 29,326,300 |

| | December 31, 2006 | | |
|---|-------------------|---------------|---------------|
| | U.S. | | |
| | Government | Commercial | Total |
| Costs incurred on uncompleted contracts | \$ 45,799,483 | \$ 15,312,176 | \$ 61,111,659 |
| Estimated earnings | 27,022,765 | 6,666,257 | 33,689,022 |
| Sub-total | 72,822,248 | 21,978,433 | 94,800,681 |
| Less billings to date | 45,978,150 | 20,038,823 | 66,016,973 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 26,844,098 | \$ 1,939,610 | \$ 28,783,708 |

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CPI Aerostructures, Inc.

NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

4. income PER COMMON SHARE:

Basic income per common share is computed using the weighted average number of shares outstanding. Diluted income per common share for the three and six month periods ended June 30, 2007 is computed using the weighted-average number of shares outstanding adjusted for the incremental shares attributed to outstanding options and warrants to purchase common stock. Incremental shares of 335,018 and 311,928 were used in the calculation of diluted income per common share in the three month and six month periods ended June 30, 2007, respectively. Incremental shares of 295,000 and 333,750 were not included in the diluted earnings per share calculations for the three month and six month periods ended June 30, 2007, respectively, as their exercise price was in excess of the Company's average stock price for the period and, accordingly, these shares are not assumed to be exercised for the diluted earnings per share calculation, as they would be anti-dilutive. Incremental shares of 865,277 were not included in the diluted earnings per share calculation at June 30, 2006 because of the reported net loss, and accordingly their

effect would be anti-dilutive.

5. CREDIT FACILITY:

In September 2003, the Company entered into a three year, revolving credit facility with JP Morgan Chase Bank (the “Chase Facility”), secured by our assets. In August 2006, the Company borrowed \$350,000 under the Chase Facility. The Chase Facility was amended and restated in October 2006, further amended in May 2007 and it expired on June 30, 2007. All borrowings under this facility were repaid in May 2007.

6. recent accounting pronouncements:

In June 2006, the FASB issued FASB Interpretation 48, “Accounting for Uncertainty in Income Taxes (as amended) — an interpretation of Statement of Accounting Standards 109” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS 109, “Accounting for Income Taxes,” and prescribes a recognition threshold and measurement attribute for the financial statements recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. During the six months ended June 30, 2007, the Company adopted FIN 48 and the impact of adoption was not material to its financial position and results of operations.

We may, from time to time, be assessed interest and/or penalties by major taxing jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. In the event we have received an assessment for interest and/or penalties, it has been classified in the statement of operations as other general and administrative expenses.

7. Subsequent event:

In August 2007, the Company entered into a new two-year, \$2.5 million revolving credit facility with Sovereign Bank (the “Sovereign Facility”), secured by the Company’s assets. The Sovereign Facility specifies an interest rate equal to the lower of LIBOR plus 2% or Sovereign Bank’s prime rate. The Sovereign Facility contains financial covenants related to interest coverage, net income and capital expenditures, as defined in the agreement.

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Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Company’s Condensed Financial Statements and footnotes thereto contained in this report.

Forward Looking Statements

When used in this Form 10-Q and in future filings by us with the Commission, the words or phrases “will likely result,” “management expects” or “we expect,” “will continue,” “is anticipated,” “estimated” or similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995.

Readers are cautioned not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The risks are included in “Item 1A: Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2006 and “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this Form 10-Q. We have no obligation to publicly release the result of any revisions, which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

Business Operations

We are engaged in the contract production of structural aircraft parts principally for the United States Air Force and other branches of the U.S. armed forces and, to a lesser extent, for prime military aircraft contractors. We also provide aircraft parts to the commercial sector of the aircraft industry. Our strategy for growth has focused on government and military sales as a prime contractor and as a subcontractor for other defense prime contractors. Due to growth in the commercial sector, we are also pursuing opportunities to increase our commercial contract business as a subcontractor.

