CPI AEROSTRUCTURES INC
Form 10-Q
November 13, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from ___________ to __________

Commission File Number: 1-11398

CPI AEROSTRUCTURES, INC.

(Exact name of registrant as specified in its charter)

New York	11-2520310
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

91 Heartland Blvd., Edgewood, NY 11717
(Address of principal executive offices) (zip code)

(631) 586-5200

(Registrant's telephone number including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer	Accelerated filer
Non-accelerated filer	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 12b-2 of the Exchange Act).
Yes No

As of November 12, 2018 the number of shares of common stock, par value $.001 per share, outstanding was 11,727,784.

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Part I - Financial Information

Item 1 – Condensed Financial Statements

CONDENSED BALANCE SHEETS

	September 30, 2018 **(Unaudited)**	December 31, 2017 **(Note 1)**
ASSETS		
Current Assets:		
Cash	$828,594	$1,430,877
Accounts receivable, net of allowance for doubtful accounts of $275,000 and $150,000 as of September 30, 2018 and December 31, 2017, respectively	6,364,186	5,379,821
Contract assets	114,094,962	111,158,551
Prepaid expenses and other current assets	2,330,830	2,413,187
Total current assets	123,618,572	120,382,436
Property and equipment, net	2,696,344	2,046,942
Deferred income taxes, net	500,318	1,566,818
Other assets	286,527	188,303
Total Assets	$127,101,761	$124,184,499
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$10,431,232	$15,129,872
Accrued expenses	1,262,373	1,911,421
Contract liabilities	464,823	246,330
Current portion of long-term debt	2,435,559	2,009,000
Line of credit	27,538,685	22,838,685
Income tax payable	—	109,327
Total current liabilities	42,132,672	42,244,635
Long-term debt, net of current portion	5,667,915	7,019,468
Other liabilities	548,815	607,063
Total Liabilities	48,349,402	49,871,166
Shareholders' Equity:		
Common stock - $.001 par value; authorized 50,000,000 shares, 8,953,137 and 8,864,319 shares, respectively, issued and outstanding	8,950	8,863
Additional paid-in capital	54,352,614	53,770,618
Retained earnings	24,390,795	20,548,652

Accumulated other comprehensive loss	—	(14,800)
Total Shareholders' Equity	78,752,359	74,313,333
Total Liabilities and Shareholders' Equity	$127,101,761	**$124,184,499**

See Notes to Condensed Financial Statements

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Unaudited)		(Unaudited)	
Revenue	$19,944,558	$20,706,460	$58,397,420	$57,471,112
Cost of revenue	15,146,080	15,794,024	44,964,256	44,337,414
Gross profit	4,798,478	4,912,436	13,433,164	13,133,698
Selling, general and administrative expenses	2,584,560	2,044,304	7,192,159	6,210,380
Income from operations	2,213,918	2,868,132	6,241,005	6,923,318
Interest expense	574,765	402,619	1,438,862	1,258,857
Income before provision for income taxes	1,639,153	2,465,513	4,802,143	5,664,461
Provision for income taxes	311,000	770,000	960,000	1,954,000
Net income	1,328,153	1,695,513	3,842,143	3,710,461
Other comprehensive income (loss), net of tax – Change in unrealized (gain) loss on interest rate swap	20,600	(2,300)	14,800	1,900
Comprehensive income	$1,348,753	$1,693,213	$3,856,943	$3,712,361
Income per common share – basic	$0.15	$0.19	$0.43	$0.42
Income per common share – diluted	$0.15	$0.19	$0.43	$0.42
Shares used in computing income per common share:				
Basic	8,952,979	8,846,507	8,926,734	8,820,379
Diluted	8,977,075	8,872,810	8,951,640	8,841,397

See Notes to Condensed Financial Statements

CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at January 1, 2017	8,739,836	$8,738	$52,824,950	$14,781,018	$ (9,000)	$67,605,706
Net income	—	—	—	3,710,461	—	3,710,461
Change in unrealized loss from interest rate swap	—	—	—	—	1,900	1,900
Stock-based compensation expense	106,981	109	787,181	—	—	787,290
Balance at September 30, 2017	8,846,817	$8,847	$53,612,131	$18,491,479	$ (7,100)	$72,105,357
Balance at January 1, 2018	8,864,319	$8,863	$53,770,618	$20,548,652	$ (14,800)	$74,313,333
Net income	—	—	—	3,842,143	—	3,842,143
Change in unrealized loss from interest rate swap	—	—	—	—	14,800	14,800
Common stock issued as employee compensation	5,130	5	45,908	—	—	45,913
Stock-based compensation expense	83,688	82	536,088	—	—	536,170
Balance at September 30, 2018	8,953,137	$8,950	$54,352,614	$24,390,795	$ —	$78,752,359

