

CPI AEROSTRUCTURES INC  
Form 10-Q  
November 09, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 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                      Commission File Number 1-11398  
September 30, 2011

CPI AEROSTRUCTURES, INC.  
(Exact name of registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation or  
organization)

11-2520310  
(IRS Employer Identification Number)

60 Heartland Blvd., Edgewood, NY  
(Address of principal executive offices)

11717  
(zip code)

(631) 586-5200  
(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 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 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer                       Accelerated filer   
Non-accelerated filer                       Smaller reporting company   
(Do not check if a smaller reporting company)

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

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As of November 5, 2011, the number of shares of common stock, par value \$.001 per share, outstanding was 6,918,646.

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Part I - Financial Information

Item 1 – Condensed Financial Statements

Condensed Balance Sheets as of September 30, 2011 (Unaudited) and December 31, 2010 3

Condensed Income Statements for the Three and Nine Months ended September 30, 2011 (Unaudited) and 2010 4 (Unaudited)

Condensed Statements of Cash Flows for the Nine Months ended September 30, 2011 (Unaudited) and 2010 5 (Unaudited)

Notes to Condensed Financial Statements (Unaudited) 6

Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations 14

Item 3 – Quantitative and Qualitative Disclosures About Market Risk 22

Item 4 – Controls and Procedures 22

Part II - Other Information

Item 6 – Exhibits 23

Signatures 24

Index

CPI AEROSTRUCTURES, INC.

Part I - Financial Information

Item 1 – Financial Statements

## CONDENSED BALANCE SHEETS

	September 30, 2011 (Unaudited)	December 31, 2010 (Note 1)
<b>ASSETS</b>		
Current Assets:		
Cash	\$ 353,377	\$ 823,376
Accounts receivable, net	9,187,805	6,152,544
Costs and estimated earnings in excess of billings on uncompleted contracts	65,466,840	47,165,166
Prepaid expenses and other current assets	686,767	606,369
<b>Total current assets</b>	<b>75,694,789</b>	<b>54,747,455</b>
Plant and equipment, net	1,819,466	881,915
Deferred income taxes	889,000	668,000
Other assets	112,080	159,817
<b>Total Assets</b>	<b>\$ 78,515,335</b>	<b>\$ 56,457,187</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 10,548,776	\$ 8,267,330
Accrued expenses	362,945	301,941
Current portion of long-term debt	882,291	685,008
Line of credit	12,600,000	800,000
Income tax payable	1,670,006	134,006
Deferred income taxes	182,000	182,000
<b>Total current liabilities</b>	<b>26,246,018</b>	<b>10,370,285</b>
Long-term debt, net of current portion	1,029,070	1,190,097
Deferred income taxes	30,000	---
Other liabilities	125,034	226,362
<b>Total Liabilities</b>	<b>27,430,122</b>	<b>11,786,744</b>
Shareholders' Equity:		
Common stock - \$.001 par value; authorized 50,000,000 shares, issued 7,048,570 and 6,911,570 shares, respectively, and outstanding 6,915,313 and 6,789,736 shares, respectively	7,049	6,912
Additional paid-in capital	35,084,963	33,272,237
Retained earnings	17,161,831	12,417,924
Accumulated other comprehensive loss	(28,404 )	(45,404 )

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Treasury stock, 133,257 and 121,834 shares, respectively (at cost)	(1,140,226 )	(981,226 )
Total Shareholders' Equity	51,085,213	44,670,443
Total Liabilities and Shareholders' Equity	\$ 78,515,335	\$ 56,457,187

See Notes to Condensed Financial Statements

Index

## CPI AEROSTRUCTURES, INC.

## CONDENSED INCOME STATEMENTS

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011 (Unaudited)	2010 (Unaudited)	2011 (Unaudited)	2010 (Unaudited)
Revenue	\$ 16,607,638	\$ 12,976,084	\$ 50,043,470	\$ 36,526,238
Cost of sales	12,440,033	9,593,671	37,780,959	27,043,414
Gross profit	4,167,605	3,382,413	12,262,511	9,482,824
Selling, general and administrative expenses	1,525,386	1,181,369	5,408,273	4,051,737
Income from operations	2,642,219	2,201,044	6,854,238	5,431,087
Interest expense	111,177	29,681	216,331	129,656
Income before provision for income taxes	2,531,042	2,171,363	6,637,907	5,301,431
Provision for income taxes	726,000	742,000	1,894,000	1,806,000
Net income	\$ 1,805,042	\$ 1,429,363	\$ 4,743,907	\$ 3,495,431
Income per common share – basic	\$0.26	\$0.21	\$0.69	\$0.54
Income per common share – diluted	\$0.25	\$0.21	\$0.66	\$0.53
Shares used in computing income per common share:				
Basic	6,915,313	6,650,756	6,853,073	6,417,729
Diluted	7,158,715	6,972,156	7,138,081	6,641,159

See Notes to Condensed Financial Statements

Index

CPI AEROSTRUCTURES, INC.