Notwithstanding defense budget increases and the Department of Defense’s (“DoD”) commitment to maintaining support for aging aircraft during the two-year period through August 2006, there was a significant slowdown in government contract awards as well as releases under previously awarded contracts. Faced with the uncertainties of appropriations and timing of contract awards and releases under previously awarded contracts, which we believe have been driven by the uncertainties of war and market and economic trends, we have expanded our activities to include operating as a subcontractor to leading aerospace prime contractors. While the slowdown in government contract awards also has affected these prime contractors, because they are able to bid on and receive contract awards for different programs than we are, we believe that pursuing such opportunities will enable us to access programs that we would not otherwise be able to access given our smaller size and resources. By increasing our customer base, we have positioned our company to take advantage of additional market opportunities and reduce the impact of the slowdown in government contract awards and releases. These subcontracting opportunities have begun to materialize, and we were awarded approximately \$7.0 million of subcontracts during 2006 compared to \$2.2 million in 2005. In addition, through July 31, 2007, we were awarded approximately \$10.9 million of subcontracts. We currently have proposals submitted to multiple prime contractors, and while we cannot predict the timing of awards, some of our outstanding proposals are so significant in size that any single award could increase our revenue and net income substantially.

The length of the contract varies but is typically between six months and two years for U.S. government contracts (although our T-38 contract and our C-5 TOP contract are for periods of 10 years and 7 years, respectively), and up to 10 years for commercial contracts. Our one commercial contract has an indefinite life. Except in cases where contract terms permit us to bill on a progress basis, we must incur upfront costs in producing assemblies and bill our customers upon delivery. Because of the upfront costs incurred, the timing of our billings and the nature of the percentage-of-completion method of accounting described below, there can be a significant disparity between the periods in which (a) costs are expended, (b) revenue and earnings are recorded and (c) cash is received.

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Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

Revenue Recognition

We recognize revenue from our contracts over the contractual period under the percentage-of-completion (POC) method of accounting. Under the POC method of accounting, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at the completion of the contract. Recognized revenues that will not be billed under the terms of the contract until a later date are recorded as an asset captioned "Costs and estimated earnings in excess of billings on uncompleted contracts." Contracts where billings to date have exceeded recognized revenues are recorded as a liability captioned "Billings in excess of costs and estimated earnings on uncompleted contracts." Changes to the original estimates may be required during the life of the contract. Estimates are reviewed monthly and the effect of any change in the estimated gross margin percentage for a contract is reflected in cost of sales in the period the change becomes known. The use of the POC method of accounting involves considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods. As a result, there can be a significant disparity between earnings (both for accounting and taxes) as reported and actual cash received by us during any reporting period. We continually evaluate all of the issues related to the assumptions, risks and uncertainties inherent with the application of the POC method of accounting; however, we cannot assure you that our estimates will be accurate. If our estimates are not accurate or a contract is terminated, we will be forced to adjust revenue in later periods. Furthermore, even if our estimates are accurate, we may have a shortfall in our cash flow and we may need to borrow money to fund our work in process or to pay taxes until the reported earnings materialize to actual cash receipts.

Stock Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123R, "Share-Based Payment" for employee options, using the modified prospective transition method. SFAS 123R revised SFAS 123 to eliminate the option to use the intrinsic value method and required the Company to expense the fair value of all employee stock-based compensation over the vesting period. Under the modified prospective transition method, we recognized compensation cost for the year ended December 31, 2006, which includes (1) period compensation cost related to share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 and (2) compensation cost related to share-based payments granted within the period, which vested fully upon grant.

Results of Operations

Revenue

Revenue for the three months ended June 30, 2007 was \$7,490,669 compared to \$2,457,016 for the same period last year, representing an increase of \$5,033,653 or 205%. For the six months ended June 30, 2007, revenue increased \$5,475,427 or 73% to \$12,962,637, compared to \$7,487,210 for the six months ended June 30, 2006.

We generate revenue primarily from government contracts and, to a lesser extent, from one commercial contract. Revenue from government contracts (including subcontract work for government aircraft) for the six months ended June 30, 2007 was \$12,464,796 compared to \$6,688,492 for the six months ended June 30, 2006, an increase of \$5,776,304 or 86%. Our one commercial contract accounted for revenue of approximately \$497,841 for the six months ended June 30, 2007 compared to approximately \$798,718 for the six months ended June 30, 2006.