See Notes to Condensed Financial Statements

CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the Nine Months Ended September 30,	2018	2017
Cash flows from operating activities:		
Net income	$3,842,143	$3,710,461
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	521,255	459,261
Debt issuance costs	58,990	48,133
Deferred rent	(53,073)	(22,525)
Loss on disposal of fixed asset	—	21,010
Stock-based compensation	536,170	787,290
Common stock issued as employee compensation	45,913	—
Adjustment for maturity of interest rate swap	20,600	—
Bad debt expense	125,000	150,000
Deferred income taxes	1,066,500	1,802,128
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(1,109,365)	3,621,017
Increase in contract assets	(2,936,411)	(8,799,379)
Decrease (increase) in prepaid expenses and other assets	82,357	(299,317)
Decrease in accounts payable and accrued expenses	(5,347,688)	(888,218)
Increase (decrease) in contract liabilities	218,493	(798,882)
Decrease in other liabilities	(10,976)	—
Decrease in income taxes payable	(109,327)	—
Net cash used in operating activities	(3,049,419)	(209,021)
Cash flows used in investing activities:		
Purchase of property and equipment	(521,499)	(240,916)
Proceeds from sale of fixed asset	—	42,480
Net cash used in investing activities	(521,499)	(198,436)
Cash flows from financing activities:		
Payments on long-term debt	(1,522,283)	(921,046)
Proceeds from line of credit	6,200,000	3,000,000
Payments on line of credit	(1,500,000)	(2,000,000)
Debt issue costs paid	(209,082)	—
Net cash provided by financing activities	2,968,635	78,954
Net decrease in cash	(602,283)	(328,503)
Cash at beginning of period	1,430,877	1,039,586
Cash at end of period	$828,594	$711,083

Supplemental disclosures of cash flow information:

Equipment acquired under capital lease	$649,158	$—
Noncash investing and financing activities:		
Cash paid during the period for:		
Interest	$1,601,144	$1,172,964
Income taxes	$—	$144,614

See Notes to Condensed Financial Statements

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NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

1.

INTERIM FINANCIAL STATEMENTS

The condensed financial statements of CPI Aerostructures, Inc. (the "Company") as of September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

The condensed balance sheet at December 31, 2017 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. All adjustments that, in the opinion of management, are necessary for a fair presentation for the periods presented have been reflected. Such adjustments are of a normal, recurring nature. It is suggested that these condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for interim periods are not necessarily indicative of the operating results to be expected for the full year or any other interim period.

The Company maintains its cash in two financial institutions. The balances are insured by the Federal Deposit Insurance Corporation. From time to time, the Company's balances may exceed these limits. As of September 30, 2018, the Company had $748,470 of uninsured balances. The Company limits its credit risk by selecting financial institutions considered to be highly creditworthy.

Effective January 1, 2018, the Company adopted Accounting Standards Codification Topic 606 *Revenue from Contracts with Customers* ("ASC 606") using the modified retrospective method for all of its contracts. ASC 606 requires sales and gross profit to be recognized over the contract period 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 "Contract assets." Contracts where billings to date have exceeded recognized revenues are recorded as a liability captioned "Contract liabilities." 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 revenue in the period the change becomes known. ASC 606 involves considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods. As a result, there can be a significant disparity between earnings (both for accounting and tax purposes) as reported and actual cash received during any reporting period. The Company continually evaluates all of the issues related to the assumptions, risks and uncertainties inherent with the process; however, it cannot be assured that estimates will be accurate. If estimates are not accurate or a contract is terminated, the Company is required to adjust revenue in later periods. Furthermore, even if estimates are accurate, there may be a shortfall in cash flow and the Company may need to borrow money, or seek access to other forms of liquidity, to fund its work in process or to pay taxes until the reported earnings materialize as actual cash receipts.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

When changes 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.

Following the adoption of ASC 606, the Company's revenue recognition for all of its contracts remained materially consistent with historical practice and there was no material impact in the nine months ended September 30, 2018 condensed financial statements upon adoption.

In compliance with ASC 606, costs and estimated earnings in excess of billings on uncompleted contracts, on the December 31, 2017 condensed balance sheet, have been reclassified to contract assets. Additionally, billings in excess of costs and estimated earnings on uncompleted contracts and contract losses, on the December 31, 2017 condensed balance sheet, have been combined and reclassified to contract liabilities.