## CONDENSED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30,	2011	2010
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$4,743,907	\$3,495,431
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	380,895	271,941
Deferred rent	(81,328 )	(3,624 )
Stock option expense	963,913	528,643
Deferred portion of provision for income taxes	(194,000 )	(171,000 )
Tax benefit of stock options	(438,000 )	---
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(3,035,261 )	2,924,597
Increase in costs and estimated earnings in excess of billings on uncompleted contracts	(18,301,674)	(9,879,977)
Decrease (increase) in prepaid expenses and other assets	(32,661 )	51,267
Increase in accounts payable and accrued expenses	2,342,450	715,847
(Decrease) increase in income taxes payable	1,974,000	(299,368 )
Net cash used in operating activities	(11,677,759)	(2,366,243)
Cash used in investing activities - purchase of plant and equipment	(742,904 )	(144,807 )
Cash flows from financing activities:		
Payments on long-term debt	(539,286 )	(506,925 )
Proceeds from line of credit	11,800,000	----
Repayment of line of credit	----	(2,200,000)
Proceeds from exercise of stock options	251,950	112,500
Proceeds from sale of common stock	----	3,531,870
Tax benefit of stock options	438,000	---
Net cash provided by financing activities	11,950,664	937,445
Net decrease in cash	(469,999 )	(1,573,605)
Cash at beginning of period	823,376	2,224,825
Cash at end of period	\$353,377	\$651,220
Supplemental disclosures of cash flow information:		
Non-cash investing and financing activities:		
Settlement of other receivables	----	\$60,000
Equipment acquired under capital lease	\$575,542	\$101,694
Accrued expenses settled in exchange for common stock	----	\$99,697
Cash paid during the period for:		
Interest	\$220,203	\$127,780

Income taxes

\$180,000

\$2,276,367

See Notes to Condensed Financial Statements

5

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Index

CPI AEROSTRUCTURES, INC.

## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

## 1. INTERIM FINANCIAL STATEMENTS

The condensed financial statements of CPI Aerostructures, Inc. (the "Company") as of September 30, 2011 and for the three and nine months ended September 30, 2011 and 2010 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

The condensed balance sheet at December 31, 2010 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. It is suggested that these condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

## 2. STOCK-BASED COMPENSATION

The Company accounts for compensation expense associated with stock options based on the fair value of the options on the date of grant.

The Company's net income for the three and nine months ended September 30, 2011 includes approximately \$22,000 and \$964,000, respectively, of non-cash compensation expense related to the Company's stock options. The Company's net income for the three and nine months ended September 30, 2010 includes approximately \$32,000 and \$529,000, 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.

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 the options granted during the three and nine months ended September 30, 2011 and 2010:

	2011	2010
Risk-free interest rate	2.1% and 2.1%, respectively	2.5% and 2.6%, respectively
Expected volatility	101% and 101%, respectively	97% and 97%, respectively
Dividend yield	0%	0%
Expected option term	5 years	5 years



Index

CPI AEROSTRUCTURES, INC.

## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

A summary of the status of the Company's stock option plans as of September 30, 2011 and changes during the nine months ended September 30, 2011 is as follows:

Fixed Options	Options	Weighted average Exercise Price	Weighted average remaining contractual term (in years)	Aggregate Intrinsic Value
Outstanding at beginning of period	780,333	\$6.68		
Granted	80,000	14.90		
Exercised	(137,000 )	3.00		
Outstanding and expected to vest, at end of period	723,333	\$8.28	2.82	\$1,406,863
Vested at end of period	708,333	\$8.32	2.57	\$1,264,696

As of September 30, 2011, there was \$43,000 of unrecognized compensation cost related to non-vested stock option awards which will be amortized through March 2012.

Options to acquire 25,000 shares and 55,000 shares of common stock were granted on January 1, 2011 and April 1, 2011, respectively, to members of our board of directors as part of their normal compensation.

