CPI AEROSTRUCTURES INC
Form 10-K
April 03, 2007

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, 2006

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.)

60 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:

Title of Each Class	Name of each exchange on which registered
Common Stock, $.001 par value	American Stock Exchange, Inc.

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 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, or a non-accelerated filer. See definition of ''accelerated filer'' and ''large accelerated filer'' in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b2 of the Exchange Act).

Yes No

As of June 30, 2006 (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 American Stock Exchange of $7.20) held by non-affiliates of the registrant was $30,841,956.

As of March 20, 2007, the registrant had 5,550,273 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 2007 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.

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PART I

Item 1. Business

General

CPI Aerostructures, Inc. (‘‘CPI Aero’’ or the ‘‘Company’’) is engaged in the contract production of structural aircraft parts principally for the United States Air Force and other branches of the U.S. armed forces and, to a lesser extent, for prime military aircraft contractors. We also provide aircraft parts to the commercial sector of the aircraft industry. Our strategy for growth includes de-emphasizing our commercial operations and concentrating on government and military sales as a prime contractor and as a subcontractor for other defense prime contractors. Approximately 93% of our revenues for 2006, 96% of our revenues for 2005 and 99% of our revenues for 2004 were derived from government contract sales.

In our capacity as a prime contractor supplying structural aircraft parts to the U.S. Government, we deliver skin panels, leading edges, flight control surfaces, engine components, wing tips, cowl doors, nacelle assemblies and inlet assemblies for military aircraft such as the C-5A ‘‘Galaxy’’ cargo jet, the T-38 ‘‘Talon’’ jet trainer, the C-130 ‘‘Hercules’’ cargo jet, the A-10 ‘‘Thunderbolt’’ or ‘‘Warthog’’ attack jet, the E-3 ‘‘Sentry’’ AWACS jet, the US-60 Blackhawk helicopter and the MH-60-S mine counter measure helicopter. We also operate as a subcontractor to leading aerospace prime contractors such as Northrop Grumman Corporation, Lockheed Martin Corporation, Sikorsky Aircraft Corporation and Vought Aircraft Industries, Inc. This is a field of opportunity that has opened up to us over the past few years. As a subcontractor, we deliver pod assemblies and bonded assemblies as well as perform small bench assembly work and various kitting work. We also supply commercial aircraft products including aprons and engine mounts, which attach jet engine housings to aircraft such as the Lear 60 and Astra Galaxy business jets. Our products are sub-assemblies, a series of parts fixed together to form a larger unit that will comprise a part of a complex aerodynamic structure. In conjunction with our assembly operations, we provide engineering, technical and program management services to our customers.

CPI Aero has 26 years of experience as a contractor, completing over 2,300 contracts to date. Most members of our management team have held management positions at large defense contractors, including Northrop Grumman Corporation, Lockheed Martin Corporation and The Fairchild Corporation. 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. While the larger prime contractors compete for significant modification awards and subcontract components to other suppliers, they generally do not compete for awards for smaller modifications or spare and repair parts, even for planes for which they are the original manufacturer. We qualify as a small business because we have less than 1,000 employees, and this allows us to compete on military awards set aside for companies with this small business status.

While historically the majority of our contracts have been valued below $200,000, we have competed for, and have been awarded, significantly larger contracts, including an estimated $61 million award for the T-38 ‘‘Talon’’ jet trainer and an estimated $215 million award for the C-5 cargo plane. We intend to continue to bid on these larger contracts. We believe that our success with the T-38 and C-5 programs will allow us to compete more effectively for larger awards in the future.

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.

Our principal office is located at 60 Heartland Blvd., Edgewood, New York 11717 and our telephone number is (631) 586-5200.

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Significant Contracts

The ongoing maintenance of existing aircraft by the U.S. Air Force is the primary driver of our growth in both the number of contracts and the size of awards through mid 2005. Our contracts with the Air Force accounted for substantially all of our revenue for 2004, 2005 and 2006. In most cases, we supply structural aircraft parts for aircraft that are no longer being manufactured but continue to be used and need to be maintained. CPI Aero has been awarded contracts within these maintenance programs on the C-5A and T-38.