In the second half of 2006, we received approximately \$22.0 million of new government contract awards. Included in 2006 contract awards were approximately \$7.0 million of awards for subcontract

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work. During the six months ended June 30, 2007, we received approximately \$8.6 million of new contract awards including approximately \$7.7 million of subcontract work, compared to \$7.9 million of new contract awards in the same period last year. Included in last years' award amount is a \$5.0 million release on our C-5 TOP contract. Revenue increased in the first six months of 2007 as we have been performing on these contracts.

As of June 30, 2007, we had approximately \$285 million in bids outstanding. We continue to make bids on contracts on a weekly basis.

Gross Profit

Gross profit for the three months ended June 30, 2007 was \$2,188,620 compared to a gross loss of \$904,490 for the three months ended June 30, 2006, an increase of \$3,093,110. As a percentage of revenue, gross profit for the three months ended June 30, 2007 was 29% compared to gross loss of 37% for the same period last year. For the six months ended June 30, 2007, gross profit was \$3,547,301, or 27% of revenue, compared with \$60,702, or 1% of revenue for the first six months of last year.

During the six months ended June 30, 2006, we incurred overtime and rework costs to correct poor supplier workmanship and delays in deliveries by some of our suppliers. In addition, we had maintained our factory overhead and labor cost structure in anticipation of releases on contracts that we had already been awarded, including the C-5 TOP contract, as well as new awards on some of our major outstanding bids. At the end of the second quarter of 2006, when these awards did not materialize, we reduced our labor force by approximately 12% and took other cost saving measures in an attempt to increase gross profit. The increase in gross profit percentage for the six months ended June 30, 2007 was due to better control over suppliers and an improved factory overhead application rate.

We anticipate that our overhead costs for the remainder of the year will remain consistent with those incurred in the six months ended June 30, 2007. Therefore, if the level of shop activity remains similar to our present level, overhead rates and gross margin should remain similar to our current rates.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended June 30, 2007 were \$1,262,172 compared to \$1,133,844 for the three months ended June 30, 2006, an increase of \$128,328, or 11%. For the six months ended June 30, 2007, selling, general and administrative expenses were \$2,185,664 compared to \$1,982,142 for the same period last year, an increase of \$203,522, or 10%. This increase was primarily due to:

- a \$182,000 increase in consulting fees related to bids and proposals;
- a \$73,000 increase in public company fees, which includes fees paid for investor relations, fees for printing our reports and SEC filings, transfer agent fees and other expenses associated with being a public company;
- a \$54,000 increase in stock compensation expense; and

- a \$49,000 increase in travel expenses related to trips for vendor management and subcontracting sales.

This increase was offset by a decrease in salaries of \$82,000 and a decrease in accounting and legal fees of \$84,000.

Income (Loss) Before Provision for (Benefit from) Income Taxes

Income before provision for income taxes for the three months ended June 30, 2007 was \$926,448 compared to loss before benefit from income taxes of \$2,038,334 for the same period last year, an

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Item 2 — Management's Discussion and Analysis of Financial Condition and Results of Operations

increase of \$2,964,782. For the six months ended June 30, 2007, income before provision for income taxes was \$1,361,637 compared to a loss before benefit from income taxes of \$1,921,440 for the same period last year, an increase of \$3,283,077. This increase was primarily due to the increase in gross profit described above.

Provision for (Benefit from) Income Taxes

Provision for income taxes was \$518,000 for the six months ended June 30, 2007, or 38% of pre-tax income. For the three months ended June 30, 2007, the provision for income taxes was \$351,000, or 38% of pre-tax income. There was a benefit from income taxes for the three months ended June 30, 2006 of \$705,000, which was the result of a recovery of taxes expensed in the first quarter of 2006, as well as federal taxes paid in 2005 which are refundable through the filing of a carryback claim. There was a benefit from income taxes of \$657,000 for the six months ended June 30, 2006, which was the result of the refundable 2005 taxes paid.