During the nine months ended September 30, 2011, 117,000 stock options were exercised for cash resulting in proceeds to the Company of \$251,950. During the same period an additional 20,000 options were exercised, pursuant to provisions of the stock option plan. The Company received no cash and 11,423 shares of its common stock in exchange for the 20,000 shares issued in the exercise. The 11,423 shares that the Company received were valued at \$159,000, the fair market value of the shares on the date of exercise, and were added to treasury stock.

The intrinsic value of all options exercised during the nine months ended September, 30, 2011 and 2010 was approximately \$1,514,000 and \$12,000, respectively.

### 3. DERIVATIVE INSTRUMENTS AND FAIR VALUE

Our use of derivative instruments has been to hedge interest rates. These derivative contracts are entered into with financial institutions. We do not use derivative instruments for trading purposes and we have procedures in place to monitor and control their use.

We record these derivative financial instruments on the condensed balance sheets at fair value. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.



Index

CPI AEROSTRUCTURES, INC.

## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Any ineffective portion of the gain or loss on the derivative instrument for a cash flow hedge is recorded in the results of operations immediately. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in the results of operations immediately. See below for a discussion of our use of derivative instruments, management of credit risk inherent in derivative instruments and fair value information.

In October 2008, the Company entered into an interest rate swap with the objective of reducing our exposure to cash flow volatility arising from interest rate fluctuations associated with certain debt. The notional amount, maturity date, and currency of these contracts match those of the underlying debt. The Company has designated this interest rate swap contract as a cash flow hedge. The Company measures ineffectiveness by comparing the cumulative change in the forward contract with the cumulative change in the hedged item. No material ineffectiveness was recognized in the quarter ended September 30, 2011. As of September 30, 2011 and December 31, 2010, we had a net deferred loss associated with cash flow hedges of approximately \$43,000 and \$69,000, respectively, due to the interest rate swap which has been included in Other Liabilities.

As a result of the use of derivative instruments, the Company is exposed to risk that the counterparties may fail to meet their contractual obligations. Recent adverse developments in the global financial and credit markets could negatively impact the creditworthiness of our counterparties and cause one or more of our counterparties to fail to perform as expected. To mitigate the counterparty credit risk, we only enter into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and continually assess the creditworthiness of counterparties. To date, all counterparties have performed in accordance with their contractual obligations.

## Fair Value

At September 30, 2011 and December 31, 2010, the fair values of cash, accounts receivable, accounts payable and accrued expenses approximated their carrying values because of the short-term nature of these instruments.

	September 30, 2011	
	Carrying Amount	Fair Value
Debt		
Short-term borrowings and long-term debt	\$14,511,361	\$14,511,361
	December 31, 2010	
	Carrying Amount	Fair Value
Debt		
Short-term borrowings and long-term debt	\$2,675,105	\$2,675,105

We estimated the fair value of debt using market quotes and calculations based on market rates.



Index

CPI AEROSTRUCTURES, INC.

## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the fair values of those financial liabilities measured on a recurring basis as of September 30, 2011 and December 31, 2010:

Description	Total	Fair Value Measurements September 30, 2011		
		Quoted Prices in Active Markets for Identical assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest Rate Swap, net	\$43,036	--	\$43,036	--
Total	\$43,036	--	\$43,036	--

  

Description	Total	Fair Value Measurements December 31, 2010		
		Quoted Prices in Active Markets for Identical assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest Rate Swap, net	\$68,794	--	\$68,794	--
Total	\$68,794	--	\$68,794	--

The fair value of the Company's interest rate swap was determined by comparing the fixed rate set at the inception of the transaction to the "replacement swap rate," which represents the market rate for an offsetting interest rate swap with the same notional amounts and final maturity date. The market value is then determined by calculating the present value interest differential between the contractual swap and the replacement swap.

As of September 30, 2011 and December 31, 2010, \$43,036 and \$68,794, respectively, was included in Other Liabilities related to the fair value of the Company's interest rate swap, and \$28,404 and \$45,404, respectively, net of tax of \$14,632 and \$23,390, was included in Other Comprehensive Income and Accumulated Other Comprehensive Loss.

The change in unrealized gain (loss) from the Company's interest rate swaps of \$17,000 and \$(3,508) is included in other comprehensive income for the nine months ended September 30, 2011 and 2010, respectively.

Comprehensive income was \$1,707,774 and \$1,429,178 for the three months ended September 30, 2011 and 2010,

respectively. Comprehensive income was \$4,657,907 and \$3,491,923 for the nine months ended September 30, 2011 and 2010, respectively.



Index

CPI AEROSTRUCTURES, INC.

## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

## 4. COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

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

	September 30, 2011		
	U.S		Total
	Government	Commercial	
Costs incurred on uncompleted Contracts	\$ 101,948,169	\$ 22,085,883	\$ 124,034,052
Estimated earnings	43,868,484	15,397,992	59,266,476
Sub-total	145,816,653	37,483,875	183,300,528
Less billings to date	95,339,902	22,493,786	117,883,688
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 50,476,751	\$ 14,990,089	\$ 65,466,840

	December 31, 2010		
	U.S		Total
	Government	Commercial	
Costs incurred on uncompleted contracts	\$ 120,072,649	\$ 33,521,525	\$ 153,594,174
Estimated earnings	51,712,912	17,647,006	69,359,918
Sub-total	171,785,561	51,168,531	222,954,092
Less billings to date	138,885,635	36,903,291	175,788,926
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 32,899,926	\$ 14,265,240	\$ 47,165,166

Revisions in the estimated gross profits on contracts and contract amounts are made in the period in which the circumstances requiring the revisions occur. During the nine months ended September 30, 2011 and 2010, the effect of such revisions in total estimated contract profits resulted in a decrease to the total gross profit to be earned on the contracts of approximately \$2,600,000 and \$2,400,000, respectively, from that which would have been reported had the revised estimates been used as the basis of recognition of contract profits in prior years.

Although management believes it has established adequate procedures for estimating costs to complete on uncompleted open contracts, it is possible that additional significant costs could occur on contracts prior to completion.

Index

CPI AEROSTRUCTURES, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

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5. 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 nine month period ended September 30, 2011 and 2010 is computed using the weighted-average number of shares outstanding adjusted for the incremental shares attributed to outstanding options to purchase common stock. Incremental shares of 643,333 were used in the calculation of diluted income per common share in the three and nine month period ended September 30, 2011. Incremental shares of 80,000 were not included in the diluted earnings per share calculations for the three and nine month period ended September 30, 2011 as their exercise price was in excess of the Company's average stock price for the respective 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 321,400 and 223,430 were used in the calculation of diluted income per common share in the three and nine month period ended September 30, 2010. Incremental shares of 75,000 and 100,000 were not included in the diluted earnings per share calculations for the three and nine month period ended September 30, 2010, 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.

Index

CPI AEROSTRUCTURES, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

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6. LINE OF CREDIT

In August 2007, we entered into a revolving credit facility with Sovereign Bank (the "Sovereign Revolving Facility"), secured by all of our assets.

On May 26, 2010, the Company and Sovereign Bank entered into a third amendment to the Sovereign Revolving Facility increasing the existing revolving credit facility under the Credit Agreement from an aggregate of \$3.5 million to an aggregate of \$4.0 million and extending the term of the revolving credit facility from August 2011 to August 2013. In addition, the interest rate on borrowings under the revolving credit facility was decreased to (i) the greater of 3.75% or 3.25% in excess of the LIBOR Rate or (ii) the greater of 3.75% or 0.50% in excess of Sovereign Bank's prime rate, as elected by the Company in accordance with the Credit Agreement.

As of December 31, 2010, because of the change in estimate on six prime government contracts which resulted in approximately \$7.2 million adjustment to revenue in the fourth quarter of 2010, the Company was not in compliance with the financial covenants contained in the credit agreement. Sovereign Bank has waived these covenants as of December 31, 2010. In addition, the credit agreement's computation for the Debt Service Coverage Ratio has been amended beginning in the first quarter of 2011 so that the change in estimate adjustment doesn't result in a covenant violation in future quarters.

On May 10, 2011, the Company entered into a fifth amendment to its credit agreement with Sovereign Bank, increasing the existing revolving credit facility from an aggregate of \$4 million to an aggregate of \$10 million and extending the term from August 2013 to August 2014. In addition, the interest rate of borrowings under the revolving credit facility will no longer be subject to a minimum rate of 3.75%.

On September 1, 2011, the Company entered into a sixth amendment to its credit agreement with Sovereign Bank, dated as of August 13, 2007, as amended as of October 22, 2008, July 7, 2009, May 21, 2010, March 14, 2011 and May 10, 2011 (the "Credit Agreement"), providing for a \$3 million increase until November 30, 2011 of the existing revolving credit facility under the Credit Agreement, from an aggregate of \$10 million to an aggregate of \$13 million. The revolving credit facility bears interest at a rate of 3.75% per annum as of September 30, 2011.

