

Section 1: 10-K (ANNUAL REPORT)

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2017

Commission file number 1-11398

CPI AEROSTRUCTURES, INC.

(Exact name of registrant as specified in its charter)

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

11-2520310
(I.R.S. Employer
Identification No.)

91 Heartland Blvd., Edgewood, New York 11717
(Address of principal executive offices)

(631) 586-5200
(Registrant's telephone number, including area code)

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

| <u>Title of Each Class</u> | <u>Name of each exchange on which registered</u> |
|--------------------------------|--|
| Common Stock, \$.001 par value | NYSE American |

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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, 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 (check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(do not check if a smaller reporting company)
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b-2 of the Exchange Act).

Yes No

As of June 30, 2017 (the last business day of the registrant’s most recently completed second fiscal quarter), the aggregate market value of the registrant’s common stock (based on its reported last sale price on the NYSE American of \$9.40) held by non-affiliates of the registrant was \$73,550,935.

As of March 5, 2018, the registrant had 8,878,965 common shares, \$.001 par value, outstanding.

Documents Incorporated by Reference:

Part III (Items 10, 11, 12, 13 and 14) from the definitive Proxy Statement for the 2018 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant’s fiscal year covered by this report.

CPI AEROSTRUCTURES, INC.
FORM 10-K ANNUAL REPORT
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PART I

Item 1. BUSINESS

General

CPI Aerostructures, Inc. (“CPI Aero®”, the “Company”, “us” or “we”) is a United States (“U.S.”) supplier of aircraft parts for fixed wing aircraft and helicopters in both the commercial and defense markets. We are a manufacturer of structural aircraft parts and aerosystems. Additionally, we leverage our global supply chain skills to assist our customers in managing a diverse worldwide supplier market by providing “one stop shopping” for an assortment of aerospace parts. Within the global aerostructures supply chain, we are either a Tier 1 supplier to aircraft original equipment manufacturers (“OEMs”) or a Tier 2 subcontractor to major Tier 1 manufacturers. We also are a prime contractor to the U.S. Department of Defense, primarily the United States Air Force (“USAF”). In addition to our assembly operations, we provide engineering; program management, supply chain management, and maintenance repair and overhaul (“MRO”) services.

Among the key programs for which CPI Aero provides key structural components, assemblies or aerospace systems are: E-2D Advanced Hawkeye, F-35 Joint strike fighter, UH-60 BLACK HAWK® helicopter, DB-110 reconnaissance system, Raytheon Next Generation Jammerpod, Increment 1 electronic warfare system, F-16 Falcon and T-38 Pacer Classic III. Key civilian aircraft programs include the Gulfstream G-650, HondaJet, Embraer Phenom 300, UTAS TacSAR pod, S-92 helicopter, MH-60S mine countermeasure helicopter, AH-1Z ZULU attack helicopter, MH-53, CH-53, C-5A Galaxy and the Embraer E2-175 regional airliner.

We are a subcontractor for leading defense prime contractors such as Northrop Grumman Corporation (“NGC”), Lockheed Martin Corporation (“Lockheed”), Sikorsky Aircraft Corporation, a Lockheed company (“Sikorsky”), Bell Helicopter (“Bell”), Raytheon and United Technologies Aerospace Systems (“UTAS”). 56%, 46% and 57% of our revenue in 2017, 2016 and 2015, respectively, was generated by subcontracts with defense prime contractors. Our 2016 defense subcontractor revenue was significantly decreased because of the change in estimate on the A-10 program, described in Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MDA”).

We also operate as a subcontractor to prime commercial contractors, including Sikorsky, Honda Aircraft Company, Inc. (“Honda”), Embraer S.A. (“Embraer”) and The Triumph Group (“Triumph”), in the production of commercial aircraft parts. 36%, 50% and 42% of our revenue in 2017, 2016 and 2015, respectively, was generated by commercial contract sales.

CPI Aero has over 37 years of experience as a contractor. Most members of our management team have held management positions at large aerospace contractors, including NGC and GKN Aerospace (“GKN”). Our technical team possesses extensive technical expertise and program management and integration capabilities. Our competitive advantage lies in our ability to offer large contractor capabilities with the flexibility and responsiveness of a small company, while staying competitive in cost and delivering superior quality products.

CPI Aero was incorporated under the laws of the State of New York in January 1980 under the name Composite Products International, Inc. CPI Aero changed its name to Consortium of Precision Industries, Inc. in April 1989 and to CPI Aerostructures, Inc. in July 1992. In January 2005, we began doing business under the name CPI Aero®, a registered trademark of the Company. Our principal office is located at 91 Heartland Blvd., Edgewood, New York 11717 and our telephone number is (631) 586-5200.

We maintain a website located at www.cpiaero.com. Our corporate filings, including our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K, our proxy statements and reports filed by our officers and directors under Section 16-(a) of the Securities Exchange Act, and any amendments to those filings, are available, free of charge, on our website as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission. We do not intend for information contained in our website to be a part of this Annual Report on Form 10-K.

Significant Contracts

Some of our significant contracts are as follows:

Military Aircraft – Subcontracts with Prime Contractors

E-2D “Advanced Hawkeye” The NGC E-2 Hawkeye is an all-weather, carrier-based tactical Airborne Early Warning aircraft. The twin turboprop aircraft was designed and developed in the 1950s by the Grumman Aircraft Company for the United States Navy as a replacement for the E-1 Tracer. The United States Navy aircraft has been progressively updated with the latest variant, the E-2D, first flying in 2007. In 2008, we received an initial \$7.9 million order from NGC to provide structural kits used in the production of Outer Wing Panels (“OWP”) of the E-2D. We initially valued the long-term agreement at approximately \$98 million over an eight-year period, with the potential to be in excess of \$195 million over the life of the aircraft program. The cumulative orders we have received on this program through January 2018 exceed \$147 million.

In addition, in 2015 we won an award to supply structural components and kits for the Outer Wing Panel (“OWP”) on the E-2D Advanced Hawkeye airborne early warning and control (“AEW&C”) aircraft that will be manufactured for Japan. We are responsible for component source selection, supply chain management, delivery of kits, and are providing manufacturing engineering services to NGC during the integration of the components into the OWP. The contract from NGC is valued at between \$25 million and \$30 million.

UH-60 “BLACK HAWK” The UH-60 BLACK HAWK helicopter is the leader in multi-mission-type aircraft. Among the mission configurations it serves are troop transport, medical evacuation, electronic warfare, attack, assault support and special operations. More than 3,000 BLACK HAWK helicopters are in use today, operating in 29 countries. We have long-term agreements from Sikorsky to manufacture gunner window assemblies, fuel panel assemblies, and perform MRO on stabilators for the BLACK HAWK helicopter through 2022.

F-16 “Fighting Falcon” The Lockheed Martin Fighting Falcon is a single-engine multirole fighter aircraft. Originally developed by General Dynamics for the USAF, over 2,900 F-16 aircraft are flown by the USAF and by air forces around the world today. CPI Aero has a contract with UTAS to manufacture pod structures for the DB-110 reconnaissance system, which is used primarily on exported F-16 aircraft.

Next Generation Jamming Pod The next generation jamming pod is an external jamming pod that will disrupt and degrade enemy aircraft and ground radar and communication systems and will replace the ALQ-99 system on the US Navy's EA-6B Growler carrier-based electronic warfare aircraft. The US Navy plans to install these pods on 138 EA-18G Growlers during the production phase. There are 2 pods per aircraft. Raytheon received a \$1 billion sole source contract from the US Navy in April 2016, and CPI has a contract with Raytheon to assemble the pod structural housing and air management system.

UTAS TacSAR Pod CPI Aero received a \$600,000 contract to begin engineering in 2017 and expects to receive an initial production order in the first half of 2018. The contract is sole-source to CPI and valued at approximately \$35 million. The work being performed by CPI is similar to work performed during the pre-production phase of the DB-110 Reconnaissance Pod we currently manufacture for UTAS. The TacSAR pod system complements the DB-110 system to provide all-weather reconnaissance and surveillance and will contain some structural components common to the DB-110 reconnaissance pod.

F-35 Lightning II The F-35 Lightning II is a family of single-seat, single-engine, all-weather stealth multirole fighters designed to perform ground attack, aerial reconnaissance, and air defense missions. The Department of Defense plans to acquire over 2,400 F-35's by 2034 and 11 other countries also have plans to acquire the aircraft. In 2015, CPI was awarded a multi-year contract to supply lock assemblies for the arresting gear door on the F-35A CTOL, estimated at up to \$10.6 million. CPI made its first delivery under that contract in May 2017. In November 2017, CPI was awarded an additional \$15.8 million multi-year contract to manufacture canopy activation drive shaft assemblies for the F-35A, F-35B, and F-35C aircraft.

Commercial Aircraft – Subcontracts with Prime Contractors

Gulfstream G650 In March 2008, Spirit Aerosystems (“Spirit”) awarded us a contract to provide leading edges for the Gulfstream G650 business jet, a commercial program that Spirit was supporting. In December 2014, Spirit transferred its work-scope on this program to Triumph. We will continue to provide leading edges for the G650 as our purchase orders and long-term agreement have transferred to Triumph.

HondaJet In May 2011, Honda awarded us a contract to manufacture engine inlets for the HondaJet advanced light business jet. We have received approximately \$30.5 million in orders on this program through December 2017. We estimate the potential value of this program to be approximately \$70 million.

Embraer Phenom 300 In May 2012, Embraer awarded us a contract to manufacture engine inlets for the Embraer Phenom 300 business jet. We have received approximately \$32.9 million in orders on this program through December 2017. We estimate the potential value of the program to be in excess of \$40 million.

Cessna Citation X In November 2012, Cessna Aircraft Company (“Cessna”) awarded us a contract to supply structural assemblies, predominately wing spars, for Cessna’s flagship aircraft, the newly-relaunched Cessna Citation X. We have received approximately \$10.4 million in orders on this program.

S-92 Helicopter The S-92 helicopter performs search and rescue missions, heads of state missions, and a variety of transportation missions for offshore oil and gas crews, utility, and airline passengers. Sikorsky has delivered more than 275 S-92 helicopters since 2004. In 2017, CPI announced a follow-on contract with Sikorsky to provide 15 different deliverable items for the S-92 helicopter, including door assemblies, cover assemblies, and various installation kits used by Sikorsky to complete final assembly of the S-92 helicopter.

Military Aircraft – Prime Contracts with U.S. Government

F-16 “Fighting Falcon” In November 2014, The Defense Logistics Agency (“DLA”) awarded CPI Aero a multi-year contract to provide structural wing components and logistical support for global F-16 aircraft MRO operations. We estimate the value of the contract, including options, to be approximately \$53.5 million.

T-38C Pacer Classic III In September 2017, the company received purchase orders valued at approximately \$2 million from the USAF to provide structural modification kits for the T-38C Pacer Classic III aircraft structural modification program.

Sales and Marketing

We are recognized within the aerospace industry as a Tier 1 or Tier 2 supplier to major aircraft suppliers. Additionally, we may bid for military contracts set aside specifically for small businesses.

We are awarded contracts for our products and services through the process of competitive bidding. This process begins when we first learn, formally or otherwise, of a potential contract from a prospective customer and concludes after all negotiations are completed upon award. When preparing our response to a prospective customer for a potential contract, we evaluate the contract requirements and determine and outline the services and products we can provide to fulfill the contract at a competitive price. Each contract also benefits from various additional services that we offer, including program management, engineering, and global supply chain program management, which streamlines the vendor management and procurement process and monitors the progress, timing, and quality of component delivery.

Our average sales cycle, which generally commences at the time a prospective customer issues a request for proposal and ends upon delivery of the final product to the customer, varies widely.

Because of the complexities inherent in the aerospace industry, the time from the initial request for proposal to award ranges from as little as a few weeks to several years. Additionally, our contracts have ranged from six months to as long as ten years. Also, repeat and follow-on jobs for current contracts frequently provide additional opportunities with minimal start-up costs and rapid rates to production.

The Market

We have positioned our Company to take advantage of opportunities in the military aerospace market but to a broad customer base thereby reducing the impact of direct government contracting limitations. Our success as a subcontractor to defense prime contractors has provided us with opportunities to act as a subcontractor to prime contractors in the production of commercial aircraft structures, which also reduced our exposure to government spending decisions.

Over time, our Company has expanded both in size and capabilities, with growth in our operational and global supply chain program management. These expansions have allowed us the ability to supply more complex aerostructure assemblies and aerosystems and structures in support of our government-based programs as well as to pursue opportunities within the commercial and business jet markets. Our capabilities have also allowed us to acquire MRO and kitting contracts.

Approximately \$3.1 million, \$8.7 million and \$9.9 million of our revenue for the years ended December 31, 2017, 2016 and 2015, respectively, was from customers outside the U.S. All other revenue for each of the three years in the period ended December 31, 2017 has been attributable to customers within the U.S. We have no assets outside the U.S. Government-based contracts are subject to national defense budget and procurement funding decisions which, accordingly, drives demand for our business in that market. Government spending and budgeting for procurement, operations and maintenance are affected not only by military action, but also the related fiscal consequences of these actions, as well as the political process.

Backlog

We produce custom assemblies pursuant to long-term contracts and customer purchase orders. Backlog consists of aggregate values under such contracts and purchase orders, excluding the portion previously included in operating revenues on the basis of percentage of completion accounting, and including estimates of future contract price escalation. Substantially all of our backlog is subject to termination at will and rescheduling, without significant penalty. Funds are often appropriated for programs or contracts on a yearly or quarterly basis, even though the contract may call for performance that is expected to take a number of years. Therefore, our funded backlog does not include the full value of our contracts. Our total backlog as of December 31, 2017 and 2016 was as follows:

| Backlog (Total) | December 31, 2017 | December 31, 2016 |
|--------------------|-------------------|-------------------|
| Funded | \$ 71,059,000 | \$ 94,540,000 |
| Unfunded | 317,667,000 | 321,744,000 |
| Total | \$ 388,726,000 | \$ 416,284,000 |

Approximately 78% of the total amount of our backlog at December 31, 2017 was attributable to government contracts. Our backlog attributable to government contracts at December 31, 2017 and 2016 was as follows:

| Backlog (Government) | December 31, 2017 | December 31, 2016 |
|-------------------------|-------------------|-------------------|
| Funded | \$ 58,919,000 | \$ 92,189,000 |
| Unfunded | 242,367,000 | 229,543,000 |
| Total | \$ 301,286,000 | \$ 321,732,000 |

Our backlog attributable to commercial contracts at December 31, 2017 and 2016 was as follows:

| Backlog (Commercial) | December 31, 2017 | December 31, 2016 |
|-------------------------|-------------------|-------------------|
| Funded | \$ 12,140,000 | \$ 2,351,000 |
| Unfunded | 75,300,000 | 92,201,000 |
| Total | \$ 87,440,000 | \$ 94,552,000 |

Our unfunded backlog is primarily comprised of the long-term contracts that we received from Spirit and NGC during 2008, Honda and Bell during 2011 and Cessna, Sikorsky and Embraer during 2012. These long-term contracts are expected to have yearly orders which will be funded in the future.