The C-5A ‘‘Galaxy’’ cargo jet is one of the largest aircraft in the world and can carry a maximum cargo load of 270,000 pounds. Lockheed delivered the first C-5A in 1970. The C-5A Galaxy carries fully equipped combat-ready military units to any point in the world on short notice and then provides field support to sustain the fighting force. The Air Force has created a comprehensive program to ensure the capabilities of its C-5A fleet until 2040. We are one of the leading suppliers of structural spare parts and assemblies for the C-5A aircraft. We assemble numerous C-5A parts, including panels, slats, spoilers and wing-tips and are the only supplier of C-5A wing-tips to the U.S. government.

Like the C-5A itself, the wing-tip is a large structure and is expensive — costing up to $750,000 for each replacement piece. Our first C-5A contract was approximately $590,000 of structural spares and was awarded in 1995. In 2004, the Air Force awarded us a seven-year TOP contract to build an assortment of parts for the C-5A, including wing tips and panels. The TOP contract is the largest contract in our history, with a potential value of up to $215 million. Since 1995, we have received releases under contracts for C-5A parts aggregating approximately $83 million, including $14.7 million from the TOP contract. Future releases under the TOP contract are unpredictable. C-5A contracts accounted for approximately 32% of our revenues for 2006.

The T-38 ‘‘Talon’’ is a twin-engine, high-altitude, supersonic jet primarily used for pilot training that first flew in 1959. More than 1,100 were delivered to the Air Force between 1961 and 1972, when production ended. There are approximately 500 T-38’s in active service with the Air Force, which has a program designed to extend the structural life of the T-38 until 2020. In 2001, we were awarded a ten-year contract to build the structural inlets for the T-38 Propulsion Modification Program. At the time, the T-38 contract was the largest in our history, worth an estimated $61 million over the life of the program. The length and size of this program allow us to develop a long-term backlog and establish ourselves as a successful prime contractor for larger and longer term programs. The T-38 contract accounted for 27% of our revenues for 2006.

The balance of our revenue is generated from various smaller contract awards on assorted aircraft, including the MH-60S helicopter and the E-3 AWACS jet.

Sales and Marketing

We obtain all of our military contracts for our products and services through the process of competitive bidding. While historically the majority of our contracts have been valued below $200,000, we successfully have competed for and have been awarded significantly larger contracts. 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, typically ranges from six to 24 months. Our military customers have included Defense Supply Center Richmond, Wright-Patterson Air Force Base (AFB), Warner Robins AFB, Tinker AFB, NAVICP, Hill AFB, U.S. Army and Redstone. Our commercial customers have included Boeing, B.F. Goodrich (Rohr), Northrop Grumman, Lockheed Martin, Nordam, Shinmaywa and Derco.

We use third party service providers to help locate small government contracts that are regularly posted by the various defense logistic agencies. The service providers screen contracts according to criteria we establish and forward matching contracts to us. We then view the relevant contracts directly on government websites and select contracts on which we will bid based on how well they fit our core competency. As of March 20, 2007, we had over $300 million in bids outstanding, and we continue to make bids on contracts on a weekly basis. We generally bid on 40 to 50 contracts per week. Over the past three years, we have been awarded approximately 13% of the contracts on which we have bid.

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We qualify for small business status because we have fewer than 1,000 employees. The military’s fiscal year 2006 program goals were 23% for small business prime contracting and 43% for subcontracting. During 2006, approximately 65% of the value of our current contracts were awarded to us under this program.

The U.S. Air Force operates three Air Logistics Centers (ALC) through which it purchases all structural replacement and modification parts. Each ALC is located on a domestic Air Force base and is responsible for the repair and modification of different aircraft. Parts worn out in the normal course of operation and discarded instead of repaired are ordered through the centralized Defense Supply Center Richmond (DSCR). We use on-site consultants at each ALC and the DSCR to help in the procurement process. These consultants are important as relationship managers and typically have previous experience on the procurement side. The consultants provide us with timely feedback and keep us apprised of large contracts that might be up for bidding. Additionally, we currently have agreements with six sales representatives to market our products to a broader base of customers.