Net Income

As a result, basic net income for the three months ended June 30, 2007 was \$575,448, or \$0.10 per basic share, compared to a net loss of \$1,333,334, or \$0.24 per basic share, for the same period last year. For the six months ended June 30, 2007, basic net income was \$843,637, or \$0.15 per basic share, compared with a net loss of \$1,264,440, or \$0.23 per basic share, for the same period last year. Diluted income per share for the three months ended June 30, 2007 was \$0.10, calculated utilizing 6,026,829 average shares outstanding. Diluted income per share for the six months ended June 30, 2007 was \$0.14, calculated utilizing 5,908,891 average shares outstanding. Diluted loss per share for the three and six months ended June 30, 2006 is the same as basic loss per share because the effect of 865,277 incremental shares were not taken into account as such effect would be anti-dilutive.

Liquidity and Capital Resources

General

At June 30, 2007, we had working capital of \$27,512,904 compared to \$25,122,504 at December 31, 2006, an increase of \$2,390,400, or 9.5%.

Cash Flow

A large portion of our cash is used to pay for materials and processing costs associated with contracts that are in process and which do not provide for progress payments. Contracts that permit us to bill on a progress basis must be classified as “on time” for us to apply for progress payments. In February 2007, we agreed to pay \$75,000 to have the late delivery orders on the C-5 TOP contract classified as “on time.” Accordingly, beginning in February 2007, we were able to apply for progress payments under this program. Costs for which we are not able to bill on a progress basis are components of “Costs and estimated earnings in excess of billings on uncompleted contracts” on our balance sheet and represent the aggregate costs and related earnings for uncompleted contracts for which the customer has not yet been billed. These costs and earnings are recovered upon shipment of products and presentation of billings in accordance with contract terms.

Because the POC method of accounting requires us to use estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods, there can be a significant disparity between earnings (both for accounting and tax purposes) as reported and actual cash that we receive during any reporting period. Accordingly, it is possible that we may have a shortfall in our cash flow and may need to borrow money until the reported earnings materialize into actual cash receipts.

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Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations

At June 30, 2007, we had a cash balance of \$1,041,745 compared to \$38,564 at December 31, 2006. In addition to the increase in cash during the six months ended June 30, 2007, our accounts receivable increased by approximately \$334,000, while our liabilities decreased by approximately \$70,000. The increase in accounts receivable was primarily due to an increase in amounts due for subcontract work.

During the years ended December 31, 2006 and 2005, we used cash of \$1,015,151 and \$676,767, respectively, to fund our operations. Because of our historical use of cash, and the expiration of a long term line of credit, beginning in June 2006, we began to reduce expenses and implement a plan to improve cash flow. As described earlier, the reduction of expenses has resulted in improved gross margin and profitability, and as a result, for the six month period ended June 30, 2007 our operations yielded a positive cash flow of approximately \$390,000.

Based on the positive results in the six months ended June 30, 2007, our projected cash expenses and sources of cash, we expect to have positive cash flow during the twelve month period ending June 30, 2008.

Credit Facility

JP MorganChase

In September 2003, we entered into a three year, revolving credit facility with JP Morgan Chase Bank (the “Chase Facility”), secured by our assets. In August 2006, we borrowed \$350,000 under the Chase Facility. The Chase Facility was amended and restated in October 2006, further amended in May 2007 and it expired on June 30, 2007. All borrowings under this facility were repaid in May 2007.

Sovereign Bank

In August 2007, we entered into a new two-year, \$2.5 million revolving credit facility with Sovereign Bank (the “Sovereign Facility”), secured by our assets. The Sovereign Facility specifies an interest rate equal to the lower of LIBOR plus 2% or Sovereign Bank’s prime rate. The Sovereign Facility contains financial covenants related to interest coverage, net income and capital expenditures, as defined in the agreement.

We believe that our existing resources, together with the availability under our credit facility, will be sufficient to meet our current working capital needs for at least the next 12 months.

Contractual Obligations

The table below summarizes information about our contractual obligations as of June 30, 2007 and the effects these obligations are expected to have on our liquidity and cash flow in the future years.

| | Total | Payments Due By Period (\$) | | | |
|---------------------------------------|-----------|-----------------------------|-----------|-----------|------------------|
| | | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Contractual Obligations | | | | | |
| Short-Term Debt | 14,215 | 14,215 | -0- | -0- | -0- |
| Operating Leases | 3,338,786 | 403,805 | 844,316 | 895,735 | 1,194,930 |
| Employment Agreement Compensation* | 1,560,875 | 670,575 | 770,300 | 120,000 | -0- |
| Total Contractual Cash Obligations | 4,913,876 | 1,088,595 | 1,614,616 | 1,015,735 | 1,194,930 |

* The employment agreements provide for bonus payments that are excluded from these amounts.