Approximately 38% of the funded backlog at December 31, 2017 is expected to be recognized as revenue during 2018.

Material and Parts

We subcontract production of substantially all parts incorporated into our products to third party manufacturers under firm fixed price orders. Our decision to purchase certain components generally is based upon whether the components are available to meet required specifications at a cost and with a delivery schedule consistent with customer requirements. From time to time, we are required to purchase custom made parts from sole suppliers and manufacturers in order to meet specific customer requirements.

We obtain our raw materials from several commercial sources. Although certain items are only available from limited sources of supply, we believe that the loss of any single supplier would not have a material adverse effect on our business.

Competition

We face competition in our role as both a prime contractor to the U.S. Government and as a Tier 1 or Tier 2 subcontractor to military and commercial aircraft manufacturers. For certain unrestricted contracts for the U.S. Government, we may compete against well-established prime contractors, including NGC, Lockheed and Boeing. All of these competitors possess significantly larger infrastructures, greater resources and the capabilities to respond to much larger contracts. We believe that our competitive advantage lies in our ability to offer large contractor capabilities with the flexibility and responsiveness of a small company, while staying competitive in cost and delivering superior quality products. While larger prime contractors compete for significant modification awards, they generally do not compete for awards in smaller modifications, spares and replacement parts, even for aircraft for which they are the original manufacturer. In certain instances, the large prime contractors often subcontract much of the work they win to their Tier 1 suppliers so we also may act as a subcontractor to some of these major prime contractors. Further, in some cases, these companies are not permitted to bid, for example when the U.S. Government designates a contract as a Small Business Set-Aside. In these restricted contracts for the U.S. Government, CPI Aero typically competes against numerous small business competitors. We believe we compete effectively against the smaller competitors because smaller competitors generally do not have the expertise we have in responding to requests for proposals for government contracts, nor will they typically have the more than 35 years of past performance in conducting more than 2000 contracts for the U.S. Government.

We also compete at the Tier 1 and Tier 2 levels for work for major subcontracts with OEMs in both the military and commercial markets. We often compete against much larger Tier 1 suppliers, such as Triumph Group, Spirit AeroSystems, Kaman Aerospace, GKN, Ducommun, LMI Aerospace, and Precision Castparts Corp. We believe that we can compete effectively with these larger companies by delivering products with the same level of quality and performance at a better value for our customer.

Government Regulation

Environmental Regulation

We are subject to regulations administered by the U.S. Environmental Protection Agency, the U.S. Occupational Safety and Health Administration, various state agencies and county and local authorities acting in cooperation with federal and state authorities. Among other things, these regulatory bodies impose restrictions to control air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous chemicals and substances. The extensive regulatory framework imposes compliance burdens and risks on us. Governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose civil and criminal fines in the case of violations.

The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (“CERCLA”) imposes strict, joint and several liability on the present and former owners and operators of facilities that release hazardous substances into the environment. The Resource Conservation and Recovery Act of 1976 (“RCRA”) regulates the generation, transportation, treatment, storage and disposal of hazardous waste. In New York State, the handling, storage and disposal of hazardous substances are governed by the Environmental Conservation Law, which contains the New York counterparts of CERCLA and RCRA. In addition, the Occupational Safety and Health Act, which requires employers to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, obligates employers to provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances.

Our operations require the use of a limited amount of chemicals and other materials for painting and cleaning, including solvents and thinners, which are classified under applicable laws as hazardous chemicals and substances. We have obtained a permit from the Town of Islip, New York, Building Division in order to maintain a paint booth containing flammable liquids.

Federal Aviation Administration Regulation

We are subject to regulation by the Federal Aviation Administration (“FAA”) under the provisions of the Federal Aviation Act of 1958, as amended. The FAA prescribes standards and licensing requirements for aircraft and aircraft components. We are subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. Our failure to comply with applicable regulations could result in the termination of or our disqualification from some of our contracts, which could have a material adverse effect on our operations.

Government Contract Compliance

Our government contracts and sub-contracts are subject to the procurement rules and regulations of the U.S. Government. Many of the contract terms are dictated by these rules and regulations. Specifically, cost-based pricing is determined under the Federal Acquisition Regulations (“FAR”), which provide guidance on the types of costs that are allowable in establishing prices for goods and services under U.S. Government contracts. For example, costs such as those related to charitable contributions, advertising, interest expense, and public relations are unallowable, and therefore not recoverable through sales. During and after the fulfillment of a government contract, we may be audited in respect of the direct and allocated indirect costs attributed thereto. These audits may result in adjustments to our contract costs. Additionally, we may be subject to U.S. Government inquiries and investigations because of our participation in government procurement. Any inquiry or investigation can result in fines or limitations on our ability to continue to bid for government contracts and fulfill existing contracts. We believe that we are in compliance with all federal, state and local laws and regulations governing our operations and have obtained all material licenses and permits required for the operation of our business.

The U.S. Government generally has the ability to terminate our contracts, in whole or in part, without prior notice, for convenience or for default based on performance. If a U.S. Government contract were to be terminated for convenience, we generally would be protected by provisions covering reimbursement for costs incurred on the contract and profit on those costs, but not the anticipated profit that would have been earned had the contract been completed. In the unusual circumstance where a U.S. Government contract does not have such termination protection, we attempt to mitigate the termination risk through other means. Termination resulting from our default may expose us to liability and could have a material adverse effect on our ability to compete for other contracts. The U.S. Government also has the ability to stop work under a contract for a limited period of time for its convenience. In the event of a stop work order, we generally would be protected by provisions covering reimbursement for costs incurred on the contract to date and for costs associated with the temporary stoppage of work on the contract. However, such temporary stoppages and delays could introduce inefficiencies for which we may not be able to negotiate full recovery from the U.S. Government, and could ultimately result in termination for convenience or reduced future orders on certain contracts. Additionally, we may be required to continue to perform for some period of time on certain of our U.S. Government contracts, even if the U.S. Government is unable to make timely payments.

Insurance

We maintain a \$2 million general liability insurance policy, a \$100 million products liability insurance policy, and a \$5 million umbrella liability insurance policy. Additionally, we maintain a \$10 million director and officers’ insurance policy. We believe this coverage is adequate for the types of products presently marketed because of the strict inspection standards imposed on us by our customers before they take possession of our products. Additionally, the FAR generally provide that we will not be held liable for any loss of or damage to property of the U.S. Government that occurs after the U.S. Government accepts delivery of our products and that results from any defects or deficiencies in our products unless the liability results from willful misconduct or lack of good faith on the part of our managerial personnel.

Proprietary Information

None of our current assembly processes or products is protected by patents. We rely on proprietary know-how and information and employ various methods to protect the processes, concepts, ideas and documentation associated with our products. These methods, however, may not afford complete protection and there can be no assurance that others will not independently develop such processes, concepts, ideas and documentation.

CPI Aero® is a registered trademark of the Company.

Employees

As of March 9, 2018, we had 230 full-time employees. We employ temporary personnel with specialized disciplines on an as-needed basis. None of our employees are members of a union. We believe that our relations with our employees are good.

Item 1A. RISK FACTORS

In addition to other risks and uncertainties described in this Annual Report on Form 10-K, the following material risk factors should be carefully considered in evaluating our business because such factors may have a significant impact on our business, operating results, liquidity and financial condition. As a result of the risk factors set forth below, actual results could differ materially from those projected in any forward-looking statements.

Risks related to our business

We depend on government contracts for a significant portion of our revenues.

We are a supplier, either directly or as a subcontractor, to the U.S. Government and its agencies. Government subcontracts accounted for 56% of our revenue in 2017, 46% of our revenue in 2016 and 57% of our revenue in 2015. In addition, 8% percent of revenue for 2017, 4% of revenue for 2016 and 1% of revenue for 2015 was derived from prime government contract sales. We depend on government contracts for a significant portion of our business. If we are suspended or barred from contracting with the U.S. Government, if our reputation or relationship with individual federal agencies were impaired, or if the U.S. Government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our business, prospects, financial condition and operating results would be materially adversely affected.

We face risks relating to government contracts.

The funding of U.S. Government programs is subject to congressional budget authorization and appropriation processes. For many programs, U.S. Congress appropriates funds on a fiscal year basis even though a program may extend over several fiscal years. Consequently, programs are often only partially funded initially and additional funds are committed only as Congress makes further appropriations. We cannot predict the extent to which total funding and/or funding for individual programs will be included, increased or reduced in budgets approved by Congress or be included in the scope of separate supplemental appropriations. In the event that appropriations for any of our programs becomes unavailable, or is reduced or delayed, our contract or subcontract under such program may be terminated or adjusted by the U.S. Government, which could have a material adverse effect on our future sales under such program, and on our financial position, results of operations and cash flows.

We also cannot predict the impact of potential changes in priorities due to military transformation and planning and/or the nature of war-related activity on existing, follow-on or replacement programs. A shift of government priorities to programs in which we do not participate and/or reductions in funding for or the termination of programs in which we do participate, unless offset by other programs and opportunities, could have a material adverse effect on our financial position, results of operations and cash flows.

In addition, the U.S. Government generally has the ability to terminate contracts, in whole or in part, without prior notice, for convenience or for default based on performance. In the event of termination for the U.S. Government's convenience, contractors are generally protected by provisions covering reimbursement for costs incurred on the contracts and profit on those costs but not the anticipated profit that would have been earned had the contract been completed. Termination by the U.S. Government of a contract for convenience could also result in the cancellation of future work on that program. Termination by the U.S. Government of a contract due to our default could require us to pay for re-procurement costs in excess of the original contract price, net of the value of work accepted from the original contract. Termination of a contract due to our default may expose us to liability and could have a material adverse effect on our ability to compete for contracts.

We have risks associated with competing in the bidding process for contracts.

We obtain many of our contracts through a competitive bidding process. In the bidding process, we face the following risks:

- we must bid on programs in advance of their completion, which may result in unforeseen technological difficulties or cost overruns;
- we must devote substantial time and effort to prepare bids and proposals for competitively awarded contracts that may not be awarded to us; and

- awarded contracts may not generate sales sufficient to result in profitability.

We are subject to strict governmental regulations relating to the environment, which could result in fines and remediation expense in the event of non-compliance.

We are required to comply with extensive and frequently changing environmental regulations at the federal, state and local levels. Among other things, these regulatory bodies impose restrictions to control air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous substances into the environment. This extensive regulatory framework imposes significant compliance burdens and risks on us. In addition, these regulations may impose liability for the cost of removal or remediation of certain hazardous substances released on or in our facilities without regard to whether we knew of, or caused, the release of such substances. Furthermore, we are required to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances. Our operations require the use of a limited amount of chemicals and other materials for painting and cleaning that are classified under applicable laws as hazardous chemicals and substances. If we are found not to be in compliance with any of these rules, regulations or permits, we may be subject to fines, remediation expenses and the obligation to change our business practice, any of which could result in substantial costs that would adversely impact our business operations and financial condition.

We may be subject to fines and disqualification for non-compliance with Federal Aviation Administration regulations.

We are subject to regulation by the FAA under the provisions of the Federal Aviation Act of 1958, as amended. The FAA prescribes standards and licensing requirements for aircraft and aircraft components. We are subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. Our failure to comply with applicable regulations could result in the termination of or our disqualification from some of our contracts, which could have a material adverse effect on our operations and financial condition.

If our subcontractors or suppliers fail to perform their contractual obligations, our contract performance and our ability to obtain future business and our profitability could be materially and adversely impacted.

Most of our contracts involve subcontracts with other companies upon which we rely to perform a portion of the services that we must provide to our customers. There is a risk that we may have disputes with our subcontractors, including disputes regarding the quality and timeliness of work performed by the subcontractor, customer concerns about the subcontract, our failure to extend existing task orders or issue new task orders under a subcontract, or our hiring of personnel of a subcontractor. A failure by one or more of our subcontractors to satisfactorily provide on a timely basis the agreed-upon supplies or perform the agreed-upon services may materially and adversely impact our ability to perform our obligations as the prime contractor. Subcontractor performance deficiencies could result in a customer eliminating our ability to progress bill or terminating our contract for default. A prohibition on progress billing may have an adverse effect upon our cash flow and profitability and a default termination could expose us to liability and have a material adverse effect on our ability to compete for future contracts and orders. In addition, a delay in our ability to obtain components and equipment parts from our suppliers may affect our ability to meet our customers' needs and may have a material adverse effect upon our profitability.

Due to fixed contract pricing, increasing contract costs exposes us to reduced profitability and the potential loss of future business.

Operating margin is adversely affected when contract costs that cannot be billed to customers are incurred. This cost growth can occur if estimates to complete a contract increase due to technical challenges or if initial estimates used for calculating the contract price were incorrect. The cost estimation process requires significant judgment and expertise. Reasons for cost growth may include unavailability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in performance, availability and timing of funding from the customer, natural disasters, and the inability to recover any claims included in the estimates to complete. A significant increase in cost estimates on one or more programs could have a material adverse effect on our financial position or results of operations.

We use estimates when accounting for contracts. Changes in estimates could affect our profitability and our overall financial position.

We primarily 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 on our balance sheet 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 on our balance sheet 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 the financial statements in the period the change becomes known. The use of the POC method of accounting involves considerable use of estimates in determining revenues 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, there is no assurance 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 pay for costs until the reported earnings materialize to actual cash receipts.