2.

aCCOUNTING STANDARDS

Recently Issued but not Adopted Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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 non-lease components in a contract in accordance with the new revenue guidance in ASC 606. ASU 2016-02 will be effective January 1, 2019, although early adoption is permitted. On July 30, 2018, the FASB issued ASU No. 2018-11, Leases (Topic 842): Targeted Improvements, which, among other things, allows companies to elect an optional transition method to apply the new lease standard through a cumulative-effect adjustment in the period of adoption. We expect to adopt the standard on January 1, 2019 using the optional transition method. We are currently evaluating the potential impact of adopting ASU 2016-02 and expect to have an estimate of the impact of ASU 2016-02 on the Company's financial position during the fourth quarter of 2018. Topic ASU 2016-02 also requires expanded disclosure regarding the amounts, timing and uncertainties of cash flows related to a company's leases. The Company is evaluating these disclosure requirements and are incorporating the collection of relevant data into our processes.

3.

REVENUE RECOGNITION

The majority of the Company’s revenues are from long-term contracts with the U.S. government and commercial contractors. The contracts with the U.S. government typically are subject to the Federal Acquisition Regulation (“FAR”) which provides guidance on the types of costs that are allowable in establishing prices for goods and services provided under U.S. government contracts. The pricing for commercial contractors are based on the specific negotiations with each customer.

The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

To determine the proper revenue recognition method, the Company evaluates whether two or more contracts should be combined and accounted for as one single contract and whether the combined or single contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment and the decision to combine a group of contracts or separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recorded in a given period.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

All of the Company’s current long-term contracts have a single performance obligation as the promise to transfer the goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. The Company’s contracts are often modified to account for changes in contract specifications and requirements. The Company considers contract modifications to exist when the modification either creates new or changes the existing enforceable rights and obligations. All of the Company’s contract modifications are for goods or services that are not distinct from the existing contract due to the significant integration service provided in the context of the contract and are accounted for as if they were part of that existing contract. The effect of a contract modification on the transaction price and the measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) on a cumulative catch-up basis.

Revenues for the Company’s long-term contracts are recognized over time as the Company performs its obligations because of continuous transfer of control to the customer. The continuous transfer of control to the customer is supported by clauses in contracts that either allow the customer to unilaterally terminate the contract for convenience, pay the Company for costs incurred plus a reasonable profit and the products and services have no alternative use or the customer controls the work in progress.

Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. The Company uses the cost-to-cost input method to measure progress for its contracts because it best depicts the transfer of assets to the customer which occurs as the Company incurs costs on its contracts.

In applying the cost-to-cost input method, the Company compares the actual costs incurred relative to the total estimated costs to determine its progress towards contract completion and to calculate the corresponding amount of estimated revenue and estimated gross profit recognized. For any costs incurred that do not contribute to a performance obligation, the Company excludes such costs from its input methods of revenue recognition as the amounts are not reflective in transferring control of the asset to the customer. Costs to fulfill include labor, materials and subcontractors’ costs, other direct costs and an allocation of indirect costs.

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 for a contract is reflected in revenue in the period the change becomes known. Contract estimates involve considerable use of estimates in determining revenues, costs and profits and in assigning the amounts to accounting periods. As a result, there can be a significant disparity between earnings (both for accounting and tax purposes) as reported and actual cash received during any reporting period. The

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

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

For the Company's uncompleted contracts, contract assets include unbilled amounts and when the estimated revenues recognized exceeds the amount billed to the customer and right to payment is not just subject to the passage of time. Amounts may not exceed their net realizable value. Contract assets are classified as current. The Company's contract liabilities consist of billings in excess of estimated revenues recognized and contract losses. Contract liabilities are classified as current. The Company's contract assets and liabilities are reported in a gross position at the end of each reporting period.

Revenue recognized for the three and nine months ended September 30, 2018, that was included in the contract liabilities at July 1, 2018 and January 1, 2018 was $151,109 and $399,381, respectively.

The Company's remaining performance obligations represents the transaction price of its long-term contracts for which work has not been performed. As of September 30, 2018, the aggregate amount of transaction price allocated to the remaining performance obligations was $77,440,322. The Company estimates that it expects to recognize approximately 31% of its remaining performance obligations in 2018 and 69% in 2019.

In addition, the Company recognizes revenue for parts supplied for certain maintenance repair and overhaul ("MRO") contracts at a point in time following the transfer of control to the customer, which typically occurs upon shipment or delivery depending on the terms of the underlying contract.

Revenue from long-term contracts transferred to customers over time and revenue from MRO contracts transferred at a point in time accounted for approximately 95% and 5%, respectively, for the nine months ended September 30, 2018.

Revenue by long-term contract type for the three and nine months ended September 30, 2018 is as follows:

	For the Three Months Ended	**For the Nine Months Ended**
Government subcontracts	$9,516,799	$28,228,457
Commercial contracts	7,536,697	22,363,979
Prime government contracts	2,891,062	7,804,984
	$19,944,558	$58,397,420

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NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

4.

stock-based compensation

The Company accounts for stock-based compensation based on the fair value of the stock or stock-based instrument on the date of grant.