The Market

The majority of our parts are sold for use by the U.S. Air Force. Accordingly, the national defense budget and procurement funding decisions drive demand for our business. The U.S. Department of Defense (DoD) budget has been increasing over the past few years. Government spending requirements for procurement, operations and maintenance for 2007 and beyond will continue to be affected by the global war on terrorism through the continued need for military missions and reconstruction efforts in Iraq and Afghanistan and the related fiscal consequences of war. We expect that DoD spending will grow with the overall level of defense spending and we expect to benefit to the extent that such spending is allocated to aircraft modification programs and spending on spare and repair parts.

In 2006 the DoD completed the Congressionally mandated 2006 Quadrennial Defense Review (QDR). The QDR affirmed the DoD’s commitment to its extensive investments in cargo transportability and strategic lift and for maintaining and enhancing this capability by recapitalizing and modernizing its mobility platforms, including the acquisition and modernization of C-5 aircraft, one of our major programs.

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

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. Congress often appropriates funds for

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a particular program or contract 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 backlog as of December 31, 2005 and December 31, 2006 was as follows:

Backlog	December 31, 2005	December 31, 2006
Funded	$ 22,218,392	$ 26,763,778
Unfunded	28,291,000	21,391,000
Total	$ 50,509,392	$ 48,154,778

Of the total amount of our backlog at December 31, 2006, approximately 97.3% was attributable to government contracts. Approximately $25.5 million (96%) of the funded backlog at December 31, 2006 is expected to be recognized as revenue during 2007.

Material and Parts

We subcontract production of substantially all component 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 delivery 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. In the second quarter of 2006, we experienced delays in deliveries and poor workmanship on parts received from some of our suppliers. These delivery delays and rework costs associated with poor workmanship caused a reduction in gross profit on some of our contracts.

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

The markets for our products are highly competitive. We compete with numerous larger, well-established prime contractors engaged in the supply of aircraft parts and assemblies to the military, including Northrop Grumman Corporation, Lockheed Martin Corporation, The Boeing Company, The Nordam Group and Vought Aircraft Industries, Inc. All of these competitors possess significantly larger infrastructures, greater resources and the capabilities to respond to much larger contracts. In certain instances, we also may act as a subcontractor to some of these major prime contractors. We also compete against smaller contractors such as Aerocomponents, Aerospace Engineering and Support, GSE Dynamics, Honeycomb Company of America, Alton Iron Works, B&B Devices and Precision Manufacturing.

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 the larger prime contractors compete for significant modification awards and subcontract components to other suppliers, they generally do not compete for awards in smaller modifications, spares and replacement parts, even for planes for which they are the original manufacturer. We believe we compete effectively against the smaller competitors because our smaller competitors generally do not have the expertise we have in responding to requests for proposals for government contracts.

Government Regulation

Environmental Regulation

We are subject to regulations administered by the United States Environmental Protection Agency, the 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

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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, 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 are subject to the procurement rules and regulations of the United States 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 substantial 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.

Insurance

We maintain a $2 million general liability insurance policy, a $10 million products liability insurance policy, and a $5 million umbrella liability insurance policy. Additionally, we maintain a $5 million director and officers' insurance policy. We believe this coverage is adequate for the types of

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products presently marketed because of the strict inspection standards imposed on us by our customers before they take possession of our products. Additionally, the Federal Acquisition Regulations generally provide that we will not be held liable for any loss of or damage to property of the government that occurs after the 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 are protected by patents. We rely on proprietary know-how and confidential 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.

Employees

As of March 20, 2007, we had 61 full-time employees. We employ temporary personnel with specialized disciplines on an as-needed basis. None of our employees is a member of a union. We believe that our relations with our employees are good.

