Initial Research Report

Investors should consider this report as only a single factor in making their investment decision.

Air Industries Group, Inc.

Speculative Buy

John Nobile
December 18, 2013

AIRI $9.15 — (NYSE MKT)

	2011A	2012A	2013E	2014E
Revenues (millions)	$53.7	$64.2	$61.4	$71.0
Earnings (loss) per share	$0.63	$0.54	$0.62*	$0.44

52-Week range	$12.00 – $2.20	Fiscal year ends:	December
Common shares out as of 11/9/12	5.7 million	Revenue per share (TTM)	$10.83
Approximate float	4.7 million	Price/Sales (TTM)	0.8X
Market capitalization	$52 million	Price/Sales (FY2014)E	0.8X
Tangible book value/share	$2.65	Price/Earnings (TTM)	13.9X
Price/tangible book value	3.5X	Price/Earnings (FY2014)E	20.8X
Annual Dividend	$0.50	Dividend Yield	5.5%

* Includes $1.8 million tax benefit of approximately $0.30 per share.

Air Industries Group, Inc., headquartered in Bay Shore, New York, operates primarily in the aerospace and defense industry. The company designs and manufactures structural parts and assemblies, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants and other components. Air Industries also provides sheet metal fabrication of aerostructures, tube bending and welding services. (www.airindustriesgroup.com)

Key investment considerations:

Initiating coverage of Air Industries Group, Inc. (AIRI) with a Speculative Buy rating and twelve-month price target of $10.50 per share based on a multiple of 24X applied to our 2014 EPS projection. Our price target and the dividend yield imply a total year-ahead return of 20%.

With its strategic acquisitions and a majority of revenue generated from defense programs that are projected to grow, we believe the company is poised for strong growth in 2014.

On November 7, 2013, Air Industries announced it acquired Miller Stuart, Inc. of Hauppauge, New York. Miller Stuart is a manufacturer of aerospace components whose customers include major aircraft manufacturers and the US Military.

On November 4, 2013, Air Industries announced it has been awarded a $27 million multi-year commercial aircraft contract from an aerostructures manufacturer. Deliveries are expected over six years beginning in the first half of 2014. On December 2, 2013, Air Industries announced it has been awarded a follow-on contract valued at $11 million over six years beginning mid-2014.

We project FY13 sales will decrease 4% to $61.4 million primarily due to significant cuts in the defense budget. Excluding a $1.8 million tax benefit related to a valuation allowance reversal, we estimate 2013 net income of approximately $0.32 per share. We project 2014 sales will grow 16% to $71 million based on recent accretive acquisitions, growth in the company's existing defense programs, and new commercial programs. We project 2014 EPS of $0.44.

****Please view our disclosures on pages 16 - 18.***

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Recommendation and Valuation

We are initiating coverage of Air Industries Group, Inc. (AIRI) with a **Speculative Buy** rating and **twelve-month price target of $10.50 per share.** Our price target and the dividend yield imply a total year-ahead return of 20%.

Shares of AIRI are currently trading at a multiple of 28X estimated 2013 EPS, excluding the $0.30 per share effect of tax benefits. We believe the market will accord the stock a multiple of 24X, a premium over the aerospace & defense sector forward multiple of 21X based largely on an improved sales mix. Applying a multiple of 24X to our 2014 earnings of $0.44 per share values the stock at approximately $10.50 per share.

Recent Developments

Acquisition of Miller Stuart – On November 7, 2013, Air Industries announced it acquired Miller Stuart, Inc. of Hauppauge, New York. Miller Stuart will initially be operated as a separate subsidiary.

Founded in 1966 Miller Stuart is a manufacturer of aerospace components whose customers include major aircraft manufacturers and the US Military. Miller Stuart specializes in electromechanical systems, harness and cable assemblies, electronic equipment and printed circuit boards.

Large Commercial Aerospace Contract – On November 4, 2013, Air Industries announced it has been awarded a multi-year contract from an aerostructures manufacturer to provide nacelle thrust struts (structural members that attach to aircraft engine housings). The contract is valued at $27 million with deliveries over six years beginning in the first half of 2014. These components will be used in a new jet engine expected to be used on several new commercial jetliners. Air Industries expects additional contracts from this customer to be awarded in the near future.

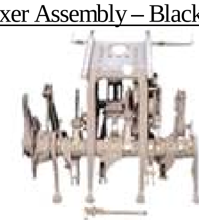
Follow-On Commercial Aerospace Contract – On December 2, 2013, Air Industries announced it has been awarded another multi-year contract by UTC Aerospace Systems - Aerostructures to provide nacelle thrust struts in support of its requirements for the Mitsubishi Regional Jet. The contract is valued at $11 million with projected deliveries over six years, and will run concurrently with the recently announced award for similar thrust struts. Deliveries are scheduled to begin mid-2014.