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Item 3 — Quantitative and Qualitative Disclosure About Market Risk

None

Item 4 — Controls and Procedures

An evaluation of the effectiveness of our disclosure controls and procedures was made as of June 30, 2007 under the supervision and with the participation of our management, including our chief executive officer and chief financial officer. During the first quarter of 2007, we implemented a plan to remediate the material weaknesses identified by our independent registered public accounting firm and discussed in detail in our Annual Report on Form 10-K for the year ended December 31, 2006. These material weaknesses related to our failure to properly recognize revenue, cost incurred and billings to the customer on certain contracts in that:

- the sales and cost estimates used to recognize revenue on a significant contract did not reflect the most current available information. As a result, the 2006 margin with respect to this contract was overstated; and

- gross margin was overstated on certain contracts because we recognized revenue on change orders where the customer approval had not been obtained.

These two errors resulted in an overstatement of net income in our statement of operations for the year ended December 31, 2006, which were corrected prior to filing of our Annual Report on Form 10-K.

Our internal control over reviewing and recording revenue recognition did not detect these matters and therefore was not effective at preventing or detecting material misstatement of the financial statements. Although we have begun remediation of these deficiencies, we have not had sufficient time to test whether these actions will be effective.

To remediate these material weaknesses, during the first quarter of 2007, our senior management implemented a new procedure requiring our chief financial officer and vice president of operations to review sales and cost estimates used to recognize revenue subsequent to the preparation of the financial statements to insure that such estimates used the most current available information. In addition, a procedure was designed to insure that all change orders have customer approval before being reflected in our contract estimates.

In addition, during the second quarter of 2007 we began to take the following corrective actions:

- We added resources to our accounting department to manage the estimating process necessary to properly and timely report our revenue.
- We started planning a regular education program for additional members of our accounting department to diversify the task of financial reporting management and allow a higher level of review.

Because we have not completed our remediation plan, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were not effective as of June 30, 2007 to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding disclosure.

During the most recently completed fiscal quarter, except as described above, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Part II: Other Information

Item 1A — Risk Factors

There are no material changes from the risk factors set forth in Item 1A, "Risk Factors," of our Annual Report on Form 10-K for the year ended December 31, 2006. Please refer to that section for disclosures regarding the risks and uncertainties to our business.

Item 4 — Submission of Matters to a Vote of Security Holders

We held our Annual Meeting of Shareholders on June 12, 2007. At the meeting, the director nominated for election, Edward J. Fred, was reelected for a three-year term expiring in 2010, with 5,194,460 shares voted in favor of his election and 59,105 shares for which authority was withheld. The terms of office of Kenneth McSweeney and Harvey J. Bazaar will expire at the Annual Meeting of Shareholders to be held in 2008. The terms of office of Walter Paulick and Eric Rosenfeld will expire at the Annual Meeting of Shareholders to be held in 2009.

Item 6 — Exhibits

| | |
|---------------|---|
| Exhibit 10.27 | Credit Agreement between CPI Aerostructures, Inc., and Sovereign Bank, dated as of August 13, 2007 |
| Exhibit 10.28 | Commercial Security Agreement, dated August 13, 2007, between CPI Aerostructures, Inc., Grantor, and Sovereign Bank, Lender |
| Exhibit 31.1 | Section 302 Certification by Chief Executive Officer |
| Exhibit 31.2 | Section 302 Certification by Chief Financial Officer |
| Exhibit 32 | Section 906 Certification by Chief Executive Officer and Chief Financial Officer |

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

| | |
|------------------------|--|
| Dated: August 14, 2007 | CPI AEROSTRUCTURES, INC. By: /S/ Edward J. Fred Edward J. Fred Chief Executive Officer, President, and Secretary |
| Dated: August 14, 2007 | By: /S/ Vincent Palazzolo Vincent Palazzolo Chief Financial Officer |

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