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Item 1A.   RISK FACTORS

You should consider the following risks carefully in evaluating us and our business before making an investment decision. The risks described below are not the only risks we face. Additional risks may also impair our business operations. If any of the following risks occur, our business, results of operations or financial condition could be materially adversely affected. If that happens, the trading price of our common shares could decline, and you may lose all or part of your investment.

Risks related to our business

We depend on government contracts for most of our revenues.

We are a supplier, either directly or as a subcontractor, to the U.S. government and its agencies, principally the U.S. Air Force. 93% of revenue for 2006, 96% of revenue for 2005 and 99% of our revenue for 2004 were derived from government contract sales. Two of our contracts, for the T-38 ''Talon'' and the C-5, accounted for 27% and 32% of our revenue for 2006, respectively. We depend on these government contracts for most 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 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.

There are inherent risks in contracting with the U.S. government, including risks that are peculiar to the defense industry, which could have a material adverse effect on our business, prospects, financial condition and operating results. All contracts with the U.S. government contain provisions and are subject to laws and regulations that give the government rights and remedies not typically found in commercial contracts, including rights that allow the government to:

- terminate contracts for convenience in whole or in part at any time;
- reduce or modify contracts or subcontracts if its requirements or budgetary constraints change;
- cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable;
- adjust contract costs and fees on the basis of audits completed by its agencies;
- claim rights in products and systems produced by us;
- suspend or bar us from doing business with U.S. government; and
- control or prohibit the export of our products.

If the U.S. government terminates a contract for convenience, we may recover only our incurred or committed costs, settlement expenses and profit on work completed prior to the termination. If the government terminates a contract for default, we may not recover even those amounts, and instead may be liable for excess costs incurred by the government in procuring undelivered items and services from another source.

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

We obtain many of our U.S. government 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

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• 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 Federal Aviation Administration 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.

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

Many 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 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 an adverse effect upon our profitability.

Contract cost growth that cannot be justified as an increase in contract value due from customers 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 increase due to technical challenges or if initial estimates used for calculating the contract price were incorrect. The cost estimation process

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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 change in cost estimates on one or more programs could have a material effect on the company's consolidated 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 recognize revenue from our contracts over the contractual period under the percentage-of-completion (POC) method of accounting. Under the POC method of accounting, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at the completion of the contract. Recognized revenues that will not be billed under the terms of the contract until a later date are recorded as an asset captioned ''Costs and estimated earnings in excess of billings on uncompleted contracts.'' Contracts where billings to date have exceeded recognized revenues are recorded as a liability captioned ''Billings in excess of costs and estimated earnings on uncompleted contracts.'' Changes to the original estimates may be required during the life of the contract. Estimates are reviewed monthly and the effect of any change in the estimated gross margin percentage for a contract is reflected in cost of sales in the period the change becomes known. The use of the POC method of accounting involves considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods. As a result, there can be a significant disparity between earnings (both for accounting and taxes) as reported and actual cash received by us during any reporting period. We continually evaluate all of the issues related to the assumptions, risks and uncertainties inherent with the application of the POC method of accounting; however, we cannot assure you that our estimates will be accurate. If our estimates are not accurate or a contract is terminated, we will be forced to adjust revenue in later periods. Furthermore, even if our estimates are accurate, we may have a shortfall in our cash flow and we may need to borrow money to pay taxes 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 government 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 actual accrual 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, 2006, our backlog was $48.2 million, of which 56% was funded and 44% was unfunded.

Our inability to generate sufficient cash flow from operations or to enter into a new credit facility could materially adversely affect our business, financial condition and operations.

At December 31, 2006, we had a cash balance of $38,564. During the years ended December 31, 2006, 2005 and 2004, we used cash of $1,015,151, $676,767 and $560,768, respectively, to fund our operations. Although we expect to have positive cash flow during the year ending December 31, 2007, our business may not generate sufficient cash flow from operations or future borrowings may not be available to us in an amount sufficient to enable us to fund our liquidity needs. Although we are currently negotiating to secure a long term credit agreement with our current lender, JPMorgan Chase Bank, or with another financial institution, we may not be able to secure a new line of credit on terms acceptable to us, or at all.