Business Overview

Air Industries Group, Inc., headquartered in Bay Shore, New York, operates primarily in the aerospace and defense industry. The company designs and manufactures structural parts and assemblies, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants and other components. Air Industries also provides sheet metal fabrication of aerostructures, tube bending and welding services.

Many of the company's products are flight critical, meaning they are a determining factor in how an aircraft performs on takeoff, during flight and when landing. Air Industries is required to have advanced certifications for these products as a condition to being a supplier. As many of these products are subject to wear and tear or fatigue and are routinely replaced on aircraft at a time of service or flight cycle basis, replacement demand should continue so long as an aircraft remains in service. This should help to lessen the effect on AIRI's revenues caused by reductions in defense spending. Nevertheless, revenues have been adversely impacted by cuts in defense spending.

Mixer Assembly – Blackhawk



E-2D Landing Gear

Source: Air Industries Group, Inc.

Components and subassemblies for defense and aerospace applications accounted for 66% of 2012 revenue. AIRI's products include electromechanical devices, mixer (primary flight control) assemblies, rotor-hub components for Blackhawk helicopters, arresting gear for the E2C/D Hawkeye, C2A Greyhound and US Navy Fighters, vibration absorbing assemblies for Sikorsky helicopters, landing gear components for the F-35 Joint Strike Fighter (JSF), and many other subassembly packages.

The company provides specialty welding services, and metal fabrications that were responsible for 23% of total revenue in FY12. Products include the inlet housing and auxiliary long and short beams for the Sikorsky Blackhawk helicopter and various welded door and panel assemblies for the Boeing CH-47 Chinook Helicopter. AIRI also provides environmental tubing to Lockheed for the F-35 Joint Strike Fighter.

Air Industries also manufactures complete landing gear assemblies and landing gear components for the F-16 Fighting Falcon and F-18 Hornet aircraft of the US Air Force and Navy which generated 11% of total revenue in FY12. The company specializes in deep hole gun-drilling (a process that produces deep, straight holes in a variety of materials) and trepanning (the removal of a disk or cylindrical core from metal) and performs sub-contract machining services for prime contractors in the defense and aerospace industries.

Defense Spending Overview

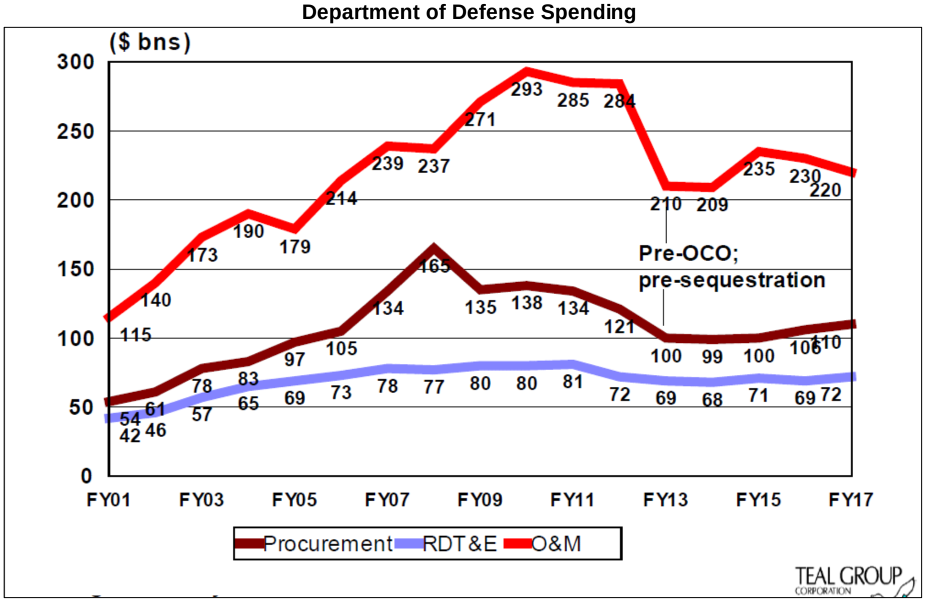
Changes in defense spending are likely to directly impact AIRI's revenues. According to a report by Deloitte (Global Defense Outlook 2013), the 2013-2017 defense budgets in higher income countries (i.e. the US, Canada, France, Germany and the United Kingdom) will drop by 0.5% to 3.7% ($5.4 billion to $39.8 billion) while lower income countries (i.e. Brazil, Egypt, Iran, Mexico, South Korea) will increase defense spending by 4.2% to 6.2% ($22.5 billion to $33.3 billion).