If the contracts associated with our backlog were terminated, our financial condition would be adversely affected.

The maximum contract value specified under each contract that we enter into is not necessarily indicative of the revenues that we will realize under that contract. Because we may not receive the full amount we expect under a contract, we may not accurately estimate our backlog because the earnings of revenues on programs included in backlog may never occur or may change. Cancellations of pending contracts or terminations or reductions of contracts in progress could have a material adverse effect on our business, prospects, financial condition or results of operations. As of December 31, 2017, our backlog was approximately \$389 million, of which 18% was funded and 82% was unfunded.

We may be unable to attract and retain personnel who are key to our operations.

Our success, among other things, is dependent on our ability to attract and retain highly qualified senior officers and engineers. Competition for key personnel is intense. Our ability to attract and retain senior officers and experienced, top rate engineers is dependent on a number of factors, including prevailing market conditions and compensation packages offered by companies competing for the same talent. The inability to hire and retain these persons may adversely affect our production operations and other aspects of our business.

We are subject to the cyclical nature of the commercial aerospace industry, and any future downturn in the commercial aerospace industry or general economic conditions could adversely impact the demand for our products.

Our business may be affected by certain characteristics and trends of the commercial aerospace industry or general economic conditions that affect our customers, such as fluctuations in the aerospace industry’s business cycle, varying fuel and labor costs, intense price competition and regulatory scrutiny, certain trends, including a possible decrease in aviation activity and a decrease in outsourcing by aircraft manufacturers or the failure of projected market growth to materialize or continue. In the event that these characteristics and trends adversely affect customers in the commercial aerospace industry, they may reduce the overall demand for our products.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results. As a result, current and potential shareholders could lose confidence in our financial reporting, which would harm our business and the trading price of our common stock.

Our management determined that as of December 31, 2017, our internal control over financial reporting was effective based on criteria created by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) set forth in *Internal Control – Integrated Framework* (2013). However, if material weaknesses are identified in our internal control over financial reporting in the future, our management will be unable to report favorably as to the effectiveness of our internal control over financial reporting and/or our disclosure controls and procedures, and we could be required to implement remedial measures. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis. Such remedial measures could be expensive and time consuming and could potentially cause investors to lose confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price and potentially subject us to litigation.

We incur risk associated with new programs

New programs with new technologies typically carry risks associated with design changes, development of new production tools, increased capital and funding commitments, ability to meet customer specifications, delivery schedules and unique contractual requirements, supplier performance, ability of the customer to meet its contractual obligations to us, and our ability to accurately estimate costs associated with such programs. In addition, any new program may not generate sufficient demand or may experience technological problems or significant delays in the regulatory or other certification or manufacturing and delivery schedule. If we were unable to perform our obligations under new programs to the customer's satisfaction, if we were unable to manufacture products at our estimated costs, or if a new program in which we had made a significant investment was terminated or experienced weak demand, delays or technological problems, then our business, financial condition and results of operations could be materially adversely affected. This risk includes the potential for default, quality problems, or inability to meet specifications, as well as our inability to negotiate final pricing for program changes, and could result in low margin or forward loss contracts, and the risk of having to write-off costs and estimated earnings in excess of billings on uncompleted contracts if it were deemed to be unrecoverable over the life of the program. In addition, beginning new work on existing programs also carries risk associated with the transfer of technology, knowledge and tooling.

In order to perform on new programs we may be required to expend up-front costs which may not have been negotiated in our selling price. Additionally, we may have made margin assumptions related to those costs, that in the case of significant program delays and/or program cancellations, or if we are not successful in negotiating favorable margin on scope changes, could cause us 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 adverse impact on our liquidity.

We are presently classified as a small business and the loss of our small business status may adversely affect our ability to compete for government contracts.

We are presently classified as a small business under certain of the codes under the North American Industry Classification Systems ("NAICS") industry and product specific codes which are regulated in the United States by the Small Business Administration. We are not considered a small business under all NAICS codes. While we do not presently derive a substantial portion of our business from contracts which are set-aside for small businesses, we are able to bid on small business set-aside contracts as well as contracts which are open to non-small business entities. As the NAICS codes are periodically revised, it is possible that we may lose our status as a small business. The loss of small business status would adversely impact our eligibility for special small business programs and limit our ability to partner with other business entities which are seeking to team with small business entities as may be required under a specific contract.

Cyber security attacks, internal system or service failures may adversely impact our business and operations.

Any system or service disruptions, including those caused by projects to improve our information technology systems, if not anticipated and appropriately mitigated, could disrupt our business and impair our ability to effectively provide products and related services to our customers and could have a material adverse effect on our business. We could also be subject to systems failures, including network, software or hardware failures, whether caused by us, third-party service providers, intruders or hackers, computer viruses, natural disasters, power shortages or terrorist attacks. Cyber security threats are evolving and include, but are not limited to, malicious software, unauthorized attempts to gain access to sensitive, confidential or otherwise protected information related to us or our products, customers or suppliers, or other acts that could lead to disruptions in our business. Any such failures could cause loss of data and interruptions or delays in our business, cause us to incur remediation costs or subject us to claims and damage our reputation. In addition, the failure or disruption of our communications or utilities could cause us to interrupt or suspend our operations or otherwise adversely affect our business. Although we utilize various procedures and controls to monitor and mitigate the risk of these threats, there can be no assurance that these procedures and controls will be sufficient. Our property and business interruption insurance may be inadequate to compensate us for all losses that may occur as a result of any system or operational failure or disruption which would adversely affect our business, results of operations and financial condition. Moreover, expenditures incurred in implementing cyber security and other procedures and controls could adversely affect our results of operations and financial condition.

Our financial results may be adversely impacted by the failure to successfully execute or integrate acquisitions and joint ventures.

The Company may evaluate potential acquisitions or joint ventures that align with our strategic objectives. The success of such activity depends, in part, upon our ability to identify suitable sellers or business partners, perform effective assessments prior to contract execution, negotiate contract terms, and, if applicable, obtain customer and government approval. These activities may present certain financial, managerial, staffing and talent, and operational risks, including diversion of management's attention from existing core businesses, difficulties integrating or separating businesses from existing operations, and challenges presented by acquisitions or joint ventures which may not achieve sales levels and profitability that justify the investments made. If the acquisitions or joint ventures are not successfully implemented or completed, there could be a negative impact on our financial condition, results of operations and cash flows.

The Company's acquisition of Welding Metallurgy, Inc. is subject to a number of conditions, and may not be completed on the terms or timeline currently contemplated, or at all.

On March 21, 2018, the Company entered into a Stock Purchase Agreement for the purchase of Welding Metallurgy, Inc. as discussed in Item 7, Management's Discussion and Analysis - Recent Developments. The completion of the acquisition is subject to certain conditions, including the Company obtaining financing to pay the purchase price, receipt of requisite customer approval, delivery of financial statements to the Company and other customary closing conditions. The Company cannot ensure that the acquisition will be completed on the terms or timeline currently contemplated, or at all. Many of the conditions to the closing of the acquisition are not within the control of the Company and the Company cannot predict when or if these conditions will be satisfied. The failure to meet any or all of the conditions could delay the closing of the acquisition or prevent it from occurring. Any delay in the completion of the acquisition could cause the Company not to realize some or all of the benefits the Company expects to achieve if the acquisition is completed within the expected timeframe.

Item 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

Item 2. PROPERTIES

CPI Aero's executive offices and production facilities are situated in an approximately 171,000 square foot building located at 91 Heartland Blvd., Edgewood, New York 11717. CPI Aero occupies this facility under a ten-year lease that commenced in June 2011. The current monthly base rent is \$139,955, including real estate taxes.

Item 3. LEGAL PROCEEDINGS

None.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common shares are listed on the NYSE American under the symbol CVU. The following table sets forth for 2017 and 2016, the high and low sales prices of our common shares for the periods indicated, as reported by the NYSE American.

| Period | High | Low |
|----------------------------------|----------|---------|
| <i>2016</i> | | |
| Quarter Ended March 31, 2016 | \$ 9.66 | \$ 6.93 |
| Quarter Ended June 30, 2016 | \$ 8.00 | \$ 5.50 |
| Quarter Ended September 30, 2016 | \$ 7.29 | \$ 6.31 |
| Quarter Ended December 31, 2016 | \$ 9.75 | \$ 6.48 |
| <i>2017</i> | | |
| Quarter Ended March 31, 2017 | \$ 9.76 | \$ 6.35 |
| Quarter Ended June 30, 2017 | \$ 9.70 | \$ 5.55 |
| Quarter Ended September 30, 2017 | \$ 10.05 | \$ 8.05 |
| Quarter Ended December 31, 2017 | \$ 9.60 | \$ 8.20 |

On March 16, 2018, the closing sale price for our common shares on the NYSE American was \$8.30. On March 16, 2018, there were 197 holders of record of our common shares and, we believe, over 2,200 beneficial owners of our common shares.

Dividend Policy

To date, we have not paid any dividends on our common shares. Any payment of dividends in the future is within the discretion of our board of directors (subject to the limitation on dividends contained in the Bank United Credit Facility, as described more fully in Item 7, Management's Discussion and Analysis), and will depend on our earnings, if any, our capital requirements and financial condition and other relevant factors. Our board of directors does not intend to declare any cash or other dividends in the foreseeable future, but intends instead to retain earnings, if any, for use in our business operations.

Recent Sales of Unregistered Securities, Use of Proceeds from Registered Securities

There have been no sales of unregistered sales of our equity securities for the three months ended December 31, 2017. There have been no repurchases of our outstanding common stock during the three months ended December 31, 2017.

Equity Compensation Plan Information

The following table sets forth certain information at December 31, 2017 with respect to our equity compensation plans that provide for the issuance of options, warrants or rights to purchase our securities.

| Plan Category | Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (excluding securities reflected in the first column) |
|--|---|---|---|
| Equity Compensation Plans Approved by Security Holders | 80,249 | \$11.05 | 443,007 |

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our financial data as of the dates and for the periods indicated. The data has been derived from our audited financial statements. The selected financial data should be read in conjunction with our audited financial statements and MDA. Our results of operations for 2016 and 2014 were materially affected by the change in estimate described in MDA.

Statement of Operations Data:

| | Years Ended December 31, | | | | |
|--|--------------------------|----------------|----------------|-----------------|---------------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Revenue | \$ 81,283,148 | \$ 81,329,858 | \$ 100,202,557 | \$ 39,687,010 | \$ 82,988,522 |
| Cost of sales | 62,637,232 | 77,010,940 | 83,600,854 | 69,411,709 | 64,555,275 |
| Gross profit (loss) | 18,645,916 | 4,318,918 | 16,601,703 | (29,724,699) | 18,433,247 |
| Selling, general and administrative expenses | 8,449,594 | 8,614,190 | 7,636,148 | 7,308,220 | 6,704,524 |
| Income (loss) from operations | 10,196,322 | (4,295,272) | 8,965,555 | (37,032,919) | 11,728,723 |
| Other income (expense): | | | | | |
| Interest/ other income (expense) | (19,774) | (22,659) | (40,433) | 145,072 | 78,957 |
| Interest expense | (1,698,914) | (1,356,645) | (918,129) | (794,428) | (653,786) |
| Total other expense, net | (1,718,688) | (1,379,304) | (958,562) | (649,356) | (574,829) |
| Income (loss) before provision for (benefit from) income taxes | 8,477,634 | (5,674,576) | 8,006,993 | (37,682,275) | 11,153,894 |
| Provision for (benefit from) income taxes | 2,710,000 | (2,066,000) | 2,991,000 | (12,473,000) | 3,417,000 |
| Net income (loss) | \$ 5,767,634 | (\$ 3,608,576) | \$ 5,015,993 | (\$ 25,209,275) | \$ 7,736,894 |
| Income (loss) per common share – basic | \$ 0.65 | (\$ 0.42) | \$ 0.59 | (\$ 2.98) | \$ 0.92 |
| Income (loss) per common share – diluted | \$ 0.65 | (\$ 0.42) | \$ 0.58 | (\$ 2.98) | \$ 0.91 |
| Basic weighted average number of common shares outstanding | 8,831,064 | 8,655,848 | 8,522,817 | 8,465,937 | 8,389,048 |
| Diluted weighted average number of common shares outstanding | 8,838,445 | 8,655,848 | 8,579,986 | 8,465,937 | 8,470,578 |

Balance Sheet Data:

| | At December 31, | | | | |
|---|-----------------|--------------|--------------|--------------|--------------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Cash | \$ 1,430,877 | \$ 1,039,586 | \$ 1,002,023 | \$ 1,504,907 | \$ 2,166,103 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 111,158,551 | 99,578,526 | 102,622,387 | 79,054,139 | 112,597,136 |
| Total current assets | 120,382,436 | 111,288,206 | 112,355,720 | 95,992,457 | 120,181,761 |
| Total assets | 124,184,499 | 117,791,895 | 116,712,536 | 103,404,723 | 124,272,594 |

| | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|
| Total current liabilities | 42,244,635 | 40,692,721 | 45,062,803 | 36,707,815 | 31,741,678 |
| Working capital | 78,137,801 | 70,595,485 | 67,292,917 | 59,284,642 | 88,440,083 |
| Short-term debt | 24,847,685 | 23,780,609 | 24,711,491 | 26,121,713 | 22,370,349 |
| Long-term debt | 7,019,468 | 8,860,724 | 483,961 | 1,289,843 | 2,198,187 |
| Shareholders' equity | 74,313,333 | 67,605,706 | 70,532,109 | 64,813,156 | 88,951,519 |
| Total liabilities and shareholders' equity | 124,184,499 | 117,791,895 | 116,712,536 | 103,404,723 | 124,272,594 |

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

When used in this Annual Report on Form 10-K 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" and "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report on Form 10-K. 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.

You should read the financial information set forth below in conjunction with our financial statements and notes thereto.

Recent Developments

On March 21, 2018, the Company entered into a Stock Purchase Agreement (the "Agreement") with Air Industries Group ("Air Industries"), pursuant to which, subject to the satisfaction or waiver of certain conditions, the Company will purchase from Air Industries all of the shares (the "Shares") of Welding Metallurgy, Inc. ("WMI"), a wholly owned subsidiary of Air Industries (the "Acquisition"). WMI is engaged in the manufacture of complex components and assemblies for the defense and commercial aircraft industries.