As of September 30, 2011, the Company was in compliance with all of the financial covenants, as amended, contained in the credit agreement and \$12.6 million was outstanding under the Sovereign Revolving Facility.

7. LONG-TERM DEBT

On October 22, 2008, the Company obtained a \$3.0 million term loan from Sovereign Bank to be amortized over five years (the "Sovereign Term Facility"). Prior to entering into the term loan, the Company had borrowed \$2.5 million under the Sovereign Revolving Facility to fund the initial tooling costs related to a long-term contract award. The Company used the proceeds from the Sovereign Term Facility to repay the borrowings under the Sovereign Revolving Facility and to pay for additional tooling related to the long-term contract. The Sovereign Term Facility bears interest at LIBOR (0.22% at September 30, 2011) plus 2.5% and is secured by all of the assets of the Company.

The terms and conditions of the Sovereign Revolving Facility are applicable to the Sovereign Term Facility.

Additionally, the Company and Sovereign Bank entered into a five-year interest rate swap agreement, in the notional amount of \$3 million. Under the interest rate swap, the Company pays an amount to Sovereign Bank representing interest on the notional amount at a rate of 5.8% and receives an amount from Sovereign representing interest on the notional amount at a rate equal to the one-month LIBOR. The effect of this interest rate swap will be the Company paying a fixed interest rate of 5.8% over the term of the Sovereign Term Facility.

Index

CPI AEROSTRUCTURES, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

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The maturities of long-term debt are as follows:

Twelve months ending September, 30	
2012	\$ 882,291
2013	777,746
2014	199,647
2015	27,014
2016	24,663
	\$ 1,911,361

Also included in long-term debt are capital leases and notes payable of \$611,361, including a current portion of \$282,291.

#### 8. MAJOR CUSTOMERS

During the nine months ended September 30, 2011, the Company's three largest commercial customers accounted for 31%, 30% and 13% of revenue, respectively. During the nine months ended September 30, 2010, the Company's three largest commercial customers accounted for 31%, 22% and 12% of revenue, respectively.

41%, 18%, 16% and 14% of Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts at September 30, 2011 were from the Company's four largest commercial customers. 28%, 22%, 19% and 10% of Cost and Estimated Earnings in Excess of Billings on Uncompleted Contracts at December 31, 2010 were from the Company's four largest commercial customers.

In addition, during the nine months ended September 30, 2011 and 2010, 10% and 23%, respectively, of revenue was directly from the U.S. government. 7% and 16% of Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts at September 30, 2011 and December 31, 2010, respectively, were from the U.S. government.

Index

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

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

Forward Looking Statements

When used in this Form 10-Q and in future filings by us with the Securities and Exchange 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 of our Annual Report on Form 10-K for the year ended December 31, 2010 and Item 2 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 U.S. Air Force and other branches of the U.S. armed forces, either as a prime contractor or as a subcontractor to other defense prime contractors. CPI Aero also acts as a subcontractor to prime aircraft manufacturers in the production of commercial aircraft parts. Our strategy for growth has been focused primarily as a subcontractor for defense prime contractors. Due to our success as a subcontractor to defense prime contractors we have pursued opportunities to increase our commercial subcontracting business.

Marketing and New Business

During the period ended November 5, 2011 we received approximately \$81.5 million of new contract awards, which included approximately \$11.7 million of government prime contract awards, approximately \$24.2 million of government subcontract awards and approximately \$45.6 million of commercial subcontract awards, compared to a total of \$57.3 million of new contract awards, of all types, in the same period last year.

Included in new contract awards are:

- The exercise of options, by Northrop Grumman Corporation (“NGC”) under a previously awarded purchase order for Outer Wing Panel (“OWP”) Kits for use in the manufacture of complete wings for the E-2D Hawkeye and the C-2A Greyhound aircraft. The new orders, valued at \$11.2 million, increases the firm, funded requirements under this program to approximately \$35.9 million. CPI Aero began work on OWP Kits in June 2008.
- Authorization from Spirit AeroSystems, Inc. (“Spirit”) for work on wing leading edge assemblies for the Gulfstream G650 aircraft through production aircraft 98. Included in new contract awards is approximately \$24.5 million for the Spirit program. In March 2008, Spirit and CPI Aero entered into a long term agreement to provide Spirit with leading edges for the wing of the Gulfstream G650 business jet. Spirit designs and manufactures the G650 wing for Gulfstream Aerospace Corporation.



Index

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

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- An \$2.85 million agreement to provide structural assemblies to Sikorsky Aircraft Corp. for use as spares for its BLACK HAWK(R) military helicopter.