Global defense spending increased through much of the post-9/11 decade. Spending growth slowed to less than one percent in 2010-2011.

As part of an overall austerity program, the US Department of Defense estimates that the overall US defense budget will decline 20% from the post 9/11 peak (reached in 2010) by 2017. This would equate to an average annual reduction in US defense spending of approximately 3% to 2017.

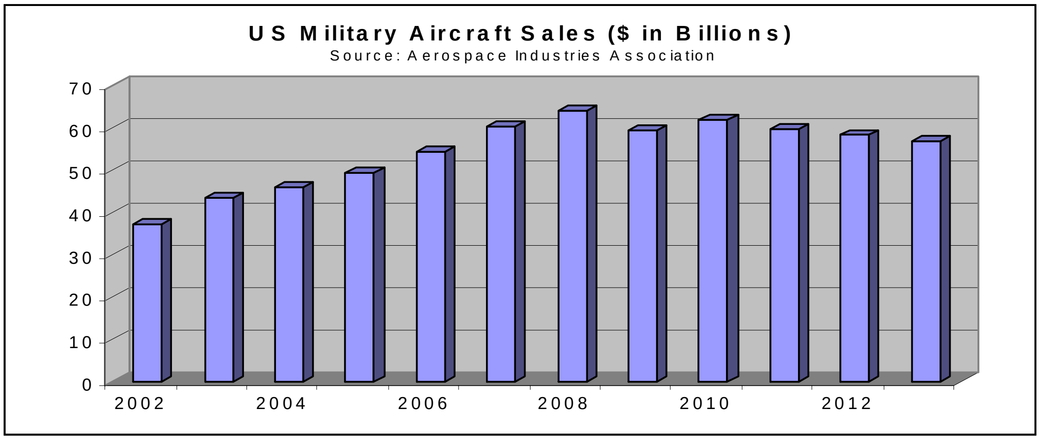
The chart at right depicts the changes in the budget authority of US Department of Defense (DoD) spending since 2001 along with the aerospace and defense consulting firm Teal Group's forecast to 2017. DoD spending on procurement (the middle line and the area of defense spending that directly relates to Air Industries) has decreased from $165 billion in 2008 to $121 billion in 2012 for a compound annual decline rate of approximately 7%. During that time of decreased procurement spending, Air Industries managed to grow revenues at a compound annual growth rate of 14%. This was due primarily to strategic acquisitions resulting in the company producing more complete sub-assemblies. The aerospace and defense consulting firm Teal Group forecasts DoD spending on procurement will level off by 2014 and eventually increase in the years to 2017.

Department of Defense Spending



A pending budget agreement in Congress should reverse some of the defense spending cuts mandated by the Budget Control Act of 2011. In December 2013, Congress reached a budget agreement that would provide $63 billion in relief of US government spending cuts in 2014. The relief would be split evenly between defense and non-defense programs and would be fully offset by savings elsewhere in the budget.

Military Aircraft Market and Forecast



The Aerospace Industries Association (AIA) forecasts that US military aircraft sales will total $56.8 billion in 2013, down 2.5% from 2012 and 11.2% from the peak in 2008. The decline is due to closure of the F-22 production line and decisions not to fund additional C-17 purchases. However, the F-35 Joint Strike Fighter program that directly affects AIRI is budgeted for a 7% increase in DoD procurement spending to $5.2 billion in 2014.

The current Air Force fleet, with planes averaging more than 23 years old, is the oldest it has been since 1907, and could continue to be in service for over 50 years. The AIA said that ground crews have pointed out that today's pilots are now flying the exact same equipment as did their fathers - and, in a few cases, their grandfathers.

Although the US has cut back on military expenditures, foreign sales of US military aircraft should help to offset in part the decline in US spending. The AIA said that as of 2012, no fewer than three key military aircraft production lines (C-17, F-15 and F-16) were being sustained largely by international export demand.

A September 2013 report (The Global Military Fixed-Wing Aircraft Market 2013-2023) by industry research firm Strategic Defence Intelligence (SDI) cited sustained demand for multi-role aircraft (such as the F-35, F-16 and F-18) which use Air Industries' products. As mentioned above, the F-35 Joint Strike Fighter program is budgeted for a 7% increase in DoD procurement spending to $5.2 billion in 2014, however, the F-16 program is budgeted for a 12% decrease in DoD procurement spending to $15.4 million, and the F-18 program is budgeted for an 82% decrease in DoD procurement spending to $$0.5 billion.