Under the terms of the Agreement, the Company will pay a purchase price for the Shares as follows: (i) \$9.0 million in cash, subject to adjustment based on the working capital of WMI at the closing of the Acquisition and (ii) up to an aggregate of \$1.0 million, in two payments of up to \$500,000 each (the "Contingent Payments") if WMI enters into certain long-term supply agreements. The Contingent Payments are reduced if milestones for signing are not achieved.

The Agreement contains customary representations, warranties, and covenants of Air Industries and the Company and post-closing indemnities. The representations and warranties set forth in the Agreement generally survive for 18 months following the closing of the Acquisition, with longer survival periods with respect to certain specified representations and warranties.

The completion of the Acquisition is subject to customary closing conditions, approval from certain customers of WMI, the Company obtaining financing to pay the purchase price and the delivery of financial statements to the Company.

The Company anticipates financing the Acquisition through a new term loan to be included with an expanded and extended credit facility to be negotiated with the Company's existing lender. There can be no assurance that the Company will be able to expand and extend the credit facility and that the Acquisition will be funded as anticipated.

The Company expects the closing of the Acquisition to occur during the second quarter of 2018.

Business Operations

We are engaged in the contract production of structural aircraft parts for fixed wing aircraft and helicopters in both the commercial and defense markets. We have also recently expanded our presence in the aerosystems segment of the market, with our production of various reconnaissance pod structures and fuel panel systems. Within the global aerostructure and aerosystem supply chain, we are either a Tier 1 supplier to aircraft OEMs or a Tier 2 subcontractor to major Tier 1 manufacturers. We also are a prime contractor to the U.S. Department of Defense, primarily the USAF. In conjunction with our assembly operations, we provide engineering, program management, supply chain management and kitting, and MRO services.

Critical Accounting Policies

Revenue Recognition

We primarily recognize revenue from our contracts over the contractual period under the percentage-of-completion (“POC”) method of accounting. Under the POC method of accounting, revenue 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 the financial statements in the period the change becomes known. The use of the POC method of accounting involves considerable use of estimates in determining revenues 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 pay for costs until the reported earnings materialize to 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.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 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. The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The fundamental principles of the guidance are that entities should recognize revenue in a manner that reflects the timing of transfer of goods and services to customers and the amount of revenue recognized reflects the consideration that an entity expects to receive for the goods and services provided. Entities have the option of two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). Effective January 1, 2018, the Company adopted Topic 606 using the modified retrospective method for all of its contracts. Following the adoption of Topic 606, the Company’s revenue recognition for all of its contracts remained materially consistent with historical practice. In addition, following the adoption of Topic 606, the Company will change the presentation of its balance sheet moving its costs and estimated earnings in excess of billings on uncompleted contracts to contract assets and its billings in excess of costs and estimated earnings to contract liabilities.

Results of Operations

Year Ended December 31, 2017 as Compared to the Year Ended December 31, 2016

Revenue. Revenue for the year ended December 31, 2017 was \$81,283,148 compared to \$81,329,858 for the same period last year, representing a decrease of \$46,710.

Overall, revenue generated from prime government contracts for the year ended December 31, 2017 was \$6,647,248 compared to \$3,493,343 for the year ended December 31, 2016, an increase of \$3,153,905. This increase is a result of revenue recognized on the T-38C Pacer Classic III aircraft structural modification program, as this program has transitioned from the start-up stage to the delivery stage.

Revenue generated from government subcontracts for the year ended December 31, 2017 was \$45,080,617 compared to \$37,355,447 for the year ended December 31, 2016, an increase of \$7,725,170. This increase is the result of many factors, predominately increases in revenue on new programs as they ramp up production, or new purchases orders on continuing programs. Examples of programs with increases in revenue in 2017 compared to 2016 include: NGC radar pod, \$1 million, Raytheon next generation jammer pod, \$7.2 million, Lockheed F-35 lock assemblies, \$1.4 million, Bell helicopter engine inlets, \$2.8 million, Sikorsky gunner windows, \$1.2 million and Sikorsky weapons pylon, \$1.2 million. These were partially offset by a \$9 million decrease in revenue on the E-2D program, as this program transitions towards the end of deliveries on the most recent multiyear order.

Revenue generated from commercial contracts was \$29,555,283 for the year ended December 31, 2017 compared to \$40,481,068 for the year ended December 31, 2016, a decrease of \$10,925,785. This decrease is predominately the result of a \$4.7 million decrease in the Company's G650 program, a result of lower production, and a \$5.6 million decrease in the Company's Embraer program. Embraer cut back on delivery requirements in the fourth quarter of 2016, as it had completed retrofitting all older aircraft with new engine inlets. Current requirements on the Embraer program are only for new production aircraft.

Cost of sales. Cost of sales for the years ended December 31, 2017 and 2016 was \$62,637,232 and \$77,010,940, respectively, a decrease of \$14,373,708 or 18.7%.

The components of cost of sales were as follows:

| | Years ended | |
|-------------------------------|----------------------|----------------------|
| | December 31, 2017 | December 31, 2016 |
| Procurement | \$ 41,286,646 | \$ 52,504,318 |
| Labor | 6,745,038 | 8,112,981 |
| Factory overhead | 15,770,436 | 15,750,146 |
| Other contract costs (credit) | (1,164,888) | 643,495 |
| Cost of Sales | \$ 62,637,232 | \$ 77,010,940 |

Procurement for the year ended December 31, 2017 was \$41,286,646 compared to \$52,504,318, a decrease of \$11,217,672 or 21.4%. The decrease in procurement was the result of lower procurement on the Company's E-2D program, as we did multiyear volume discounted buys in 2016.

Labor costs for the year ended December 31, 2017 were \$6,745,038 compared to \$8,112,981, a decrease of \$1,367,943 or 16.9%. This decrease is predominately due to decreases in labor on our A-10 program, as we near completion on the assemblies from that program, as well as a decrease in labor on the Company's Embraer program, as we decreased production on that program, as described above.

During the three months ended March 31, 2016, the Company had information that the USAF was intending to increase the number of ship sets on order for the A-10. An increase in the number of ship sets on order would improve the Company's estimated gross margin on the overall program.

In April 2016, the Company became aware that the USAF had reevaluated its position and as such had deferred any decision regarding increasing the orders on the A-10 program. These changes in position by the USAF were supported by communications from Boeing, the Company's customer.

Based on the above facts, the Company believed that, it was not probable that there would be any future orders on the A-10 beyond the 173 currently on order. As a result of the information that management became aware of in April 2016, for the quarter ended March 31, 2016 the Company estimated that the A-10 program would run through the conclusion of its current purchase order with Boeing at ship set number 173. The change in estimate resulted in a reduction of revenue of approximately \$8.9 million in the quarter ended March 31, 2016.

Other contract costs (credit) for the year ended December 31, 2017 was (\$1,164,888) compared to \$643,495, a decrease of \$1,808,383. Other contract costs relate to expenses recognized for changes in estimates and expenses predominately associated with loss contracts. Other contract costs are comprised predominantly of charges related to the change in estimate on the A-10 program in 2016. In the year ended December 31, 2017, other contract costs are a credit, as we have incurred actual expenses on our A-10 program that had been previously recognized as part of the change in estimate charge.

Gross profit. Gross profit for the year ended December 31, 2017 was \$18,645,916 compared to \$4,318,918 for the year ended December 31, 2016, an increase of \$14,326,998. Gross profit percentage (“gross margin”) for the year ended December 31, 2017 was 22.9% compared to 5.3% for the same period last year, predominately the result of the change in estimate on the Company’s A-10 program in 2016.

Favorable/Unfavorable Adjustments to Gross Profit

During the years ended December 31, 2017, 2016 and 2015, circumstances required that we make changes in estimates to various contracts. Such changes in estimates resulted in decreases in total gross profit as follows:

| | <u>Years Ended</u> | | |
|-------------------------|-----------------------|-----------------------|-----------------------|
| | <u>2017</u> | <u>2016</u> | <u>2015</u> |
| Favorable adjustments | \$ 944,000 | \$ 269,000 | \$ 1,067,000 |
| Unfavorable adjustments | (1,984,000) | (1,936,000) | (2,942,000) |
| Net adjustments | <u>(\$ 1,040,000)</u> | <u>(\$ 1,667,000)</u> | <u>(\$ 1,875,000)</u> |

During the year ended December 31, 2017 we had one contract which had an approximately \$822,000 of unfavorable adjustments caused by changing estimates on a long-term program. We are working with the customer to agree to contract extensions and expect to decrease our selling price. Additionally, we had one contract that had a gap in production, as well as a smaller than expected order quantity. The gap in production and low quantity has resulted in an unfavorable adjustment of approximately \$514,000. There were no other material changes, favorable or unfavorable, during the year ended December 31, 2017.

During the year ended December 31, 2016 we had one contract which had an approximately \$270,000 unfavorable adjustment caused by excess labor and procurement costs due to difficulty in the manufacturing process. In addition, we had an approximate \$354,000 unfavorable adjustment on one contract that was canceled by the government. Also, we had 4 contracts that each had between \$140,000 and \$245,000 (cumulatively \$890,000) of unfavorable adjustments caused by excess labor costs incurred. No other individual favorable or unfavorable changes in estimates for the year ended December 31, 2016 were material.

For the year ended December 31, 2015, we had one contract on which we experienced technical issues, which resulted in excess engineering time and additional procurement costs that caused an unfavorable adjustment of approximately \$1,434,000. Additionally there was one contract that was running over the budgeted labor, which caused an unfavorable adjustment of approximately \$758,000. Additionally, on one contract we had significant engineering changes, which resulted in excess labor and procurement costs that caused an unfavorable adjustment of approximately \$3,000,000. No other individual favorable or unfavorable changes in estimates for the year ended December 31, 2015 were material.

Selling, general and administrative expenses. Selling, general and administrative expenses for the year ended December 31, 2017 were \$8,449,594 compared to \$8,614,190 for the year ended December 31, 2016, a decrease of \$164,596, or 1.9%. This decrease was primarily due to a decrease of approximately \$364,000 in accounting and legal fees related mostly to the extension of 2016 costs related to the 2015 audit process and an executive compensation study, a decrease of \$311,000 for the reserve for disputed account receivables with various customers, offset by an increase of \$400,000 in accrued bonuses and an increase of \$93,000 in salaries.

Interest expense. Interest expense for the year ended December 31, 2017 was \$1,698,914, compared to \$1,356,645 for 2016, an increase of \$342,269 or 25.2%. The increase in interest expense is the result of an increase in the average amount of outstanding debt during 2017 as compared to 2016.

Income (loss) from operations. We had income from operations for the year ended December 31, 2017 of \$10,196,322 compared to loss from operations of \$4,295,272 for the year ended December 31, 2016. The increase was predominately the result in the increase in gross profit described above.

Provision for (benefit from) income taxes. Our historic effective tax rate has been between 30%-32% of taxable income. The rate has been below the statutory federal income tax rate of 34% because of our ability to utilize the domestic production activity deduction, available to companies that do manufacturing within the United States. Since 2015, we have been providing for state income taxes in states where, although we don't have any property or full time employees, the historic method for the allocation of state income taxes, we do have sales and have employees present on at least a part time basis. As such the effective tax rate for both 2017 and 2016 is approximately 32% and 37%, respectively.

In accordance with the Tax Cuts and Jobs Act that was enacted on December 22, 2017 ("U.S. Tax Reform"), we have recorded a credit for income taxes of \$207,000. The impact of the U.S. Tax Reform is primarily from revaluing our U.S. deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. For U.S. federal purposes the corporate statutory income tax rate was reduced from 35% to 21%, effective for our 2018 tax year. The provisional impact of the U.S. Tax Reform is our current best estimate based on the preliminary review of the new law and is subject to revision based on our existing accounting for income taxes policy as further information is gathered and interpretation and analysis of the tax legislation evolves. The Securities and Exchange Commission has issued rules allowing for a measurement period of up to one year after the enactment date of the U.S Tax Reform to finalize the recording of the related tax impacts. Any future changes to our provisional estimated impact of the U.S Tax Reform will be included as an adjustment to the provision for income taxes.

Year Ended December 31, 2016 as Compared to the Year Ended December 31, 2015

Revenue. Revenue for the year ended December 31, 2016 was \$81,329,858 compared to \$100,202,557 for the year ended December 31, 2015, representing a decrease of \$18,872,699.

Overall, revenue generated from prime government contracts for the year ended December 31, 2016 was \$3,493,343 compared to \$892,752 for the year ended December 31, 2015, an increase of \$2,600,591. This increase is a result of our deliveries on our F-16 contract, that began in 2016.

Revenue generated from government subcontracts for the year ended December 31, 2016 was \$37,355,447 compared to \$56,982,785 for the year ended December 31, 2015, a decrease of \$19,627,338. This decrease is the result of many factors including: a \$13.4 million decrease in revenue on the Company's A-10 program with Boeing because of a change in estimate on the program, as previously described, a \$5.6 million decrease in revenue from the Company's E-2D program with NGC, due to the timing of work related to the multiyear order received in 2014, a \$1.0 million decrease in revenue from the Company's gunner window program with Sikorsky, due to lower orders, and a \$1.3 million decrease in revenue from the Company's fuel panel program with Sikorsky, due to lower orders. These decreases were offset by a \$4.8 million increase in the Company's E-2D wet outer wing program, which had only nominal activity in 2015 and was in production in 2016.

Revenue generated from commercial contracts was \$40,481,068 for the year ended December 31, 2016 compared to \$42,327,020 for the year ended December 31, 2015, a decrease of \$1,845,952. This decrease is predominately the result of a \$3.9 million decrease in the Company's Cessna Citation + program, as we completed production on our outstanding order, a \$1.3 million decrease in the Company's Embraer program, as Embraer cut back on delivery requirements in the fourth quarter of 2016, a \$800,000 decrease in revenue on the Company's Honda program, as we near completion of the flap and vane portion of this program and a \$2.8 million decrease in revenue from various Sikorsky commercial programs, the result of lower demand. These decreases were offset by a \$6.5 million increase in revenue from the Company's G650 program.