We have approximately \$399 million in formalized bids outstanding as of September 30, 2011 and continue to make bids on contracts on a weekly basis. While we cannot predict the probability of obtaining or the timing of awards, some of these outstanding proposals are significant in amount.



Index

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

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While historically our direct U.S. Government work has typically ranged from six months to two years, our major subcontract awards for the E-2D, A-10 and G650 average a 7 year life. Except in cases where contract terms permit us to bill on a progress basis, we must incur upfront costs in producing assemblies, amortize the costs 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.

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 tax purposes) 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, or seek access to other forms of liquidity, to fund our work in process or to pay taxes until the reported earnings materialize as actual cash receipts.

Index

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

---

Results of Operations

Revenue

Revenue for the three months ended September 30, 2011 was \$16,607,638 compared to \$12,976,084 for the same period last year, representing an increase of \$3,631,554 or 28.0%. For the nine months ended September 30, 2011, revenue was \$50,043,470 compared to \$36,526,238 for the same period last year, representing an increase of \$13,517,232 or 37.0%.

We generate revenue from government contracts for which we act as a prime contractor or as a subcontractor as well as from commercial contracts. Revenue generated from prime government contracts for the nine months ended September 30, 2011 was \$4,999,825 compared to \$8,221,185 for the nine months ended September 30, 2010, a decrease of \$3,221,360 or 39.2%. This anticipated decrease resulted from our refocused marketing efforts on subcontracting work over the last two years. Revenue generated from government subcontracts for the nine months ended September 30, 2011 was \$38,180,940 compared to \$22,563,530 for the nine months ended September 30, 2010, an increase of \$15,617,410 or 69.2%. The increase in revenue is primarily the result of work performed for the Boeing Company on the A-10 attack jet and Northrop Grumman Corporation on the E-2D surveillance airplane. Revenue for these two programs accounted for 71.6% of government subcontracting revenue and 54.6% of total revenue for the nine months ended September 30, 2011.

Revenue generated from commercial contracts was \$6,862,705 for the nine months ended September 30, 2011 compared to \$5,741,523 for the nine months ended September 30, 2010, an increase of \$1,121,182 or 19.5%.

Gross Profit

Gross profit for the three months ended September 30, 2011 was \$4,167,605 compared to \$3,382,413 for the three months ended September 30, 2010, an increase of \$785,192. As a percentage of revenue, gross profit for the three months ended September 30, 2011 was 25.1% compared to 26.1% for the same period last year. Gross profit for the nine months ended September 30, 2011 was \$12,262,511 compared to \$9,482,824 for the nine months ended September 30, 2010, an increase of \$2,779,687. As a percentage of revenue, gross profit for the nine months ended September 30, 2011 was 24.5% compared to 26.0% for the same period last year. Our gross margin of 25.1% for the three months ended September 30, 2011 is 80 basis points higher than our gross margin for the three months ended June 30, 2011. This was predominately the result of lower travel and labor costs required for supplier surveillance in the third quarter of 2011 compared to the first half of the year.

Our gross margin percentage of 24.5% for the nine months ended September 30, 2011 was in the center of our expected gross margin percentage range of 24%-25%.

We expect gross margin percentage to be the range of 24%-25% for the remainder of 2011.

Index

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

---

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended September 30, 2011 were \$1,525,386 compared to \$1,181,369 for the three months ended September 30, 2010, an increase of \$344,017, or 29.1%. For the nine months ended September 30, 2011, selling, general and administrative expenses were \$5,408,273 compared to \$4,051,737 for the same period last year, an increase of \$1,356,536, or 33.5%. The increase is primarily due to a \$430,000 increase in public fees, the result of higher Black Sholes valuation for stock options granted to our board of directors as compensation, a \$231,000 increase in salaries and payroll taxes, predominantly for an increase in the number of people, an \$156,000 increase in computer expense and a \$75,000 increase in accrued bonus.

Income Before Provision for Income Taxes

Income before provision for income taxes for the three months ended September 30, 2011 was \$2,531,042 compared to \$2,171,363 for the same period last year, an increase of \$359,679. For the nine months ended September 30, 2011, income before provision for income taxes was \$6,637,907 compared to \$5,301,431 for the same period last year, and increase of \$1,336,476.

