

CPI AEROSTRUCTURES INC
Form 10-K
March 06, 2015

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, 2014

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 (I.R.S. Employer
incorporation or organization) Identification No.)

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

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

including
area code)

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

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

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

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

Yes No

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

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a smaller reporting company)

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

Yes No

As of June 30, 2014 (the last business day of the registrant's most recently completed second fiscal quarter), the aggregate market value of the registrant's common stock (based on its reported last sale price on the NYSE MKT of \$12.67) held by non-affiliates of the registrant was \$98,094,700.

As of February 27, 2015, the registrant had 8,500,555 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 2015 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year covered by this report.

CPI AEROSTRUCTURES, INC.

FORM 10-K ANNUAL REPORT

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PART I

Item 1. BUSINESS

General

CPI Aerostructures, Inc. (“CPI Aero®” or the “Company”) is a United States (“U.S.”) manufacturer of structural aircraft parts for fixed wing aircraft and helicopters in both the commercial and defense markets. We have also recently expanded our presence in the aerosystems segment of the defense market, with our production of various reconnaissance pod structures and fuel panel systems. Within the global aerospace supply chain, we are either a Tier 1 supplier to aircraft original equipment manufacturers (“OEMs”) or a Tier 2 subcontractor to major Tier 1 manufacturers. We also are a prime contractor to the U.S. Department of Defense, primarily the Air Force. In conjunction with our assembly operations, we provide engineering, program management, supply chain management, and maintenance repair and overhaul (“MRO”) services.

Among the key programs that CPI Aero supplies are the E-2D Advanced Hawkeye surveillance aircraft, the A-10 Thunderbolt attack jet, the Gulfstream G650, the UH-60 BLACK HAWK® helicopter, the S-92® helicopter, the MH-60S mine countermeasure helicopter, the AH-1Z ZULU attack helicopter, the HondaJet-Advanced Light Jet, the MH-53 and CH-53 variant helicopters, the C-5A Galaxy cargo jet, the F-16 fighter aircraft, the Embraer Phenom 300 light business jet and the New Cessna Citation X+.

We act as a subcontractor to leading defense prime contractors such as Northrop Grumman Corporation (“NGC”), The Boeing Company (“Boeing”), Lockheed Martin Corporation (“Lockheed”), Sikorsky Aircraft Corporation (“Sikorsky”) and Bell Helicopter (“Bell”). 5%, 66% and 63% of our revenue in 2014, 2013 and 2012, respectively, was generated by subcontracts with defense prime contractors. Our 2014 defense subcontractor revenue was significantly decreased because of the change in estimate on the A-10 program, described in Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”).

We also operate as a subcontractor to prime commercial contractors, including Sikorsky, Honda Aircraft Company, Inc. (“Honda”), Embraer S.A. (“Embraer”) and The Triumph Group (“Triumph”), in the production of commercial aircraft parts. 93%, 32% and 30% of our revenue in 2014, 2013 and 2012 respectively, was generated by commercial contract sales.

We also perform as a prime contractor supplying aircraft structural parts directly to the U.S. Government. In this role, we have delivered 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 cargo jet, the T-38 “Talon” jet trainer, the

C-130 “Hercules” cargo jet, the A-10 attack jet, and the F-16. 2%, 2% and 7% of our revenue in 2014, 2013 and 2012 respectively, was generated by prime government contract sales.

CPI Aero has over 35 years of experience as a contractor, completing over 2,500 contracts to date. Most members of our management team have held management positions at large aerospace contractors, including NGC, Lockheed 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.

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

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

Significant Contracts

Some of our significant contracts are as follows:

Military Aircraft – Subcontracts with Prime Contractors

E-2D “Hawkeye” The NGC E-2 Hawkeye is an all-weather, carrier-based tactical Airborne Early Warning aircraft. The twin turboprop aircraft was designed and developed in the 1950s by Grumman for the United States Navy as a replacement for the E-1 Tracer. The United States Navy aircraft has been progressively updated with the latest variant, the E-2D, first flying in 2007. In 2008, we received an initial \$7.9 million order from NGC to provide structural kits for the E-2D. We initially valued the long-term agreement at approximately \$98 million over an eight-year period, with the potential to be in excess of \$195 million over the life of the aircraft program. The cumulative orders we have received on this program through January 2015 exceed \$140 million.