During the year ended December 31, 2016, we received approximately \$36.5 million of new contract awards, which included \$6.3 million of government prime contract awards, approximately \$10.4 million of government subcontract awards and approximately \$19.8 million of commercial contract awards, compared to \$61.6 million of new contract awards in 2015, which included \$13.3 million in government prime contract awards, \$14.1 million of government subcontract awards and \$34.2 million of commercial contract awards.

Cost of sales

Cost of sales for the years ended December 31, 2016 and 2015 was \$77,010,940 and \$83,600,854, respectively, a decrease of \$6,589,914 or 7.9%.

The components of the cost of sales were as follows:

| | Year ended | |
|----------------------|----------------------|----------------------|
| | December 31, 2016 | December 31, 2015 |
| Procurement | \$ 52,504,318 | \$ 57,473,129 |
| Labor | 8,112,981 | 9,188,417 |
| Factory overhead | 15,750,146 | 16,431,764 |
| Other contract costs | 643,495 | 507,544 |
| Cost of Sales | \$ 77,010,940 | \$ 83,600,854 |

Procurement for the year ended December 31, 2016 was \$52,504,318 compared to \$57,473,129, a decrease of \$4,968,811 or 8.6%. The decrease in procurement was the result of lower procurement on the Company's E-2D program, as we did multiyear volume discounted buys in 2015. .

Labor costs for the year ended December 31, 2016 were \$8,112,981 compared to \$9,188,417, a decrease of \$1,075,436 or 11.7%. This decrease is predominately due to decreases in labor on our A-10 program, as we near completion on some of the assemblies from that program, as well as a decrease in labor on the Company's Cessna Citation program, as we completed the assemblies on order on that program. .

Factory overhead for the year ended December 31, 2016 was \$15,750,146 compared to \$16,431,764, a decrease of \$681,618 or 4.2%. This decrease is the result of a decrease in employee benefits, factory supplies and indirect salaries, as shop production has declined. .

Gross profit. Gross profit for the year ended December 31, 2016 was \$4,318,918 compared to \$16,601,703 for the year ended December 31, 2015, a decrease of \$12,282,785. Gross profit percentage (“gross margin”) for the year ended December 31, 2016 was 5.3% compared to 16.6% for the same period in 2015, predominately the result of the change in estimate on the Company’s A-10 program.

Selling, general and administrative expenses. Selling, general and administrative expenses for the year ended December 31, 2016 were \$8,614,190 compared to \$7,636,148 for the year ended December 31, 2015, an increase of \$978,042, or 12.8%. This increase was primarily due to an approximately a \$460,000 increase in accounting and legal fees related mostly to the extended 2015 audit process and an executive compensation study, a \$411,000 reserve for disputed account receivables with various customer and an increase of \$355,000 in salaries.

Interest expense. Interest expense for the year ended December 31, 2016 was \$1,356,645, compared to \$918,129 for 2015, an increase of \$438,516 or 47.8%. The increase in interest expense is the result of an increase in the average amount of outstanding debt during 2016 as compared to 2015.

Income (loss) from operations. We had loss from operations for the year ended December 31, 2016 of \$4,295,272 compared to income from operations of \$8,965,555 for the year ended December 31, 2015.

Provision for (benefit from) income taxes. Our historic effective tax rate has been between 30%-32% of taxable income. The rate has been below the statutory federal income tax rate of 34% because of our ability to utilize the domestic production activity deduction, available to companies that do manufacturing within the United States. Beginning in 2015, we are providing for state income taxes in states where, although we don’t have any property or full time employees, the historic method for the allocation of state income taxes, we do have sales and have employees present on at least a part time basis. As such the effective tax rate for both 2016 and 2015 is approximately 37%.

Business Outlook

The statements in the “Business Outlook” section and other forward-looking statements of this Annual Report on Form 10-K are subject to revision during the course of the year in our quarterly earnings releases and SEC filings and at other times.

Liquidity and Capital Resources

General. At December 31, 2017, we had working capital of \$78,137,801 compared to \$70,595,485 at December 31, 2016, an increase of \$7,542,316, or 10.7%. This increase is predominately the result of increases in Costs and Estimated Earnings in excess of Billings on Uncompleted Contracts (“CEE”).

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. Costs for which we are not able to bill on a progress basis are components of CEE 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.

Several of our programs require us 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 and results of operations.

We continue to work to obtain better payment terms with our customers, including accelerated progress payment arrangements, as well as exploring alternative funding sources.

At December 31, 2017, our cash balance was \$1,430,877 compared to \$1,039,586 at December 31, 2016, an increase of \$391,291. Our accounts receivable balance at December 31, 2017 decreased to \$5,379,821 from \$8,514,613 at December 31, 2016.

Bank Credit Facilities.

On December 5, 2012, the Company entered into an Amended and Restated Credit Agreement with Santander Bank (as further amended on August 6, 2014 and March 31, 2015, the “Credit Agreement”) as the sole arranger, administrative agent, collateral agent and lender and Valley National Bank as lender. The Credit Agreement provided for a revolving credit facility of \$35 million (the “Revolving Facility”). The Revolving Facility and term loan under the Credit Agreement are secured by all of our assets.

On March 9, 2012, the Company obtained a \$4.5 million term loan from Santander Bank to be amortized over five years (the “Santander Term Loan”). The Santander Term Loan was used by the Company to purchase tooling and equipment for new programs. The Santander Term Loan was payable in monthly installments of \$75,000, with a final payment of the remaining principal balance on March 9, 2017. The Santander Term Loan bore interest at the lower of LIBOR plus 3% or Santander Bank’s prime rate. The Santander Term Loan was subject to the amended and restated terms and conditions of the Credit Agreement.

In connection with the Santander Term Loan, the Company and Santander Bank entered into a five-year interest rate swap agreement, in the notional amount of \$4.5 million. Under the interest rate swap, the Company paid an amount to Santander Bank representing interest on the notional amount at 4.11% and received an amount from Santander representing interest on the notional amount at a rate equal to the one-month LIBOR plus 3%. The effect of this interest rate swap was that the Company paid a fixed interest rate of 4.11% over the term of the Santander Term Loan.

Bank United, N.A. assumed and succeeded to all the right and interest of Santander in connection with the Credit Agreement, Revolving Facility and Santander Term Loan. On March 24, 2016, the Company entered into an Amended and Restated Credit Agreement with Bank United, N.A. as the sole arranger, administrative agent and collateral agent (the “BankUnited Facility”). The BankUnited Facility provides for a revolving credit loan commitment of \$30 million and a \$10 million term loan. The term of the BankUnited Facility is through March of 2019. The revolving loan bears interest at a rate based upon a pricing grid, as defined in the agreement. The range for LIBOR based loans is between 2.5% and 3.25% above the then applicable LIBOR rate. The range of base rate loans is between the bank’s prime rate and 0.75% above the bank’s prime rate.

In connection with the BankUnited Facility, the Company terminated the Santander interest swap agreement.

On May 9, 2016, the Company entered into an amendment (the “Amendment”) to the BankUnited Facility. The Amendment changed the definition of EBITDA for the Leverage Coverage Ratio Covenant for the remainder of 2016 and changed the maximum leverage ratio from 3 to 1 to 3.5 to 1 for the quarters ending June 30, 2016 and September 30, 2016. Also, the Amendment increased the interest rate on the BankUnited Facility by 50 basis points and requires the repayment of a portion of the Term Loan in and to the extent that the Company receives any contract reimbursement payments from its current Request for Equitable Adjustment with Boeing on the A-10 program.

Also, in May 2016, the Company entered into a new 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 this contract match those of the underlying debt.

As of December 31, 2017, the Company was in compliance with all of the covenants contained in the Bank United Facility, as amended.

As of December 31, 2017, the Company had \$22.8 million outstanding and as of December 31, 2016, the Company had \$22.4 million outstanding under the BankUnited Facility.

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 from the date of issuance of our financial statements.

Contractual Obligations. The table below summarizes information about our contractual obligations as of December 31, 2017 and the effects these obligations are expected to have on our liquidity and cash flow in the future years.

| Contractual Obligations | Payments Due By Period | | | | |
|---|-------------------------------|-------------------------|----------------------|---------------------|----------------------|
| | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Debt | \$ 8,500,000 | \$ 1,833,333 | \$ 6,666,667 | — | — |
| Capital Lease Obligations | 555,209 | 175,667 | 305,596 | \$ 73,946 | — |
| Operating Leases | 7,572,922 | 1,679,465 | 3,484,025 | 2,409,432 | — |
| Interest Rate Swap Agreement | 18,781 | 18,781 | — | — | — |
| Total Contractual Cash Obligations | \$ 16,646,912 | \$ 3,707,246 | \$ 10,456,288 | \$ 2,483,378 | \$ — |

Inflation. Inflation historically has not had a material effect on our operations.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Management does not believe that there is any material market risk exposure with respect to derivative or other financial instruments that would require disclosure under this item.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

This information appears following Item 15 of this Report and is incorporated herein by reference.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures that is designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, as appropriate, to allow timely decisions regarding required disclosures. Disclosure controls and procedures also include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, and Board of Directors, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2017. Based on this evaluation, they have concluded that the Company’s disclosure controls and procedures as of the end of the period covered by this report are effective in timely providing them with material information relating to the Company required to be disclosed in the reports the Company files or submits under the Exchange Act.

There were no material changes in our internal control over financial reporting during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our disclosure controls and procedures.

The report called for by Item 308(a) of Regulation S-K is included herein as “Management’s Report on Internal Control Over Financial Reporting.”

The attestation report called for by Item 308(b) of Registration S-K is included herein as “Report of Independent Registered Public Accounting Firm”.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), is a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management conducted an evaluation of the effectiveness of internal control over financial reporting based on criteria established in *Internal Control- Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2017.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

To the Board of Directors and Shareholders CPI Aerostructures, Inc.

Opinion on Internal Control over Financial Reporting

We have audited CPI Aerostructures, Inc.'s (the Company's) internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the balance sheets and the related statements of operations and comprehensive income (loss), shareholders' equity, and cash flows of the Company, and our report dated March 22, 2018, expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

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

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

/s/ CohnReznick LLP

Jericho, New York
March 22, 2018

(Continued)

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

See Item 14.

Item 11. EXECUTIVE COMPENSATION

See Item 14.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

See Item 14.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

See Item 14.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Items 10, 11, 12, 13 and 14 will be contained in our definitive proxy statement for our 2018 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission not later than 120 days after the end of our fiscal year covered by this report pursuant to Regulation 14A under the Exchange Act, and incorporated herein by reference.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

1. The following financial statements are filed as a part of this report:

Report of Independent Registered Public Accounting Firm
Balance Sheets as of December 31, 2017 and 2016
Statements of Operations and Comprehensive Income (Loss) for the Years Ended December 31, 2017, 2016 and 2015
Statements of Shareholders' Equity for the Years Ended December 31, 2017, 2016 and 2015
Statements of Cash Flows for the Years Ended December 31, 2017, 2016 and 2015
Notes to Financial Statements

| <u>Exhibit Number</u> | <u>Name of Exhibit</u> | <u>No. in Document</u> |
|-----------------------|--|------------------------|
| 3.1 | Certificate of Incorporation of the Company, as amended. (1) | 3.1 |
| 3.1(a) | Certificate of Amendment of Certificate of Incorporation filed on July 14, 1998. (2) | 3.1(a) |
| 3.2 | Amended and Restated By-Laws of the Company. (3) | 3.2 |
| 10.20 | Performance Equity Plan 2009 (4) | |
| 10.21 | 2016 Long Term Incentive Plan | |
| 10.23 | Agreement of Lease, dated June 30, 2011, between Heartland Boys II L.P. and CPI Aerostructures Inc. (5) | 10.1 |
| 10.31 | Amended and Restated Credit Agreement, dated as of March 24, 2016, as amended on May 6, 2016, among CPI Aerostructures, Inc., the several lenders from time to time party thereto, and Bank United, N.A. | 10.1 |
| 14 | Code of Business Conduct and Ethics | |
| **21 | Subsidiaries of the Registrant | |
| **23.1 | Consent of CohnReznick LLP | |
| **31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | |
| **31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | |
| **32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | |
| ***101.INS | XBRL Instance Document | |
| ***101.SCH | XBRL Taxonomy Extension Schema Document | |
| ***101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | |
| ***101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | |
| ***101.LAB | XBRL Taxonomy Extension Label Linkbase Document | |
| ***101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | |

**Filed herewith.

***XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

- (1) Filed as an exhibit to the Company's Registration Statement on Form S-1 (No. 33-49270) declared effective on September 16, 1992 and incorporated herein by reference.
- (2) Filed as an exhibit to the Company's Annual Report on Form 10-KSB for the year ended December 31, 1998 and incorporated herein by reference.
- (3) Filed as an exhibit to the Company's Current Report on Form 8-K dated November 13, 2007 and incorporated herein by reference.
- (4) Included as Appendix A to the Company's Proxy Statement filed on April 30, 2009.
- (5) Filed as an exhibit to the Company's Current Report on Form 10-Q for the quarter ended June 30, 2011 and incorporated herein by reference

CPI AEROSTRUCTURES, INC.
INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

F-1

Financial Statements:

Balance Sheets as of December 31, 2017 and 2016

F-2

Statements of Operations and Comprehensive Income (Loss) for the Years Ended December 31, 2017, 2016 and 2015

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Statements of Shareholders' Equity for the Years Ended December 31, 2017, 2016 and 2015

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders CPI Aerostructures Inc.

Opinion on the Financial Statements

We have audited the accompanying balance sheets of CPI Aerostructures, Inc. (the Company) as of December 31, 2017 and 2016, and the related statements of operations and comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 22, 2018, expressed an unqualified opinion.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ CohnReznick LLP

We have served as the Company's auditor since 2004.