We may be unable to 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

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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 will be required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 for the year ending December 31, 2007 and beyond. Any delays or difficulty in satisfying these requirements could adversely affect our future results of operations and our stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to document and test the effectiveness of our internal control over financial reporting in accordance with an established internal control framework and to report on our conclusion as to the effectiveness of our internal controls. It also requires an independent registered public accounting firm to test our internal control over financial reporting and report on the effectiveness of such controls for the year ending December 31, 2008 and subsequent years. An independent registered public accounting firm is also required to test, evaluate and report on the completeness of our assessment.

We may discover areas of our internal controls that need improvement. We cannot be certain that any remedial measures we take will ensure that we implement and maintain adequate internal controls over our financial processes and reporting in the future. Our failure to implement or maintain adequate internal controls, or any difficulties we experience in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to conclude that we have effective internal control over financial reporting, or if our independent auditors are unable to provide us with an unqualified report regarding the effectiveness of our management’s assessment of our internal control over financial reporting as of December 31, 2008 and in future periods as required by Section 404, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the price of our common stock. Failure to comply with Section 404 could potentially subject us to sanctions or investigations by the SEC, the American Stock Exchange or other regulatory authorities.

Our independent registered public accounting firm has reported material weaknesses in our internal control over financial reporting. If these material weaknesses are not remediated or were to recur, it could result in a material misstatement in our financial statements that would not be prevented or detected, cause investors to lose confidence in our reported financial information and have a negative effect on the trading price of our stock.

Item 1B. UNRESOLVED STAFF COMMENTS

Not Applicable

Item 2. PROPERTIES

CPI Aerostructures' executive offices and production facilities are situated in an approximate 60,000 square foot building located at 60 Heartland Blvd., Edgewood, New York 11717. CPI Aerostructures occupies this facility under a ten-year lease that commenced in January 2005. The current monthly base rent is $33,684, plus real estate taxes. Our base rent increases at 3% per year through 2014. We believe that our facilities are adequate for our current needs.

Item 3. LEGAL PROCEEDINGS

None

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS

None

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PART II

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

Market Information

Our common shares are listed on the American Stock Exchange under the symbol CVU. The following table sets forth for 2006 and 2005, the high and low sales prices of our common shares for the periods indicated, as reported by the American Stock Exchange.

Period	High	Low
2005		
Quarter Ended March 31, 2005	$11.66	$ 9.55
Quarter Ended June 30, 2005	$10.14	$ 8.80
Quarter Ended September 30, 2005	$10.35	$ 8.90
Quarter Ended December 31, 2005	$10.10	$ 9.14
2006		
Quarter Ended March 31, 2006	$10.35	$ 7.95
Quarter Ended June 30, 2006	$8.17	$ 7.12
Quarter Ended September 30, 2006	$7.25	$ 4.35
Quarter Ended December 31, 2006	$7.25	$ 4.50

On March 20, 2007, the closing sale price for our common shares on the American Stock Exchange was $6.60. On March 20, 2007, there were 141 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 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

We made the following sales of unregistered securities during the three months ended December 31, 2006.

Date of Sale	Title of Security	Number Sold	Consideration Received and Description of Underwriting or Other Discounts to Market Price Afforded to Purchasers	Exemption from Registration Claimed	If Option, Warrant or Convertible Security, Terms of Exercise or Conversion
12/4/06	Common Stock	750	Common Stock issued under Performance Equity Plan 2000 — no cash consideration received by the Company	4(2)	N/A

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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 financial statements and ‘‘Management’s Discussion and Analysis of Financial Condition and Results of Operations.’’