A-10 “Thunderbolt” The A-10 Thunderbolt II is a single-seat, twin-engine, straight-wing jet aircraft developed by Fairchild-Republic for the United States Air Force to provide close air support of ground forces by attacking tanks, armored vehicles, and other ground targets with a limited air interdiction capability. It is the first U.S. Air Force aircraft designed exclusively for close air support. In 2008, we received an initial order of \$3.2 million from the Integrated Defense Systems unit of Boeing in support of its \$2 billion award to produce up to 242 enhanced wings for the A-10. As of February 2015, we estimate that this contract will be terminated at approximately 130 ship sets valued at approximately \$54 million.

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

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

Commercial Aircraft – Subcontracts with Prime Contractors

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

HondaJet© advanced light business jet In May 2011 Honda, Inc. awarded us a contract to manufacture engine inlets and flaps and vane assemblies for the HondaJet advanced light business jet. We have received approximately \$11.5 million in orders on this program through December 2014. We estimate the potential value of this program to be approximately \$70 million.

Embraer Phenom 300 In May 2012 Embraer. awarded us a contract to manufacture engine inlets for the Embraer Phenom 300 business jet. We have received approximately \$14.8 million in orders on this program through December 2014. We estimate the potential value of the program to be in excess of \$40 million.

Cessna Citation X In November 2012, Cessna Aircraft Company (“Cessna”) awarded us a contract to supply structural assemblies, predominately wing spars, for Cessna’s flagship aircraft, the newly-relaunched Cessna Citation X. We have received approximately \$13.5 million in orders on this program through December 2014. We estimate the value of the contract, over a seven-year period, to be approximately \$41 million.

Military Aircraft – Prime Contracts with U.S. Government

C-5A “Galaxy” 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. 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 tips other and panels (“TOP”) contract to build an assortment of parts for the C-5A, including wing tips and panels. The ordering period for the C-5 TOP contract ended in May of 2011. We delivered the last part on this program in February 2015.

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

Sales and Marketing

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

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

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

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

Our military customers have included Defense Supply Center Richmond, Wright-Patterson Air Force Base (“AFB”), Warner Robins AFB, Tinker AFB, NAVICP, Hill AFB and the U.S. Army Redstone Arsenal. Our commercial customers have included NGC, Lockheed , Spirit, Sikorsky, Bell, Boeing Military, Nordam, UTAS, Embraer, Cessna and Honda.

The Market

Since our founding in 1980 until 2007, our company concentrated on manufacturing small assemblies and structures to prime contractors for use by the U.S. Military. Government-based contracts are subject to the national defense budget and procurement funding decisions which, accordingly, drives demand for our business in that market. Government spending and budgeting for procurement, operations and maintenance are affected not only by military action, but also the related fiscal consequences of these actions, as well as the political electoral process.

Since 2008, we have widened the scope of our target markets, positioning our company to take advantage of the opportunities a broader customer base provides while simultaneously reducing the impact of direct government contracting limitations. Our success as a subcontractor to defense prime contractors has provided us with opportunities to act as a subcontractor to prime contractors in the production of commercial aircraft structures, which also reduced our exposure to government spending decisions.

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

Approximately \$7.1 million and \$2.0 million of our revenue for the years ended December 31, 2014 and 2013, respectively was from customers outside the U.S. All other revenue for each of the three years in the period ended December 31, 2014 has been attributable to customers within the U.S. We have no assets outside the U.S.

Backlog

We produce custom assemblies pursuant to long-term contracts and customer purchase orders. Backlog consists of aggregate values under such contracts and purchase orders, excluding the portion previously included in operating revenues on the basis of percentage of completion accounting, and including estimates of future contract price escalation. Substantially all of our backlog is subject to termination at will and rescheduling, without significant penalty. Funds are often appropriated for programs or contracts on a yearly or quarterly basis, even though the contract may call for performance that is expected to take a number of years. Therefore, our funded backlog does not include the full value of our contracts. Our total backlog as of December 31, 2014 and 2013 was as follows:

Backlog	December 31, 2014	December 31, 2013
(Total)		
Funded	\$ 120,570,000	\$ 110,431,000
Unfunded/unreleased	283,078,000	321,011,000
Total	\$ 403,648,000	\$ 431,442,000

Approximately 63% of the total amount of our backlog at December 31, 2014 was attributable to government contracts. Our backlog attributable to government contracts at December 31, 2014 and 2013 was as follows:

Backlog	December 31, 2014	December 31, 2013
(Government)		
Funded	\$ 117,875,000	\$ 82,803,000
Unfunded	136,893,000	165,574,000
Total	\$ 254,768,000	\$ 248,377,000

Our backlog attributable to commercial contracts at December 31, 2014 and 2013 was as follows:

Backlog	December 31, 2014	December 31, 2013
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(Commercial)

Funded	\$	2,695,000	\$	27,628,000
Unfunded/unreleased		146,185,000		155,437,000
Total	\$	148,880,000	\$	183,065,000

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

Approximately 70% of the funded backlog at December 31, 2014 is expected to be recognized as revenue during 2015.

Material and Parts

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

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

Competition

We face competition in our role as both a prime contractor to the U.S. Government and as a subcontractor to military and commercial aircraft manufacturers. We compete with numerous larger, well-established prime contractors engaged in the supply of aircraft parts and assemblies to the military, including NGC, Lockheed, Boeing, Nordam and Triumph. 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 Solutions.

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 aircraft for which they are the original manufacturer. We believe we compete effectively against the smaller competitors because smaller competitors generally do not have the expertise we have in responding to requests for proposals for government contracts.

Government Regulation

Environmental Regulation

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

The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (“CERCLA”) imposes strict, joint and several liability on the present and former owners and operators of facilities that release hazardous substances into the environment. The Resource Conservation and Recovery Act of 1976 (“RCRA”) regulates the generation, transportation, treatment, storage and disposal of hazardous waste. In New York State, the handling,

storage and disposal of hazardous substances are governed by the Environmental Conservation Law, which contains the New York counterparts of CERCLA and RCRA. In addition, the Occupational Safety and Health Act, which requires employers to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, obligates employers to provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances.

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

Federal Aviation Administration Regulation

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

Government Contract Compliance

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

Government Contract Compliance

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

Insurance

We maintain a \$2 million general liability insurance policy, a \$100 million products liability insurance policy, and a \$5 million umbrella liability insurance policy. Additionally, we maintain a \$10 million director and officers' insurance policy. We believe this coverage is adequate for the types of products presently marketed because of the strict inspection standards imposed on us by our customers before they take possession of our products. Additionally, the FAR generally provide that we will not be held liable for any loss of or damage to property of the 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 information and employ various methods to protect the processes, concepts, ideas and documentation associated with our products. These methods, however, may not afford complete protection and there can be no assurance that others will not independently develop such processes, concepts, ideas and documentation.

CPI Aero® is a registered trademark of the Company.

Employees

As of February 27, 2015, we had 281 full-time employees. We employ temporary personnel with specialized disciplines on an as-needed basis. None of our employees are members of a union. We believe that our relations with our employees are good.

Item 1A. RISK FACTORS

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

Risks related to our business

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

We are a supplier, either directly or as a subcontractor, to the U.S. Government and its agencies. Government subcontracts accounted for 5% of our revenue in 2014, 66% of our revenue in 2013 and 63% of our revenue in 2012. In addition, 2% percent of revenue for 2014, 2% of revenue for 2013 and 7% of revenue for 2012 was derived from prime government contract sales. We depend on government contracts for a significant portion of our business. If we are suspended or barred from contracting with the U.S. Government, if our reputation or relationship with individual federal agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our business, prospects, financial condition and operating results would be materially adversely affected.

We face risks relating to government contracts.

The funding of U.S. Government programs is subject to congressional budget authorization and appropriation processes. For many programs, U.S. Congress appropriates funds on a fiscal year basis even though a program may extend over several fiscal years. Consequently, programs are often only partially funded initially and additional funds are committed only as Congress makes further appropriations. We cannot predict the extent to which total funding and/or funding for individual programs will be included, increased or reduced in budgets approved by Congress or be included in the scope o