Provision for Income Taxes

Provision for income taxes was \$726,000 for the three months ended September 30, 2011, or 29% of pre-tax income, compared to \$742,000 or 34% of pre-tax income for the three months ended September 30, 2010. Provision for income taxes was \$1,894,000 for the nine months ended September 30, 2011, or 29% of pre-tax income compared to \$1,806,000 or 34% of pre-tax income for the nine months ended September 30, 2010. The provision for income taxes as a percentage of pre-tax income decreased because of three factors. In 2011, the Company began taking a deduction for domestic production activity which results in approximately a 2%-3% tax savings. In addition we received a \$66,000 refund of income taxes applicable to the 2007 tax year for research and development tax credits, which reduced the current period tax rate by approximately 1%. In addition, the Company has approximately \$103,000 of research and development tax credits carrying forward from our 2010 tax return, which will reduce the tax provision for 2011 by approximately 1%. Lastly, the Company realized a tax benefit for the exercise of non-qualified stock options during the period which resulted in a 1% reduction in current period tax rate.

Index

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

---

Net Income

Net income for the three months ended September 30, 2011 was \$1,805,042, or \$0.26 per basic share, compared to net income of \$1,429,363, or \$0.21 per basic share, for the same period last year. Net income for the nine months ended September 30, 2011 was \$4,743,907, or \$0.69 per basic share, compared to net income of \$3,495,431, or \$0.54 per basic share, for the same period last year. Diluted income per share for the three months ended September 30, 2011 was \$0.25, calculated utilizing 7,158,715 average shares outstanding. Diluted income per share for the nine months ended September 30, 2011 was \$0.66, calculated utilizing 7,138,081 average shares outstanding.

Liquidity and Capital Resources

General

At September 30, 2011, we had working capital of \$49,266,771 compared to \$44,377,170 at December 31, 2010, an increase of \$4,889,601, or 11.0%.

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. 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 condensed balance sheets 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 revenue, 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.

At September 30, 2011, we had a cash balance of \$353,377 compared to \$823,376 at December 31, 2010. During the nine months ended September 30, 2011, we used cash to pay taxes of \$180,000.

Our costs and estimated earnings in excess of billings increased by approximately \$18.3 million during the nine months ended September 30, 2011. The Boeing A-10 contract accounted for approximately \$13.5 million of this increase. Although this contract does provide for milestone billings, the Company has been limited in its ability to invoice Boeing because of the lack of performance by certain suppliers. This has resulted in us not achieving certain milestone billing events. The supplier performance problem has been rectified, subsequent to September 30, 2011. Additionally, the contract provides that we can’t bill Boeing for approved changes to first articles until such time as the government approves the entire A-10 wing. We have submitted all first articles on this program and are awaiting government approval of Boeing’s complete submission. Lastly, a significant amount of production has been completed, however can’t be shipped and invoiced, as we are awaiting a minor Boeing configuration change. The effect of these conditions on the Boeing contract has resulted in the \$13.3 million increase in costs and estimated

earnings in excess of billings and had a material impact on our liquidity.

Index

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

---

In order to perform on new programs, such as the recently announced Bell and Honda programs, we may be required to expend up-front costs that may have to be amortized over a portion of production units. In the case of significant program delays and/or program cancellations, we could be required to bear impairment charges which may be material, for costs that are not recoverable. Such charges and the loss of up-front costs could have a material impact on our liquidity.

Because of the historical use of cash necessary to fund our rapid growth, in May 2011 and in September 2011 we increased our line of credit with Sovereign Bank. In addition, we continue to work to obtain better payment terms with our customers, expanded progress payment arrangements, as well as exploring alternative funding sources.

On June 30, 2011 we entered into a lease agreement for the premises located at 91 Heartland Boulevard, Edgewood, New York, directly across the street from our current location. The approximate 171,000 square foot building will be used as our assembly facility and principal offices. We intend to move all of our operations presently at 60 Heartland Boulevard, to the new facility by December 31, 2011. We estimate that the cost of the move, along with capital additions, furniture and equipment necessary to complete the transfer of all operations to the new building to be approximately \$1.6 million.

Index

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

---

Credit Facilities

Line of Credit

In August 2007, we entered into a revolving credit facility with Sovereign Bank (the “Sovereign Revolving Facility”), secured by all of our assets.

On May 26, 2010, the Company entered into a third amendment to its credit agreement with Sovereign Bank increasing the existing revolving credit facility under the Credit Agreement from an aggregate of \$3. million to an aggregate of \$4 million and extending the term of the revolving credit facility from August 2011 to August 2013. In addition, the interest rate on borrowings under the revolving credit facility was decreased to (i) the greater of 3.75% or 3.25% in excess of the LIBOR Rate or (ii) the greater of 3.75% or 0.50% in excess of Sovereign Bank’s prime rate, as elected by the Company in accordance with the Credit Agreement.

