CPI AEROSTRUCTURES INC
Form 10-Q
May 08, 2015

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 March 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to __________

Commission File Number: 1-11398

CPI AEROSTRUCTURES, INC.

(Exact name of registrant as specified in its charter)

New York	11-2520310

(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

91 Heartland Blvd., Edgewood, NY	11717
(Address of principal executive offices)	(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 (Do not check if a smaller reporting company)	Smaller reporting company

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

As of May 3, 2015 the number of shares of common stock, par value $.001 per share, outstanding was 8,551,578.

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Part I - Financial Information

Item 1 – Financial Statements

CONDENSED BALANCE SHEETS

	March 31, 2015 (Unaudited)	**December 31, 2014 (Note 1)**
ASSETS		
Current Assets:		
Cash	$838,374	$1,504,907
Accounts receivable, net	8,716,418	6,466,814
Costs and estimated earnings in excess of billings on uncompleted contracts	82,916,324	79,054,139
Deferred income taxes	1,708,000	1,708,000
Refundable income taxes	8,480,255	8,138,322
Prepaid expenses and other current assets	957,763	828,275
Total current assets	**103,617,134**	**97,700,457**
Plant and equipment, net	2,747,781	2,755,186
Deferred income taxes	3,199,000	3,591,000
Other assets	108,080	108,080
Total Assets	**$109,671,995**	**$104,154,723**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$9,204,620	$8,928,456
Accrued expenses	978,920	1,061,747
Billings in excess of costs and estimated earnings on uncompleted contracts	123,412	193,650
Current portion of long-term debt	1,001,080	971,713
Contract loss	607,442	396,182
Line of credit	29,150,000	25,150,000
Income tax payable	21,067	6,067
Deferred income taxes	128,000	128,000
Total current liabilities	**41,214,541**	**36,835,815**
Long-term debt, net of current portion	1,102,725	1,289,843
Deferred income taxes	622,000	622,000
Other liabilities	604,406	593,909
Total Liabilities	**43,543,672**	**39,341,567**
Shareholders' Equity:		
	8,540	8,501

Common stock - $.001 par value; authorized 50,000,000 shares, 8,538,742 and 8,500,555 shares, respectively, issued and outstanding		
Additional paid-in capital	51,826,771	51,440,770
Retained earnings	14,301,721	13,373,601
Accumulated other comprehensive loss	(8,709)	(9,716)
Total Shareholders' Equity	**66,128,323**	**64,813,156**
Total Liabilities and Shareholders' Equity	**$109,671,995**	**$104,154,723**

See Notes to Condensed Financial Statements

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CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For the Three Months Ended March 31, 2015 (Unaudited)	2014
Revenue	$19,876,566	$21,883,517
Cost of sales	16,274,495	17,392,385
Gross profit	3,602,071	4,491,132
Selling, general and administrative expenses	2,019,365	1,838,660
Income from operations	1,582,706	2,652,472
Interest expense	214,586	143,603
Income before provision for income taxes	1,368,120	2,508,869
Provision for income taxes	440,000	780,000
Net income	928,120	1,728,869
Other comprehensive income, net of taxes		
Change in unrealized gain on interest rate swap	1,007	3,179
Comprehensive income	$929,127	$1,732,048
Income per common share – basic	$0.11	$0.21
Income per common share – diluted	$0.11	$0.20
Shares used in computing income per common share:		
Basic	8,516,973	8,421,142
Diluted	8,594,479	8,534,856

See Notes to Condensed Financial Statements

CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY **(UNAUDITED)**

	CommonStock Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at January 1, 2014	8,410,493	$ 8,410	$ 50,381,348	$ 38,582,876	$ (21,115)	$ 88,951,519
Net income	----	----	----	1,728,869	----	1,728,869
Change in unrealized loss from interest rate swap	----	----	----	----	3,179	3,179
Common stock issued upon exercise of options	50,292	51	278,049	----	----	278,100
Tax benefit of stock option exercise	---	---	52,000	---	---	52,000
Stock- based compensation expense	----	----	102,809	----	----	102,809
Balance at March 31, 2014	8,460,785	$ 8,461	$ 50,814,206	$ 40,311,745	$ (17,936)	$ 91,116,476
Balance at January 1, 2015	8,500,555	$ 8,501	$ 51,440,770	$ 13,373,601	$ (9,716)	$ 64,813,156
Net income	----	----	----	928,120	----	928,120
Change in unrealized loss from interest rate swap	----	----	----	----	1,007	1,007
Common stock issued upon exercise of options	25,352	26	79,974	----	----	80,000
Tax benefit of stock option exercise	---	---	33,000	---	---	33,000
Stock-based compensation expense	12,835	13	273,027	----	----	273,040
Balance at March 31, 2015	8,538,742	$ 8,540	$ 51,826,771	$ 14,301,721	$ (8,709)	$ 66,128,323