Statements of Operations Data:	Years Ended December 31,				
	2006	2005	2004	2003	2002
Revenue	$17,907,989	$25,526,404	$30,269,030	$27,288,035	$23,999,257
Cost of sales	16,264,351	19,513,391	19,973,231	18,283,252	16,297,905
Gross profit	1,643,638	6,013,013	10,295,799	9,004,783	7,701,352
Selling, general and administrative expenses	3,551,974	3,342,729	3,424,953	3,177,173	2,691,632

Income (loss) from operations	(1,908,336)	2,670,284	6,870,846	5,827,610	5,009,720
Other income (expense):					
Interest/ other income	6,656	5,463	7,294	16,206	69,233
Interest expense	(20,326)	(18,314)	(8,109)	(148,006)	(510,329)
Gain on extinguishment of debt	—	—	—	2,431,233	—
Total other income (expense), net	(13,670)	(12,851)	(815)	2,299,433	(441,096)
Income (loss) before taxes	(1,922,006)	2,657,433	6,870,031	8,127,043	4,568,624
Provision for income taxes	(657,000)	1,138,000	1,794,000	195,000	124,000
Income (loss) from continuing operations	(1,265,006)	1,519,433	5,076,031	7,932,043	4,444,624
Gain (loss) on sale of assets held for sale — discontinued operations	—	—	—	461,235	—
Net income (loss)	$ (1,265,006)	$ 1,519,433	$ 5,076,031	$ 8,393,278	$ 4,444,624
Basic net income per common share:					
Income (loss) from continuing operations	$ (0.23)	$ 0.28	$ 0.94	$ 1.63	$ 1.63
Income from discontinued operations	—	—	—	0.09	—
Income (loss) per common share — basic	$ (0.23)	$ 0.28	$ 0.94	$ 1.72	$ 1.63
Diluted net income per common share:					
Income from continuing operations	$ (0.23)	$ 0.25	$ 0.83	$ 1.47	$ 1.40
Income from discontinued operations	—	—	—	0.09	—
Income per common share — diluted	$ (0.23)	$ 0.25	$ 0.83	$ 1.56	$ 1.40
Basic weighted average number of shares outstanding	5,446,711	5,422,101	5,386,595	4,872,255	2,721,522
Diluted weighted average number of shares outstanding	5,446,711	6,114,808	6,096,302	5,382,266	3,181,834

Balance Sheet Data:			At December 31,		
	2006	2005	2004	2003	2002
Cash	$ 38,564	$ 877,182	$ 1,756,350	$ 2,794,310	$ 91,937
Costs and estimated earnings in excess of billings on uncompleted contracts	28,783,708	28,389,202	26,030,507	17,449,887	11,382,106
Total current assets	31,006,495	31,458,345	29,609,862	23,399,350	15,202,592
Total assets	32,160,187	32,687,784	30,759,124	23,939,090	15,604,746
Total current liabilities	5,883,991	5,428,429	5,213,460	4,079,976	13,227,018
Working capital	25,122,504	26,029,916	24,396,402	19,319,374	1,975,574
Short term debt	392,188	87,617	83,144	7,303	8,024,160
Long term debt	—	42,188	129,276	26,311	40,192
Shareholders' equity	26,177,655	27,162,272	25,416,388	19,832,803	2,337,536
Total liabilities and shareholders' equity	32,160,187	32,687,784	30,759,124	23,939,090	15,604,746

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

Forward-Looking Statements

When used in this Form 10-K and in future filings by us with the Commission, the words or phrases ‘‘will likely result,’’ ‘‘management expects’’ or ‘‘we expect,’’ ‘‘will continue,’’ ‘‘is anticipated,’’ ‘‘estimated’’ or similar expressions are intended t 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. As 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 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.

Business Operations

We are engaged in the contract production of structural aircraft parts principally for the United States Air Force and other branches of the U.S. armed forces and to a lesser extent, for prime military aircraft contractors. We also provide aircraft parts to the commercial sector of the aircraft industry. Our strategy for growth includes de-emphasizing our commercial operations and concentrating on government and military sales as a prime contractor and as a subcontractor for other defense prime contractors.

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

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

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Critical Accounting Policies

Revenue Recognition

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

Stock Based Compensation

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

Results of Operations

Year Ended December 31, 2006 as Compared to the Year Ended December 31, 2005

Revenue.   Revenue for the year ended December 31, 2006 was $17,907,989 compared to $25,526,404 for the same period last year, representing a decrease of $7,618,415 or 30%. The decrease was due to fewer contract awards and releases in 2006 as compared to 2005, which resulted from the overall slowdown in the government contract award process and smaller than anticipated releases on our multiyear contracts during the 18 month period from February 2005 through August 2006.