In January 2018, the Company granted 58,578 restricted stock units ("RSUs") to its board of directors as partial compensation for the 2018 year. In January 2017, the Company granted 59,395 RSUs to its board of directors as partial compensation for the 2017 year. RSUs vest quarterly on a straight-line basis over a one-year period. The Company's net income for the nine months ended September 30, 2018 and 2017 includes approximately $491,500 and $517,000, respectively, of non-cash 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 January 2018, the Company granted 5,130 shares of common stock to various employees. For the nine months ended September 30, 2018 approximately $10,000 of compensation expense is included in selling, general and administrative expenses and approximately $36,000 of compensation expense is included in cost of revenue for this grant. In January 2017, the Company granted 5,550 shares of common stock to various employees. For the nine months ended September 30, 2017, 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 revenue for this grant.

In March 2018, the Company granted 68,764 shares of common stock 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 2022 based upon the service and performance thresholds. For the nine months ended September 30, 2018, approximately $88,100 of compensation expense is included in selling, general and administrative expenses and approximately $18,400 of compensation expense is included in cost of revenue for this grant.

In March 2017, the Company granted 73,060 shares of common stock 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. For the nine months ended September 30, 2017, approximately $208,800 of compensation expense is included in selling, general and administrative expenses and approximately $44,100 of compensation expense is included in cost of revenue for this grant.

In March 2018, 12,330 and 9,130 of the shares granted in 2016 and 2017, respectively, were forfeited because the Company failed to achieve certain performance criteria for the year ended December 31, 2017. In addition, on March 22, 2018, these employees returned 7,552 common shares, valued at approximately $62,000, to pay the employees' withholding taxes.

In March 2017, 12,330 of the shares granted in August of 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.

A summary of the status of the Company's stock option plans as of September 30, 2018 and changes during the nine months ended September 30, 2018 is as follows:

	Options	**Weighted average exercise price**	**Weighted average remaining contractual term (in years)**	**Aggregate intrinsic value**
Outstanding at beginning of period	78,064	$ 11.05		
Outstanding and vested at end of period	78,064	$ 11.05	0.36	$ 61,250

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NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

During the nine months ended September 30, 2018 and 2017, no stock options were granted or exercised.

5.

Derivative Instruments and Fair Value

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

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

Any ineffective portion of the gain or loss on the derivative instrument for a cash flow hedge is recorded in the results of operations immediately. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in the results of operations immediately.

In May 2016, 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 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 contact with the cumulative change in the hedged item.

Fair Value

At September 30, 2018 and December 31, 2017, the fair values of cash, accounts receivable, accounts payable and accrued expenses approximated their carrying values because of the short-term nature of these instruments.

	September 30, 2018	
	Carrying Amount	**Fair Value**
Debt		
Short-term borrowings and long-term debt	$35,694,028	$35,694,028

	December 31, 2017	
	Carrying Amount	**Fair Value**
Debt		
Short-term borrowings and long-term debt	$31,893,894	$31,893,894

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

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

The following table presents the fair values of those financial liabilities measured on a recurring basis as of December 31, 2017:

		Fair Value Measurements December 31, 2017		
Description	**Total**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Interest Rate Swap, net	$18,781	—	$ 18,781	—
Total	$18,781	—	$ 18,781	—

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 of the interest differential between the contractual swap and the replacement swap.

As of December 31, 2017, $18,781 was included in other liabilities related to the fair value of the Company's interest rate swap $15,000, net of tax of approximately $4,000, respectively, was included in accumulated other comprehensive loss.

During the month of June, the interest rate swap matured and the Company realized a net gain of approximately $7,000.

6.

Contract assets and contract liabilities

Net Contract assets (liabilities) consist of the following:

	September 30, 2018		
	U.S. Government	Commercial	Total
Contract assets	$49,102,036	$64,992,926	$114,094,962
Contract liabilities	(422,666)	(42,157)	(464,823)
Net contract assets (liabilities)	$48,679,370	$64.950,769	$113,630,139

	December 31, 2017 (1)		
	U.S. Government	Commercial	Total
Contract assets	$54,591,601	$56,566,950	$111,158,551
Contract liabilities	(224,339)	(21,991)	(246,330)
Net contract assets (liabilities)	$54,367,262	$56,544,959	$110,912,221

(1) On January 1, 2018, as a result of the adoption of ASC 606, the Company reclassified costs and estimated earnings in excess of billings on uncompleted contracts to contract assets and billings in excess of costs and estimated earnings on uncompleted contracts to contract liabilities.

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NOTES TO CONDENSED FINANCIAL STATEMENTS