Jericho, New York

March 22, 2018

BALANCE SHEETS

| | December 31, 2017 | December 31, 2016 |
|---|-----------------------|-----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash | \$ 1,430,877 | \$ 1,039,586 |
| Accounts receivable, net | 5,379,821 | 8,514,613 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 111,158,551 | 99,578,526 |
| Prepaid expenses and other current assets | 2,413,187 | 2,155,481 |
| Total current assets | 120,382,436 | 111,288,206 |
| Property and equipment, net | 2,046,942 | 2,298,610 |
| Deferred income taxes | 1,566,818 | 3,952,598 |
| Other assets | 188,303 | 252,481 |
| Total Assets | \$ 124,184,499 | \$ 117,791,895 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 15,129,872 | \$ 14,027,457 |
| Accrued expenses | 1,911,421 | 1,386,147 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 74,657 | 115,337 |
| Current portion of long-term debt | 2,009,000 | 1,341,924 |
| Contract loss | 171,673 | 1,377,171 |
| Line of credit | 22,838,685 | 22,438,685 |
| Income taxes payable | 109,327 | 6,000 |
| Total current liabilities | 42,244,635 | 40,692,721 |
| Long-term debt, net of current portion | 7,019,468 | 8,860,724 |
| Other liabilities | 607,063 | 632,744 |
| Total Liabilities | 49,871,166 | 50,186,189 |
| Commitments | | |
| Shareholders' Equity: | | |
| Common stock - \$.001 par value; authorized 50,000,000 shares, 8,864,319 and 8,739,836 shares, respectively, issued and outstanding | 8,863 | 8,738 |
| Additional paid-in capital | 53,770,618 | 52,824,950 |
| Retained earnings | 20,548,652 | 14,781,018 |
| Accumulated other comprehensive loss | (14,800) | (9,000) |
| Total Shareholders' Equity | 74,313,333 | 67,605,706 |
| Total Liabilities and Shareholders' Equity | \$ 124,184,499 | \$ 117,791,895 |

SEE NOTES TO FINANCIAL STATEMENTS

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

| Years ended December 31, | 2017 | 2016 | 2015 |
|--|---------------|----------------|----------------|
| Revenue | \$ 81,283,148 | \$ 81,329,858 | \$ 100,202,557 |
| Cost of sales | 62,637,232 | 77,010,940 | 83,600,854 |
| Gross profit | 18,645,916 | 4,318,918 | 16,601,703 |
| Selling, general and administrative expenses | 8,449,594 | 8,614,190 | 7,636,148 |
| Income (loss) from operations | 10,196,322 | (4,295,272) | 8,965,555 |
| Other expense: | | | |
| Other expense | (19,774) | (22,659) | (40,433) |
| Interest expense | (1,698,914) | (1,356,645) | (918,129) |
| Total other expense, net | (1,718,688) | (1,379,304) | (958,562) |
| Income (loss) before provision for (benefit from) income taxes | 8,477,634 | (5,674,576) | 8,006,993 |
| Provision for (benefit from) income taxes | 2,710,000 | (2,066,000) | 2,991,000 |
| Net income (loss) | 5,767,634 | (3,608,576) | 5,015,993 |
| Other comprehensive income (loss), net of tax | | | |
| Change in unrealized (gain) loss-interest rate swap | (5,800) | (5,547) | 6,263 |
| Comprehensive income (loss) | \$ 5,761,834 | (\$ 3,614,123) | \$ 5,022,256 |
| Income (loss) per common share-basic | \$ 0.65 | (\$ 0.42) | \$ 0.59 |
| Income (loss) per common share-diluted | \$ 0.65 | (\$ 0.42) | \$ 0.58 |
| Shares used in computing earnings per common share: | | | |
| Basic | 8,831,064 | 8,655,848 | 8,552,817 |
| Diluted | 8,838,445 | 8,655,848 | 8,579,986 |

SEE NOTES TO FINANCIAL STATEMENTS

STATEMENTS OF SHAREHOLDERS' EQUITY

Years ended December 31, 2017, 2016 and 2015

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|--|---------------------------|---------------------------|----------------------------------|----------------------|---|----------------------------------|
| Balance at January 1, 2015 | 8,500,555 | \$ 8,501 | \$ 51,440,770 | \$ 13,373,601 | (\$ 9,716) | \$ 64,813,156 |
| Net income | — | — | — | 5,015,993 | — | 5,015,993 |
| Change in unrealized loss from interest rate swap | — | — | — | — | 6,263 | 6,263 |
| Common stock issued upon exercise of options, net | 25,352 | 26 | 79,974 | — | — | 80,000 |
| Common stock issued as employee compensation | 6,255 | 6 | 59,417 | — | — | 59,423 |
| Stock based compensation expense | 51,349 | 51 | 524,223 | — | — | 524,274 |
| Tax benefit from stock option plans | — | — | 33,000 | — | — | 33,000 |
| Balance at December 31, 2015 | 8,583,511 | 8,584 | 52,137,384 | 18,389,594 | (3,453) | 70,532,109 |
| Net loss | — | — | — | (3,608,576) | — | (3,608,576) |
| Change in unrealized loss from interest rate swap | — | — | — | — | (5,547) | (5,547) |
| Common stock issued upon exercise of options, net | 3,448 | 3 | (3) | — | — | — |
| Common stock issued as employee compensation | 98,645 | 97 | 163,354 | — | — | 163,451 |
| Stock based compensation expense | 54,232 | 54 | 524,215 | — | — | 524,269 |
| Balance at December 31, 2016 | 8,739,836 | 8,738 | 52,824,950 | 14,781,018 | (9,000) | 67,605,706 |
| Net income | — | — | — | 5,767,634 | — | 5,767,634 |
| Change in unrealized loss from interest rate swap | — | — | — | — | (5,800) | (5,800) |
| Common stock issued upon exercise of options | 3,334 | 3 | (3) | — | — | — |
| Common stock issued as employee compensation | 5,550 | 6 | 50,776 | — | — | 50,782 |
| Stock based compensation expense | 115,599 | 116 | 894,895 | — | — | 895,011 |
| Balance at December 31, 2017 | 8,864,319 | \$ 8,863 | \$ 53,770,618 | \$ 20,548,652 | (\$ 14,800) | \$ 74,313,333 |

SEE NOTES TO FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS

| Years ended December 31, | 2017 | 2016 | 2015 |
|--|------------------|--------------------|--------------------|
| Cash flows from operating activities: | | | |
| Net income (loss) | \$ 5,767,634 | (\$ 3,608,576) | \$ 5,015,993 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 616,291 | 661,921 | 854,063 |
| Debt issue cost | 85,571 | 61,320 | — |
| Deferred rent | (30,680) | 8,235 | 46,017 |
| Stock based compensation expense | 895,011 | 524,269 | 524,274 |
| Common stock issued as employee compensation | 50,782 | 163,451 | 59,423 |
| Loss on disposal of fixed asset | 21,010 | — | — |
| Deferred portion of provision for income taxes | 2,384,980 | (2,077,299) | 2,659,000 |
| Tax benefit for stock options | — | — | (33,000) |
| Bad debt expense | 150,000 | 460,514 | 50,000 |
| Changes in operating assets and liabilities: | | | |
| (Increase) decrease in accounts receivable | 2,984,792 | (1,309,290) | (1,249,023) |
| (Increase) decrease in costs and estimated earnings in excess of billings on uncompleted contracts | (11,580,025) | 3,043,861 | (23,568,248) |
| Increase in prepaid expenses and other current assets | (257,706) | (1,013,008) | (237,199) |
| (Increase) decrease in refundable income taxes | — | (77,000) | 8,133,433 |
| Increase (decrease) in accounts payable and accrued expenses | 1,627,689 | (4,023,547) | 9,446,948 |
| (Decrease) increase in accrued losses on uncompleted contracts | (1,205,498) | 827,448 | 153,541 |
| Increase (decrease) in income taxes payable | 103,327 | (183,000) | 220,822 |
| Decrease in billings in excess of costs and estimated earnings on uncompleted contracts | (40,680) | (60,101) | (18,212) |
| Net cash provided by (used in) operating activities | 1,572,498 | (6,600,802) | 2,057,832 |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (281,922) | (136,320) | (209,718) |
| Proceeds from sale of fixed assets | 42,480 | — | — |
| Net cash used in investing activities | (239,442) | (136,320) | (209,718) |
| Cash flows from financing activities: | | | |
| Proceeds from exercise of stock options | — | — | 80,000 |
| Payment of line of credit | (4,100,000) | (30,400,000) | (9,650,000) |
| Proceeds from line of credit | 4,500,000 | 29,138,685 | 8,200,000 |
| Payment of long-term debt | (1,341,765) | (1,710,145) | (1,013,998) |
| Proceeds from long-term debt | — | 10,000,000 | — |
| Debt issue costs | — | (253,855) | — |
| Tax benefit for stock options | — | — | 33,000 |
| Net cash (used in) provided by financing activities | (941,765) | 6,774,685 | (2,350,998) |
| Net increase (decrease) in cash | 391,291 | 37,563 | (502,884) |
| Cash at beginning of year | 1,039,586 | 1,002,023 | 1,504,907 |
| Cash at end of year | \$ 1,430,877 | \$ 1,039,586 | \$ 1,002,023 |
| Supplemental schedule of noncash investing and financing activities: | | | |
| Equipment acquired under capital lease | \$ 146,192 | \$ 465,475 | \$ 247,881 |
| Cashless exercise of stock options | \$ 202,500 | \$ 168,750 | — |
| Supplemental schedule of cash flow information: | | | |
| Cash paid during the year for interest | \$ 1,578,627 | \$ 1,182,791 | \$ 1,000,403 |
| Cash paid for income taxes | \$ 144,718 | \$ 302,025 | \$ 351,275 |

SEE NOTES TO FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS

1. PRINCIPAL BUSINESS ACTIVITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CPI Aerostructures, Inc. (“CPI Aero®” or the “Company”) is a U.S. supplier of aircraft parts for fixed wing aircraft and helicopters in both the commercial and defense markets. We manufacture complex aerostructure assemblies, as well as aerosystems. Additionally, we supply parts for maintenance, repair and overhaul (“MRO”) and kitting contracts.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires the use of estimates by management. Actual results could differ from these estimates.

Revenue Recognition

The Company’s revenue is primarily recognized based on the percentage of completion method of accounting for its contracts measured by the percentage of total costs incurred to date to estimated total costs at completion for each contract. Contract costs include all direct material, labor costs, tooling and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Selling, general and administrative costs are charged to expense as incurred. Estimated losses on uncompleted contracts are recognized in the period in which such losses are determined. Changes in job performance may result in revisions to costs and income and are recognized in the period in which revisions are determined to be required. The percentage of completion method of accounting involves considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods and, as a result, there can be a significant disparity between earnings (both for accounting and taxes) as reported and actual cash received by the Company during any reporting period. In accordance with industry practice, costs and estimated earnings in excess of billings on uncompleted contracts, included in the accompanying balance sheets, contain amounts relating to contracts and programs with long production cycles, a portion of which will not be realized within one year. The Company’s recorded revenue may be adjusted in later periods in the event that the Company’s cost estimates prove to be inaccurate or a contract is terminated.

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.

In addition, the Company recognizes revenue for parts supplied for certain MRO contracts when parts are shipped.

Government Contracts

The Company’s government contracts are subject to the procurement rules and regulations of the U.S. government. Many of the contract terms are dictated by these rules and regulations. Specifically, cost-based pricing is determined under the Federal Acquisition Regulation (“FAR”), which provides guidance on the types of costs that are allowable in establishing prices for goods and services under U.S. government contracts. For example, costs such as those related to charitable contributions, advertising, interest expense, and public relations are unallowable, and therefore not recoverable through sales. During and after the fulfillment of a government contract, the Company may be audited in respect of the direct and allocated indirect costs attributable thereto. These audits may result in adjustments to the Company’s contract cost, and/or revenue.

When contractual terms allow, the Company invoices its customers on a progress basis.

Cash

The Company maintains its cash in three 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 December 31, 2017 and 2016, the Company had approximately \$1,377,000 and \$1,276,000, respectively, of uninsured balances. The Company limits its credit risk by selecting financial institutions considered to be highly credit worthy.

Accounts Receivable

Accounts receivable are reported at their outstanding unpaid principal balances. The Company writes off accounts when they are deemed to be uncollectible.

Property and Equipment

Depreciation and amortization of property and equipment is provided by the straight-line method over the shorter of estimated useful lives of the respective assets or the life of the lease, for leasehold improvements.

Rent

We recognize rent expense on a straight-line basis over the expected lease term. Within the provisions of certain leases there are escalations in payments over the lease term. The effects of the escalations have been reflected in rent expense on a straight-line basis over the expected lease term.

Long-Lived Assets

The Company reviews its long-lived assets and certain related intangibles for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. As a result of its review, the Company does not believe that any such change has occurred. If such changes in circumstance are present, a loss is recognized to the extent the carrying value of the asset is in excess of the fair value of cash flows expected to result from the use of the asset and amounts expected to be realized upon its eventual disposition.

Short-Term Debt

The fair value of the Company's short-term debt is estimated based on the current rates offered to the Company for debt of similar terms and maturities. Using this method, the fair value of the Company's short-term debt was not significantly different than the stated value at December 31, 2017 and 2016.

Derivatives

Our use of derivative instruments has primarily 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 balance sheet 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 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. See below for a discussion of the Company's use of derivative instruments, management of credit risk inherent in derivative instruments and fair value information.

In March 2012, the Company entered into an interest rate swap with the objective of reducing its 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 cash flow hedge. The Company measures ineffectiveness by comparing the cumulative change in the forward contract with the cumulative change in the hedged item. The interest rate swap contract was terminated as of March 24, 2016. The Company paid approximately \$4,000 at termination to settle the swap contract.

In May 2016, the Company entered into a new 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 this contract 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.

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 December 31, 2017 and 2016, the fair values of cash, accounts receivable and accounts payable approximated their carrying values because of the short-term nature of these instruments.

| | 2017 | | 2016 | |
|--|-----------------|---------------|-----------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Debt | | | | |
| Short-term borrowings and long-term debt | \$ 31,893,894 | \$ 31,893,894 | \$ 32,689,467 | \$ 32,689,467 |

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

The following tables present the fair values of liabilities measured on a recurring basis as of December 31, 2017 and 2016:

| Description | Total | Fair Value Measurements 2017 | | |
|--------------------|-----------|--|---|---|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | | | | |
| Interest Rate Swap | \$ 18,781 | — | \$ 18,781 | — |
| Total | \$ 18,781 | — | \$ 18,781 | — |

| Description | Total | Fair Value Measurements 2016 | | |
|--------------------|-----------|--|---|---|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | | | | |
| Interest Rate Swap | \$ 13,685 | — | \$ 13,685 | — |
| Total | \$ 13,685 | — | \$ 13,685 | — |

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 December 31, 2017 and 2016, \$18,781 and \$13,685, respectively, was included in other liabilities related to the fair value of the Company's interest rate swap, and \$15,000 and \$9,000, respectively, net of tax of approximately \$4,000 and \$5,000, respectively, was included in Accumulated Other Comprehensive Loss.