We generate revenue primarily from government contracts and to a lesser extent from one commercial contract. Revenue from government contracts for the year ended December 31, 2006 was $16,627,210 compared to $24,473,234 for the year ended December 31, 2005, a decrease of $7,846,024 or 32%.

During the year December 31, 2006, we received approximately $30.0 million of new contract awards. Included in this amount is approximately $7.9 million related to the C-5 TOP contract and $7.0 million related to our work as a subcontractor for other prime contractors. Although the C-5

contract is valued at up to $215 million over the seven-year life of the program, orders under this program, including the $7.9 million of awards received during 2006, totaled only $14.7 million as of December 31, 2006. As of December 31, 2006, we had over $300 million in bids outstanding.

Although we are not actively pursuing commercial contract work, our one remaining commercial contract accounted for revenue of $1,304,433 for the year ended December 31, 2006 compared to $1,112,380 for the year ended December 31, 2005.

Gross profit. Gross profit for the year ended December 31, 2006 was $1,643,638 compared to $6,013,013 for the year ended December 31, 2005, a decrease of $4,369,375. As a percentage of revenue, gross profit for the year ended December 31, 2006 was 9.2% compared to gross profit of 23.6% for the same period last year.. The decrease in gross profit percentage was due to overtime and rework costs incurred to correct poor supplier workmanship and delays in deliveries by some of our suppliers.

Additionally, as previously reported, we had maintained our overhead levels through June 2006 in anticipation of new awards and releases on contracts we had already been awarded. We reduced our staff by approximately 12% at the end of the second quarter of 2006 when these awards and releases did not materialize. These staff reductions, along with tighter control over other overhead costs, reduced factory overhead by approximately $70,000 in the year ended December 31, 2006 as compared to the year ended December 31, 2005.

Selling, general and administrative expenses. Selling, general and administrative expenses year ended December 31, 2006 were $3,551,974 compared to $3,342,729 for the year ended December 31, 2005, an increase of $209,245, or 6.3%. This increase was primarily due to recording non-cash compensation of approximately $256,000 related to stock options as required pursuant to SFAS 123R as described in Note 9 of the Financial Statements, offset by a decrease in legal and accounting fees of approximately $40,000.

Interest Expense. Interest expense for the year ended December 31, 2006 was $20,326, compared to $18,314 for 2005, an increase of $2,012. The change is deemed immaterial.

Income (Loss) from operations. We had a loss from operations for the year ended December 31, 2006 of $1,908,336 compared to income from operations of $2,670,284 for the year ended December 31, 2005. The loss was a result of lower sales and lower gross margins described earlier.

Year Ended December 31, 2005 as Compared to the Year Ended December 31, 2004

Revenue. Our revenue for the year ended December 31, 2005 was $25,526,404 compared to $30,269,030 for 2004, representing a decrease of $4,742,626 or 16%. This decrease was due to fewer contracts in 2005 as compared to 2004 and a less favorable product mix.

Gross profit.   Gross profit for the year ended December 31, 2005 was $6,013,013, compared to $10,295,799 for 2004, a decrease of $4,282,786 or 42%. Gross profit as a percentage of revenue for the year ended December 31, 2005 was 24% compared to 34% for December 31, 2004. Gross profit percentage declined for a number of reasons, including rework costs related to a first article rejection, increased factory overhead related to our move to new, larger facilities and related utility and maintenance costs, and higher indirect labor costs. The increased level of factory overhead and indirect labor have been maintained in anticipation of releases on contracts, including the C-5 TOP contract, that we already have been awarded and the receipt of any additional awards on some of our major outstanding bids. If these events are not forthcoming, we plan on reassessing this position.