As of December 31, 2010, because of the change in estimate on three prime government contracts which resulted in approximately \$7.2 million adjustment to revenue in the fourth quarter of 2010, the Company was not in compliance with the financial covenants contained in the credit agreement. Sovereign Bank has waived these covenants as of December 31, 2010. In addition, the credit agreement's computation for the Debt Service Coverage Ratio has been amended beginning in the first quarter of 2011 so that the change in estimate adjustment doesn't result in a covenant violation in future quarters.

On May 10, 2011, the Company entered into a fifth amendment to its credit agreement with Sovereign Bank, increasing the existing revolving credit facility from an aggregate of \$4 million to an aggregate of \$10 million and extending the term from August 2013 to August 2014. In addition, the interest rate of borrowings under the revolving credit facility will no longer be subject to a minimum rate of 3.75%.

On September 1, 2011, the Company entered into a sixth amendment to its credit agreement with Sovereign Bank, dated as of August 13, 2007, as amended as of October 22, 2008, July 7, 2009, May 21, 2010, March 14, 2011 and May 10, 2011 (the “Credit Agreement”), providing for a \$3 million increase until November 30, 2011 of the existing revolving credit facility under the Credit Agreement, from an aggregate of \$10 million to an aggregate of \$13 million. The revolving credit facility bears interest at a rate of 3.75% per annum as of September 30, 2011.

As of September 30, 2011, we were in compliance with all of the financial covenants contained in the credit agreement, as amended, and \$12.6 million was outstanding under the Sovereign Revolving Facility.

Term Loan

On October 22, 2008, we obtained a \$3 million term loan from Sovereign Bank to be amortized over five years (the “Sovereign Term Facility”). Prior to entering into the term loan we had borrowed \$2.5 million under the Sovereign Revolving Facility to fund the initial tooling costs related to the previously mentioned long-term contract with Spirit. We used the proceeds from the Sovereign Term Facility to repay the borrowings under the Sovereign Revolving Facility and to pay for additional tooling related to the Spirit contract. The Sovereign Term Facility bears interest at LIBOR plus 2.5% and is secured by all of our assets.

The terms and conditions of the Sovereign Revolving Facility are applicable to the Sovereign Term Facility.

Additionally, the Company and Sovereign Bank entered into a five-year interest rate swap agreement, in the notional amount of \$3 million. Under the interest rate swap, the Company pays an amount to Sovereign Bank representing interest on the notional amount of 5.8% and receives an amount from Sovereign representing interest on the notional amount at a rate equal to the one-month LIBOR plus 2.5%. The effect of this interest rate swap will be the Company paying a fixed interest rate of 5.8% over the term of the Sovereign Term Facility.



Index

Item 3 – Quantitative and Qualitative Disclosure About Market Risk

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Not Applicable

Item 4 – Controls and Procedures

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Evaluation of Disclosure Controls and Procedures

The Company's management has established disclosure controls and procedures designed to ensure that information it is required to disclose in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commission rules and forms. Such disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information the Company is required to disclose in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management to allow timely decisions regarding required disclosure.

Based on an evaluation of the Company's disclosure controls and procedures as of September 30, 2011 made by management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) were effective as of September 30, 2011.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting occurred during the quarter ended September 30, 2011 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Index

Part II: Other Information

Item 1 – Legal Proceedings

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None.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

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None.

Item 3 – Defaults Upon Senior Securities

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None.

Item 4 – Reserved

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None

Item 5 – Other Information

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None.

Item 6 – Exhibits

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Exhibit Section 302 Certification by Chief Executive Officer and President

31.1

Exhibit Section 302 Certification by Chief Financial Officer (Principal Accounting Officer)

31.2

Exhibit Section 906 Certification by Chief Executive Officer and Chief Financial Officer

32

Exhibit The following financial information from CPI Aerostructures, Inc Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2011 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Statements of Income, (ii) the condensed Balance Sheet, (iii) the Condensed Statements of Cash Flows, and (iv) the Notes to the Condensed Financial Statements.\*

Index

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.

CPI AEROSTRUCTURES, INC.

Dated: November 9, 2011

By. /s/ Edward J. Fred  
Edward J. Fred  
Chief Executive Officer and President

Dated: November 9, 2011

By. /s/ Vincent Palazzolo  
Vincent Palazzolo  
Chief Financial Officer (Principal Accounting Officer)