Earnings Per Share

Basic earnings (loss) per common share is computed using the weighted-average number of shares outstanding. Diluted earnings (loss) per common share 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 approximately 35,000 were used in the calculation of diluted earnings per common share in 2017. Incremental shares of 45,249 were not included in the diluted earnings per share calculations at December 31, 2017, as their exercise price was in excess of the Company's quoted market price and, accordingly, these shares are not assumed to be exercised for the diluted earnings per share calculation. No incremental shares were used in the calculation of diluted loss per common share in 2016, as the effect of incremental shares would be anti-dilutive. Incremental shares of approximately 85,000 were used in the calculation of diluted earnings per common share in 2015. Incremental shares of 184,983 were not included in the diluted earnings per share calculations at December 31, 2015, as their exercise price was in excess of the Company's quoted market price and, accordingly, these shares are not assumed to be exercised for the diluted earnings per share calculation.

Income taxes

Income taxes are accounted for under the asset and liability method whereby deferred tax assets and liabilities are recognized for future tax consequences attributable to the temporary differences between the financial statements carrying amounts of assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company does not have any liabilities for unrecognized tax benefits resulting from tax positions taken, or expected to be taken, in an income tax return. It is the Company's policy to recognize interest and penalties related to uncertain tax positions as a component of income tax expense. Uncertain tax positions are evaluated and adjusted as appropriate, while taking into account the progress of audits of various taxing jurisdictions.

In accordance with the Tax Cuts and Jobs Act that was enacted on December 22, 2017 ("U.S. Tax Reform"), we have recorded a credit for income taxes of \$207,000. The impact of the U.S. Tax Reform is primarily from revaluing our U.S. deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. For U.S. federal purposes the corporate statutory income tax rate was reduced from 35% to 21%, effective for our 2018 tax year. The provisional impact of the U.S. Tax Reform is our current best estimate based on the preliminary review of the new law and is subject to revision based on our existing accounting for income taxes policy as further information is gathered and interpretation and analysis of the tax legislation evolves. The Securities and Exchange Commission has issued rules allowing for a measurement period of up to one year after the enactment date of the U.S. Tax Reform to finalize the recording of the related tax impacts. Any future changes to our provisional estimated impact of the U.S. Tax Reform will be included as an adjustment to the provision for income taxes.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 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. The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The fundamental principles of the guidance are that entities should recognize revenue in a manner that reflects the timing of transfer of goods and services to customers and the amount of revenue recognized reflects the consideration that an entity expects to receive for the goods and services provided. Entities have the option of two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). Effective January 1, 2018, the Company adopted Topic 606 using the modified retrospective method for all of its contracts. Following the adoption of Topic 606, the Company’s revenue recognition for all of its contracts remained materially consistent with historical practice. In addition, following the adoption of Topic 606, the Company will change the presentation of its balance sheet moving its costs and estimated earnings in excess of billings on uncompleted contracts to contract assets and its billings in excess of costs and estimated earnings to contract liabilities and will also include additional disclosures required in accordance with Topic 606.

In February 2016, the FASB issued ASU 2016-02, “*Leases (Topic 842)*.” The updated guidance requires lessees to recognize lease assets and lease liabilities for most operating leases. In addition, the updated guidance requires that lessors separate lease and nonlease components in a contract in accordance with the new revenue guidance in ASU 2014-09. The updated guidance is effective for interim and annual periods beginning after December 15, 2018. The Company is currently evaluating the effect on its financial statements.

2. COSTS AND ESTIMATED EARNINGS IN EXCESS OF BILLINGS ON UNCOMPLETED CONTRACTS

At December 31, 2017, costs and estimated earnings in excess of billings on uncompleted contracts (unbilled) consist of:

| | U.S. Government | Commercial | Total |
|--|-----------------------------|-----------------------------|------------------------------|
| Costs incurred on uncompleted contracts | \$ 380,585,374 | \$ 176,564,952 | \$ 557,150,326 |
| Estimated earnings | 44,708,920 | 65,341,115 | 110,050,035 |
| | <u>425,294,294</u> | <u>241,906,067</u> | <u>667,200,361</u> |
| Less billings to date | <u>370,755,359</u> | <u>185,361,108</u> | <u>556,116,467</u> |
| Costs and estimated earnings in excess of billings on uncompleted contracts | <u>\$ 54,538,935</u> | <u>\$ 56,544,959</u> | <u>\$ 111,083,894</u> |

At December 31, 2016, costs and estimated earnings in excess of billings on uncompleted contracts (unbilled) consist of:

| | U.S. Government | Commercial | Total |
|--|----------------------|----------------------|----------------------|
| Costs incurred on uncompleted contracts | \$ 341,003,461 | \$ 153,898,425 | \$ 494,901,886 |
| Estimated earnings | 39,638,231 | 58,346,518 | 97,984,749 |
| | <u>380,641,692</u> | <u>212,244,943</u> | <u>592,886,635</u> |
| Less billings to date | 331,277,942 | 162,145,504 | 493,423,446 |
| | <u>49,363,750</u> | <u>50,099,439</u> | <u>99,463,189</u> |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 49,363,750 | \$ 50,099,439 | \$ 99,463,189 |

The above amounts are included in the accompanying balance sheets under the following captions at December 31, 2017 and 2016.

| | 2017 | 2016 |
|---|-----------------------|----------------------|
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 111,158,551 | \$ 99,578,526 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (74,657) | (115,337) |
| Totals | \$ 111,083,894 | \$ 99,463,189 |

Unbilled costs and estimated earnings are billed in accordance with applicable contract terms. As of December 31, 2017, approximately \$35 million of the balances above are not expected to be collected within one year. There are no amounts billed under retainage provisions.

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 years ended December 31, 2017, 2016 and 2015, 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 \$1,040,000, \$1,667,000 and \$1,875,000, respectively, from that which would have been reported had the revised estimate 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 at least reasonably possible that additional significant costs could occur on contracts prior to completion.

3. ACCOUNTS RECEIVABLE

Accounts receivable consists of trade receivables as follows:

| | December 31, | |
|---------------------------------------|--------------|--------------|
| | 2017 | 2016 |
| Billed receivables | \$ 5,529,821 | \$ 9,050,127 |
| Less: allowance for doubtful accounts | (150,000) | (535,514) |
| | \$ 5,379,821 | \$ 8,514,613 |

4. PROPERTY AND EQUIPMENT

| | December 31, | | Estimated Useful Life (years) |
|--|--------------|--------------|-------------------------------------|
| | 2017 | 2016 | |
| Machinery and equipment | \$ 2,461,047 | \$ 2,289,175 | 5 to 10 |
| Computer equipment | 3,476,454 | 3,417,701 | 5 |
| Furniture and fixtures | 610,323 | 610,323 | 7 |
| Automobiles and trucks | 13,162 | 13,162 | 5 |
| Leasehold improvements | 1,798,823 | 1,694,900 | Lesser of lease term or 10 years |
| | 8,359,809 | 8,025,261 | |
| Less accumulated depreciation and amortization | 6,312,867 | 5,726,651 | |
| | \$ 2,046,942 | \$ 2,298,610 | |

Depreciation and amortization expense for the years ended December 31, 2017, 2016 and 2015 was \$616,291, \$661,921 and \$854,063, respectively.

During the years ended December 31, 2017 and 2016, the Company acquired \$146,192 and \$465,475, respectively, of property and equipment under capital leases.

5. LINE OF CREDIT

On December 5, 2012, the Company entered into an Amended and Restated Credit Agreement (“Restated Agreement”) with Sovereign Bank, now called Santander Bank, N.A. (“Santander”), as the sole arranger, administrative agent and collateral agent and Valley National Bank. The Restated Agreement provided for a revolving credit loan (“Revolving Facility”) commitment of \$35 million.

On March 24, 2016, the Company entered into a Credit Agreement with Bank United, N.A. as the sole arranger, administrative agent and collateral agent and Citizens Bank N.A. (the “BankUnited Facility”). The BankUnited Facility provides for a revolving credit loan commitment of \$30 million (the “Revolving Loan”) and a \$10 million term loan (“Term Loan”). The proceeds of the BankUnited Facility were used to pay off all amounts outstanding under the Santander Term Loan and the Revolving Facility. The Revolving Loan bears interest at a rate based upon a pricing grid, as defined in the agreement.

On May 9, 2016, the Company entered into an amendment (the “Amendment”) to the BankUnited Facility. The Amendment changes the definition of EBITDA for the Leverage Coverage Ratio Covenant for the remainder of 2016 and changes the maximum leverage ratio from 3 to 1 to 3.5 to 1 for the quarters ending June 30, 2016 and September 30, 2016. Also, the Amendment increased the interest rate on the BankUnited Facility by 50 basis points and requires the repayment of a portion of the Term Loan if and to the extent that the Company receives any contract reimbursement payments from its current Request for Equitable Adjustment with Boeing on the A-10 program.

As of December 31, 2017, the Company was in compliance with all of the financial covenants, contained in the Restated Agreement, as amended. As of December 31, 2017, the Company had \$22.8 million outstanding under the Restated Agreement bearing interest at 4.75%.

The BankUnited Facility is secured by all of the Company's assets.

6. LONG-TERM DEBT

On March 9, 2012, the Company obtained a \$4.5 million term loan from Santander to be amortized over five years (the "Santander Term Facility"). The Santander Term Facility was used to purchase tooling and equipment for new programs.

Additionally, the Company and Santander entered into a five-year interest rate swap agreement, in the notional amount of \$4.5 million. Under the interest rate swap, the Company pays an amount to Santander representing interest on the notional amount at a fixed rate of 4.11% and receives an amount from Santander Bank representing interest on the notional amount of a rate equal to the one-month LIBOR plus 3%. The effect of this interest rate swap will be the Company paying a fixed interest fixed rate of 4.11% over the term of the Santander Term Facility.

The Santander interest swap agreement was terminated and the Santander Term Facility was paid off on March 24, 2016 using the proceeds of the Bank United Facility (See Note 5).

The Company paid approximately \$254,000 of debt issuance costs with the Bank United Facility of which approximately \$80,000 is included in other current assets and \$27,000 is a reduction of long-term debt.

The Term Loan had an initial amount of \$10 million, payable in monthly installments, as defined in the agreement, which matures on March 31, 2019. The maturities of the Term Loan are included in the maturities of long-term debt.

The maturities of the long-term debt (excluding unamortized debt issuance costs) are as follows:

| Year ending December 31, | | |
|--------------------------|----|-----------|
| 2018 | \$ | 2,009,000 |
| 2019 | | 6,837,608 |
| 2020 | | 134,655 |
| 2021 | | 42,073 |
| 2022 | | 31,873 |
| | \$ | 9,055,209 |

Also included in long-term debt are capital leases and notes payable of \$555,209 and \$584,116 at December 31, 2017 and 2016, respectively, including a current portion of \$175,667 and \$175,257, respectively.

The cost of assets under capital leases was \$1,975,642 and \$1,829,450 at December 31, 2017 and 2016, respectively. Accumulated depreciation of assets under capital leases was approximately \$1,300,970 and \$1,157,000 at December 31, 2017 and 2016, respectively.

7. COMMITMENTS

The Company leases an office and warehouse facility under a non-cancelable operating lease which expires in April, 2022. The aggregate future commitment under this agreement is as follows:

Year ending December 31,

| | | |
|------|----|-----------|
| 2018 | \$ | 1,679,465 |
| 2019 | | 1,720,750 |
| 2020 | | 1,763,275 |
| 2021 | | 1,807,074 |
| 2022 | | 602,358 |
| | \$ | 7,572,922 |

Rent expense for the years ended December 31, 2017, 2016 and 2015 was \$1,608,701, \$1,608,701 and \$1,608,701, respectively.

8. INCOME TAXES

The provision for (benefit from) income taxes consists of the following:

| Year ended December 31, | 2017 | 2016 | 2015 |
|--------------------------|--------------|----------------|--------------|
| Current: | | | |
| Federal | \$ 200,000 | — | \$ 82,000 |
| Prior year under accrual | — | — | 143,000 |
| State | 126,000 | (\$ 51,000) | 107,000 |
| Deferred: | | | |
| Federal | 2,244,000 | (2,015,000) | 2,659,000 |
| State/Local | 140,000 | — | — |
| | \$ 2,710,000 | (\$ 2,066,000) | \$ 2,991,000 |

The difference between the income tax provision computed at the federal statutory rate and the actual tax provision is accounted for as follows:

| December 31, | 2017 | 2016 | 2015 |
|--|--------------|----------------|--------------|
| Taxes computed at the federal statutory rate | \$ 2,882,000 | (\$ 1,929,000) | \$ 2,722,000 |
| State income tax, net | 176,000 | (34,000) | 70,000 |
| Prior year true-up | 2,000 | (3,000) | 325,000 |
| Research and development tax credit | (235,000) | (246,000) | (177,000) |
| Change in Federal Statutory Rate | (207,000) | — | — |
| Permanent differences | 92,000 | 146,000 | 51,000 |
| Provision for (benefit from) income taxes | \$ 2,710,000 | (\$ 2,066,000) | \$ 2,991,000 |

The components of deferred income tax assets and liabilities are as follows:

| Deferred Tax Assets: | 2017 | 2016 |
|----------------------------------|---------------------|---------------------|
| Interest rate swap | \$ 1,000 | \$ 9,000 |
| Allowance for doubtful accounts | 32,000 | 187,000 |
| Credit carryforwards | 1,986,000 | 1,548,000 |
| Deferred rent | 126,000 | 221,000 |
| Stock options | 102,000 | 295,000 |
| Restricted stock | 90,000 | 47,000 |
| Net operating loss carryforward | 750,000 | 5,057,000 |
| Deferred Tax Assets | 3,087,000 | 7,364,000 |
| Deferred Tax Liabilities: | | |
| Prepaid expenses | 141,000 | 130,000 |
| Revenue recognition | 1,036,000 | 2,807,000 |
| Property and equipment | 276,000 | 475,000 |
| State taxes | 67,000 | — |
| Deferred tax liabilities | 1,520,000 | 3,412,000 |
| Net Deferred Tax Assets | \$ 1,567,000 | \$ 3,952,000 |

The Company recognized, for income tax purposes, a tax benefit of \$33,000 for the year ended December 31, 2015 for compensation expense related to its stock option plan for which no corresponding charge to operations has been recorded. Such amounts have been added to additional paid-in capital in those years.