Selling, general and administrative expenses.   Selling, general and administrative expenses for the year ended December 31, 2005 were $3,342,729, compared to $3,424,953 for 2004, a decrease of $82,224, or 2%. This decrease reflects a decrease of approximately $240,000 in officers' bonuses, offset by an increase in expenses related to our efforts to sell to prime contractors.

Income from operations.   Income from operations for the year ended December 31, 2005 was $2,670,284 compared to income from operations of $6,870,846 for the year ended December 31, 2004,

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a decrease of $4,200,562, or 61%. The decrease was due to the decrease in gross profit decribed earlier and increases in expenses related to our efforts to sell to prime contractors.

Interest Expense.   Interest expense for the year ended December 31, 2005 was $18,314, compared to $8,109 for 2004, an increase of $10,205, or 126%. Interest expense is considered immaterial to our operations in both 2005 and 2004.

Income before income taxes.   Income before income taxes for the year ended December 31, 2005 was $2,657,433 compared to income before income taxes for the year ended December 31, 2004 of $6,870,031, a decrease of $4,212,598, or 61%. The decrease was due to the decrease in gross profit described earlier and increases in expenses related to our efforts to sell to prime contractors. The 2005 results include income taxes computed at an effective tax rate of 43% compared to 26% for 2004. The increase was the result of us utilizing our remaining state net operating loss carryforward at the beginning of 2005. Basic income per common share for the year ended December 31, 2005 was $0.28 on an average of 5,422,101 shares outstanding, compared to $0.94 per share from continuing operations on an average of 5,386,595 shares outstanding for the year ended December 31, 2004.

Liquidity and Capital Resources

General

At December 31, 2006, we had working capital of $25,122,504 compared to $26,029,916 at December 31, 2005, a decrease of $907,412, or 3%.

Cash Flow

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

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

At December 31, 2006, we had a cash balance of $38,564. During the years ended December 31, 2006, 2005 and 2004, we used cash of $1,015,151, $676,767 and $560,768, respectively, to fund our operations. Because of our historical use of cash, and the expiration of a long term line of credit, beginning in June 2006, we began to reduce expenses and implement a plan to improve cash flow.

At December 31, 2006, we had costs in excess of billings on uncompleted contracts of $28,783,708, which represents unbilled receivables of which we expect approximately 96% to be converted into cash within the next year. This amount represents $27,653,000 of funded delivery orders, or funded backlog, to be shipped and collected by December 31, 2007. In addition, we will be filing a tax refund of approximately $628,000 for the carryback of our net tax loss recorded during the year ended December 31, 2006.

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Based on our projected cash expenses and the above described sources of cash, we expect to have positive cash flow during the year ending December 31, 2007.

JP Morgan Chase Credit Facility

In September 2003, we entered into a three year, $5.0 million revolving credit facility with JP Morgan Chase Bank (the ‘‘Chase Facility’’), secured by our assets. The facility specified interest rates that ranged between the Prime Rate and 225 basis points over LIBOR, depending on certain terms and conditions.

In October 2006, the Chase Facility was amended and restated to provide for a $1.0 million revolving credit facility, secured by our assets. The facility specifies an interest rate equal to the greater of (a) the prime rate and (b) the federal funds rate, plus 0.5%. The Chase Facility expired on December 31, 2006 and has been extended until April 30, 2007.

Although we are currently negotiating to secure a long term credit agreement with JP Morgan Chase Bank, or with another financial institution, there is no assurance that a new line of credit can be secured on terms acceptable to us.

As of December 31, 2006, the Company had borrowed $350,000 under the Chase Facility.

Contractual Obligations

The table below summarizes information about our contractual obligations as of December 31, 2006 and the effects these obligations are expected to have on our liquidity and cash flow in the future years.

	Payments Due By Period ($)				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Short-Term Debt	350,000	350,000	-0-	-0-	-0-
Capital Lease Obligations	42,188	42,188	-0-	-0-	-0-
Operating Leases	3,537,705	397,838	831,838	882,499	1,425,530
Employment Agreement Compensation**	1,487,450	773,150	714,300	-0-	-0-
Total Contractual Cash Obligations	5,417,343	1,563,176	1,546,138	882,499	