See Notes to Condensed Financial Statements

CONDENSED STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31,	2015	2014
Cash flows from operating activities:		
Net income	$928,120	$1,728,869
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	204,676	175,043
Deferred rent	11,504	4,274
Stock-based compensation	273,040	102,809
Deferred and refundable income taxes	50,067	108,000
Tax benefit (provision) from stock option plans	(33,000)	(52,000)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(2,249,604)	(3,716,105)
(Increase) decrease in costs and estimated earnings in excess of billings on uncompleted contracts	(3,862,185)	(6,608,417)
Increase in prepaid expenses and other assets	(129,488)	(128,599)
Decrease (increase) in accounts payable and accrued expenses	193,337	(39,126)
Decrease in billings in excess of costs and estimated earnings on uncompleted contracts	(70,238)	(96,472)
Increase in accrued losses on uncompleted contracts	211,260	---
Increase (decrease) in income taxes payable	48,000	(171,837)
Net cash used in operating activities	(4,424,511)	(8,693,561)
Cash used in investing activities - purchase of plant and equipment	(105,442)	(56,137)
Cash flows from financing activities:		
Payments on long-term debt	(249,580)	(272,980)
Proceeds from line of credit	4,000,000	7,500,000
Proceeds from exercise of stock options	80,000	278,100
Tax benefit from stock option plans	33,000	52,000
Net cash provided by financing activities	3,863,420	7,557,120
Net decrease in cash	(666,533)	(1,192,578)
Cash at beginning of period	1,504,907	2,166,103
Cash at end of period	$838,374	$973,525
Supplemental disclosures of cash flow information:		
Noncash investing and financing activities:		
Equipment acquired under capital lease	$91,829	---
Cash paid during the period for:		
Interest	$233,074	$250,852

Income taxes	$29	$850,000

See Notes to Condensed Financial Statements

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NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1. INTERIM FINANCIAL STATEMENTS

The condensed financial statements of CPI Aerostructures, Inc. (the "Company") as of March 31, 2015 and for the three months ended March 31, 2015 and 2014 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). 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, 2014 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. All adjustments that, in the opinion of management, are necessary for a fair presentation for the periods presented have been reflected as required by the SEC. Such adjustments are of a normal, recurring nature. 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, 2014. The results of operations for interim periods are not necessarily indicative of the operating results to be expected for the full year or any other interim period.

The Company maintains its cash in two financial institutions. The balances are insured by the Federal Deposit Insurance Corporation. From time to time, the Company's balances may exceed these limits. As of March 31, 2015, the Company had approximately $639,000 of uninsured balances. The Company limits its credit risk by selecting financial institutions considered to be highly creditworthy.

The Company predominantly recognizes revenue from 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 during any reporting period. The Company continually evaluates all of the issues related to the assumptions, risks and uncertainties inherent with the application of the POC method of accounting; however, it cannot be assured that estimates will be accurate. If estimates are not accurate or a contract is terminated, the Company is required to adjust revenue in later periods. Furthermore, even if estimates are accurate, there may be a shortfall in cash flow and the Company may need to borrow money, or seek access to other forms of liquidity, to fund its work in process or to pay taxes until the reported earnings materialize as actual cash receipts.

When adjustments are required for the estimated total revenue on a contract, these changes are recognized with an inception-to-date effect in the current period. Also, when estimates of total costs to be incurred exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded in the period in which the loss is determined.

Because of the change in estimate on the Company's A-10 program recognized in the quarter ended June 30, 2014 the Company incurred a net loss for the year ended December 31, 2014. The A-10 program, along with all the Company's programs, is evaluated on an ongoing basis. If facts and circumstances change, previously recognized estimates may be adjusted in the future and such adjustments may be material. This net loss, after adjustment for carrying back tax losses to recover previously paid taxes of approximately $8,400,000, results in a net operating loss carry forward at March 31, 2015 of approximately $5,900,000 which will expire in 2029. The Company's 2014 tax return, along with its claim to recover the aforementioned previously paid taxes, were filed with the IRS in April of 2015.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2016. ASU 2014-09 is effective for our first quarter of fiscal year 2017 using either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

In April 2015, the FASB proposed deferring the effective date of ASU 2014-09 for one year, and proposed some modifications to the original provisions. These proposals are pending.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

2. **stock-based compensation**

The Company accounts for compensation expense associated with stock options and restricted stock units ("RSUs") based on the fair value of the options and units on the date of grant.

The Company's net income for the three months ended March 31, 2015 and 2014 includes approximately $273,000 and $103,000, respectively, of non-cash compensation expense related to the Company's stock compensation grants. On January 1, 2015, the Company granted 51,349 RSUs to its board of directors as partial compensation for the 2015 year. RSU's vest straight line on a quarterly basis over a one year period. On January 1, 2014, the Company granted 36,292 options to its board of directors as partial compensation for the 2014 year. 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 estimated fair value of each RSU granted was determined based on the fair market value of the Company's common stock on the date of grant.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

The following weighted-average assumptions were used for the options granted during the three months ended March 31, 2014:

	2014	
Risk-free interest rate	1.45	%
Expected volatility	102	%
Dividend yield	0	%
Expected option term (in years)	5	

A summary of the status of the Company's stock option plans as of March 31, 2015 and changes during the three months ended March 31, 2015 is as follows:

	Options	Weighted average Exercise Price	Weighted average remaining contractual term (in years)	Aggregate Intrinsic Value
Outstanding at beginning of period	349,983	$ 10.97		
Exercised	(55,000)	8.00		
Outstanding and vested at end of period	294,983	$ 11.53	2.32	$ 520,578

During the three months ended March 31, 2015, 10,000 stock options were exercised for cash resulting in proceeds to the Company of $80,000. During the same period 45,000 options were exercised, pursuant to provisions of the stock option plan, where the Company received no cash and 29,648 shares of its common stock in exchange for the 45,000 shares issued in the exercise. The 29,648 shares that the Company received were valued at $362,012, the fair market value of the shares on the dates of exercise.

The intrinsic value of all options exercised during the three months ended March 31, 2015 and 2014 was approximately $230,500 and $413,450, 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 a financial institution. We do not use derivative instruments for trading purposes and we have procedures in place to monitor and control their use.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

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.

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.

In March 2012, the Company entered into interest rate swaps 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 these interest rate swap contracts as cash flow hedges. The Company measures ineffectiveness by comparing the cumulative change in the forward contact with the cumulative change in the hedged item. No material ineffectiveness was recognized in the quarter ended March 31, 2015. As of March 31, 2015 and December 31, 2014, we had a net deferred loss associate