9. 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 used the modified transition method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee stock based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of the fair value method.

The Company’s net income (loss) for the years ended December 31, 2017, 2016 and 2015, includes approximately \$946,000, \$688,000 and \$584,000 of stock based compensation expense, respectively, for the grant of stock options and RSUs.

In January 2017, the Company granted 59,395 RSUs to its board of directors as partial compensation for the 2017 year. On January 1, 2016, the Company granted 53,882 RSUs to its board of directors as partial compensation for the 2016 year. RSUs vest quarterly on a straight-line basis over a one-year period. The Company’s net income (loss) for the year ended December 31, 2017 and 2016 includes approximately \$550,000 and \$524,000, respectively, of noncash compensation expense related to the RSU grants to the board of directors. This expense is recorded as a component of selling, general and administrative expenses. In addition, for the year ended December 31, 2017, the Company granted 5,550 shares of common stock to various employees and approximately \$13,300 of compensation expense is included in selling, general and administrative expenses and approximately \$37,500 of compensation expense is included in cost of sales for this grant.

In August 2016 and March 2017, the Company granted 98,645 and 73,060 shares of common stock, respectively, to various employees. In the event that any of these employees voluntarily terminates their employment prior to certain dates, portions of the shares may be forfeited. In addition, if certain Company performance criteria are not achieved, portions of these shares may be forfeited. These shares will be expensed during various periods through March 2021 based upon the service and performance thresholds. In March 2017, 12,330 of the shares granted in August 2016 were forfeited because the Company failed to achieve certain performance criteria for the year ended December 31, 2016. In addition, on March 9, 2017, these employees returned 4,525 common shares, valued at approximately \$33,000, to pay the employees’ withholding taxes. For the years ended December 31, 2017 and 2016, approximately \$219,000 and \$135,100, respectively, of compensation expense is included in selling, general and administrative expenses and approximately \$46,300 and \$28,400, respectively of compensation expense is included in cost of sales for this grant.

The Company recorded reductions in income tax payable of approximately \$325,000 for the year ended December 31, 2015 as a result of the tax benefit upon exercise of options. The compensation expense related to the Company's stock based compensation arrangements is recorded as a component of selling, general and administrative expenses. Cash flows resulting from tax deductions in excess of the cumulative compensation cost recognized from options exercised (excess tax benefits) are classified as cash inflows from financing activities and cash inflows from operating activities.

In 2009, the Company adopted the Performance Equity Plan 2009 (the "2009 Plan"). The 2009 Plan reserved 500,000 common shares for issuance. The 2009 Plan provides for the issuance of either incentive stock options or nonqualified stock options to employees, consultants or others who provide services to the Company. The options' exercise price is equal to the closing price of the Company's shares on the day of issuance, except for incentive stock options granted to any person possessing more than 10% of the total combined voting power of all classes of Company stock, which are exercisable at 110% of the closing price of the Company's shares on the date of issuance.

The Company has 172,978 shares available for grant under the 2009 Plan.

In 2016, the Company adopted the 2016 Long Term Incentive Plan (the "2016 Plan"). The 2016 Plan reserved 600,000 common shares for issuance, provided that, no more than 200,000 common shares be granted as incentive stock options. Awards may be made or granted to employees, officers, directors and consultants in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards.

The Company has 270,309 shares available for grant under the 2016 Plan.

The Company did not grant any stock options in 2017, 2016 or 2015.

A summary of the status of the Company's stock option plans is as follows:

| Fixed Options | Options | Weighted Average Exercise Price | Average remaining contractual term (in years) | Aggregate Intrinsic Value |
|----------------------------------|----------|---------------------------------------|--|------------------------------|
| Outstanding at January 1, 2015 | 349,983 | 10.97 | 2.20 | |
| Granted during period | — | — | | |
| Exercised | (55,000) | 8.00 | | |
| Forfeited/Expired | (25,000) | 14.08 | | |
| Outstanding at December 31, 2015 | 269,983 | 11.29 | 1.71 | |
| Granted during period | — | — | | |
| Exercised | (25,000) | 6.75 | | |
| Forfeited/Expired | (95,517) | 13.83 | | |
| Outstanding at December 31, 2016 | 149,466 | \$ 10.43 | 1.58 | |
| Granted during period | — | — | | |
| Exercised | (25,000) | 8.10 | | |
| Forfeited/Expired | (44,217) | 10.62 | | |
| Outstanding at December 31, 2017 | 80,249 | \$ 11.05 | 1.10 | \$ 82,250 |
| Vested at December 31, 2017 | 80,249 | \$ 11.05 | 1.10 | \$ 82,250 |

The Company's stock options granted to non-employee directors vest immediately upon grant and have a maximum contractual term of five years. Stock options granted to employees vest over three years and have a maximum contractual term of ten years. The expected option term is calculated utilizing historical data of option exercises.

During the year ended December 31, 2017, no stock options were exercised for cash. During the same period, 25,000 options were exercised, pursuant to provisions of the stock option plan, where the Company received no cash and 21,666 shares of its common stock in exchange for the 25,000 shares issued in the exercise. The 21,666 shares that the Company received were valued at \$202,580, the fair market value of the shares on the dates of exercise.

During the year ended December 31, 2016, no stock options were exercised for cash. During the same period, 25,000 options were exercised, pursuant to provisions of the stock option plan, where the Company received no cash and 21,552 shares of its common stock in exchange for the 25,000 shares issued in the exercise. The 21,552 shares that the Company received were valued at \$168,750, the fair market value of the shares on the dates of exercise.

The intrinsic value of stock options exercised during the years ended December 31, 2017, 2016 and 2015 was approximately \$31,300, \$27,000 and \$230,500, respectively.

The fair value of all options vested during the years ended December 31, 2017, 2016 and 2015 was approximately \$82,000, \$151,000 and \$221,000, respectively.

10. EMPLOYEE BENEFIT PLAN

On September 11, 1996, the Company's board of directors instituted a defined contribution plan under Section 401(k) of the Internal Revenue Code (the "Code"). On October 1, 1998, the Company amended and standardized its plan as required by the Code. Pursuant to the amended plan, qualified employees may contribute a percentage of their pretax eligible compensation to the Plan and the Company will match a percentage of each employee's contribution. Additionally, the Company has a profit-sharing plan covering all eligible employees. Contributions by the Company are at the discretion of management. The amount of contributions recorded by the Company in 2017, 2016 and 2015 amounted to \$361,682, \$351,932 and \$422,334, respectively.

11. MAJOR CUSTOMERS

Eight percent of revenue in 2017, 4% of revenue in 2016 and 1% of revenue in 2015 were directly to the U.S. government. Less than 6% and 10% of accounts receivable at December 31, 2017 and 2016, respectively, were from the U. S. Government.

In addition, in 2017, 25%, 23% and 12% of our revenue were to our three largest commercial customers, respectively. In 2016, 36%, 29%, 12% and 11% of our revenue were to our four largest commercial customers, respectively. At December 31, 2017, 44%, 18% and 13% of accounts receivable were from our three largest commercial customers. At December 31, 2016, 35%, 24% and 17% of accounts receivable were from our three largest commercial customers.

At December 31, 2017 and 2016, 4% and 1%, respectively, of costs and estimated earnings in excess of billings on uncompleted contracts were from the U.S. Government.

At December 31, 2017, 32%, 20%, 12%, and 10% of costs and estimated earnings in excess of billings on uncompleted contracts were from our four largest commercial customers. At December 31, 2016, 33%, 26%, 12%, and 11% of Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts were from our four largest commercial customers.

In 2017 and 2016, approximately 4% and 11%, respectively, of our revenue was from a customer who is located outside the United States.

12. QUARTERLY FINANCIAL DATA (UNAUDITED)

The results of any single quarter are not necessarily indicative of the Company's results for the full year. Earnings per share data is computed independently for each of the periods presented. As a result, the sum of the earnings per share amounts for the quarter may not equal the total for the year.

| | 2017 | Quarter ended | | | |
|--------------------------------|---------|---------------|---------------|---------------|---------------|
| | | March 31, | June 30, | September 30, | December 31, |
| Revenue | | \$ 20,032,701 | \$ 16,731,951 | \$ 20,706,460 | \$ 23,812,036 |
| Gross Profit | | 4,537,514 | 3,683,748 | 4,912,436 | 5,512,218 |
| Net Income | | 1,249,301 | 765,647 | 1,695,513 | 2,057,173 |
| Income per common share | | | | | |
| | Basic | 0.14 | 0.09 | 0.19 | 0.23 |
| | Diluted | 0.14 | 0.09 | 0.19 | 0.23 |
| | 2016 | | | | |
| Revenue | | \$ 12,670,032 | \$ 22,280,964 | \$ 22,110,829 | \$ 24,268,033 |
| Gross Profit (loss) | | (11,639,104) | 5,034,001 | 5,024,368 | 5,899,653 |
| Net Income (loss) | | (9,220,220) | 1,790,580 | 1,686,065 | 2,134,999 |
| Income (loss) per common share | | | | | |
| | Basic | (1.07) | 0.21 | 0.19 | 0.24 |
| | Diluted | (1.07) | 0.21 | 0.19 | 0.24 |

13. SUBSEQUENT EVENTS

On March 21, 2018, the Company entered into a Stock Purchase Agreement (the "Agreement") with Air Industries Group ("Air Industries"), pursuant to which, subject to the satisfaction or waiver of certain conditions, the Company will purchase from Air Industries all of the shares (the "Shares") of Welding Metallurgy, Inc. ("WMI"), a wholly owned subsidiary of Air Industries (the "Acquisition"). WMI is engaged in the manufacture of complex components and assemblies for the defense and commercial aircraft industries.

Under the terms of the Agreement, the Company will pay a purchase price for the Shares as follows: (i) \$9.0 million in cash, subject to adjustment based on the working capital of WMI at the closing of the Acquisition and (ii) up to an aggregate of \$1.0 million, in two payments of up to \$500,000 each (the "Contingent Payments") if WMI enters into certain long-term supply agreements. The Contingent Payments are reduced if milestones for signing are not achieved.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: March 22, 2018

CPI AEROSTRUCTURES, INC.
(Registrant)

By: /s/ Vincent Palazzolo
Vincent Palazzolo
Chief Financial Officer and Secretary
(Principal financial and accounting officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|---|----------------|
| <u>/s/ Eric Rosenfeld</u> Eric Rosenfeld | Chairman of the Board of Directors | March 22, 2018 |
| <u>/s/ Douglas McCrosson</u> Douglas McCrosson | Chief Executive Officer and President | March 22, 2018 |
| <u>/s/ Vincent Palazzolo</u> Vincent Palazzolo | Chief Financial Officer and Secretary (Principal financial and accounting officer) | March 22, 2018 |
| <u>/s/ Walter Paulick</u> Walter Paulick | Director | March 22, 2018 |
| <u>/s/ Harvey Bazaar</u> Harvey Bazaar | Director | March 22, 2018 |
| <u>/s/ Michael Faber</u> Michael Faber | Director | March 22, 2018 |
| <u>/s/ Terry Stinson</u> Terry Stinson | Director | March 22, 2018 |
| <u>/s/ Carey Bond</u> Carey Bond | Director | March 22, 2018 |

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Section 2: EX-23.1 (CONSENT OF COHNREZNICK LLP)

[CPI Aerostructures, Inc. 10-K](#)

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Registration Nos. 333-11669, 333-42403, 333-130077, 333-164687 and 333-212837) and on Form S-3 (Registration No. 333-220090), of CPI Aerostructures, Inc. of our report dated March 22, 2018, on our audits of the financial statements of CPI Aerostructures, Inc. as of December 31, 2017 and 2016 and for each of the years in the three-year period ended December 31, 2017, and of our report dated March 22, 2018 which expresses an unqualified opinion on the effectiveness of internal control over financial reporting of CPI Aerostructures, Inc. as of December 31, 2017 included in the Form 10-K of CPI Aerostructures, Inc. for the year ended December 31, 2017.

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Section 3: EX-31.1 (CERTIFICATION OF CHIEF EXECUTIVE OFFICER)

[CPI Aerostructures, Inc. 10-K](#)

EXHIBIT 31.1

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Douglas McCrosson, certify that:

1. I have reviewed this Annual Report on Form 10-K of CPI Aerostructures, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 22, 2018

CPI AEROSTRUCTURES, INC.
(Registrant)

By: /s/ Douglas McCrosson
Douglas McCrosson
Chief Executive Officer, President and Director

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Section 4: EX-31.2 (CERTIFICATION OF CHIEF FINANCIAL OFFICER)

[CPI Aerostructures, Inc. 10-K](#)

EXHIBIT 31.2

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Vincent Palazzolo, certify that:

1. I have reviewed this Annual Report on Form 10-K of CPI Aerostructures, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 22, 2018

CPI AEROSTRUCTURES, INC.
(Registrant)

By: /s/ Vincent Palazzolo

Vincent Palazzolo
Chief Financial Officer and Secretary
(Principal financial and accounting officer)

Section 5: EX-32.1 (CERTIFICATION OF CHIEF EXECUTIVE AND CHIEF FINANCIAL OFFICERS)

[CPI Aerostructures, Inc. 10-K](#)

EXHIBIT 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of CPI Aerostructures, Inc. (the "Company") on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission (the "Report"), the undersigned, in the capacities and on the date indicated below, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Dated: March 22, 2018

CPI AEROSTRUCTURES, INC.
(Registrant)

By: /s/ Douglas McCrosson
Douglas McCrosson
Chief Executive Officer, President and Director
(Principal executive officer)

Dated: March 22, 2018

CPI AEROSTRUCTURES, INC.
(Registrant)

By: /s/ Vincent Palazzolo
Vincent Palazzolo
Chief Financial Officer and Secretary
(Principal financial and accounting officer)