According to the SDI report, the US is making significant investments in early warning aircraft such as the E2D Hawkeye platform (AIRI manufactures arresting gear for this platform) in an effort to defend against technological advances in modern ballistic missiles. The DoD is budgeted for a 29% increase in procurement spending to $1.3 billion in 2014 for the E2D Hawkeye program.

Although the US is decreasing its budget for the F-16 and F-18 programs, SDI cited foreign demand for F-16 and F-18 fighters across the world which could offset declining US military sales. While the rate of increase in foreign sales was not mentioned, the US State Department's Bureau of Political-Military Affairs said the increase in foreign sales of F-16s and other weapons systems would be substantial. The US State Department said that foreign military sales more than doubled to $69 billion in 2012 from $34 billion in 2011. However, 2012 included a large $29 billion order for the sale of 84 F-15s to Saudi Arabia.

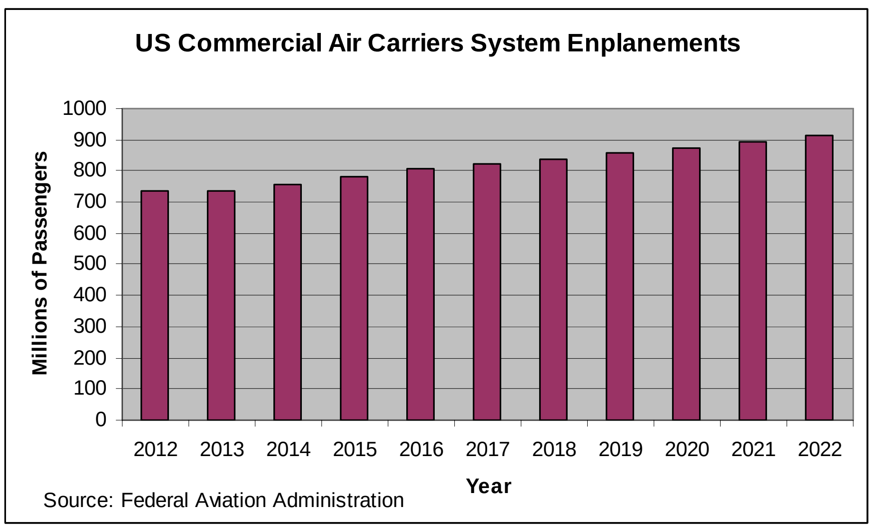
Prior to 2006, US foreign military sales were between $10 billion and $13 billion annually. The US Defense Security Cooperation Agency (DSCA) said that US foreign military sales have been more than twice that amount each year since, and the Agency expects that trend to continue because of an increased emphasis on foreign sales, interoperability and fighting in a coalition environment. The DSCA expects foreign military sales of $25 billion in 2013 growing to about $30 billion annually in 2014 and beyond.

Forecast – In August 2013, long-range industry forecaster Forecast International, projected military aircraft production to decline over the next ten years. According to Forecast International, about 11,940 military aircraft, worth an estimated $480 billion, will be produced during the 2013 – 2022 period. Production is estimated to peak at 1,367 units in 2014, dropping to a low of 1,095 in 2018, and then rising slightly to 1,122 by 2020 before tapering off for the remainder of the period for an average annual decline rate of approximately 2%.

But not all segments of the market will shrink. Approximately 75% of AIRI's revenues are currently generated from defense programs that are growing. These include the Blackhawk, E-2C/D Hawkeye, F-16, F-18, and F-35 Joint Strike Fighter programs.

While the US DoD Blackhawk helicopter budget is for a 25% decrease in procurement spending to $1.2 billion in 2014, there is an option for a 40% increase in units manufactured. Regardless, foreign interest in the Blackhawk helicopter should more than offset the decline in US spending. Turkey is set to sign a $3.5 billion contract with Sikorsky for Blackhawk helicopters over the next ten years and Sikorsky signed a letter of intent with Poland to supply 26 Blackhawk helicopters which we estimate at $464 million. In December 2013, the DSCA notified Congress of a possible sale of three Blackhawk helicopters to Austria which we estimate at $54 million. In November 2013, Sikorsky was awarded a $47 million contract to convert 26 Blackhawk helicopters to meet Taiwan configurations. Sikorsky was also awarded a contract from Colombia for two additional Blackhawk helicopters, which we estimate at $36 million, to be delivered in 4Q13. We believe foreign demand will result in an increase in worldwide Blackhawk spending through our forecast horizon.

Commercial Aircraft Market and Forecast



In 2000, approximately 60% of AIRI's total revenue was generated from sales for commercial aircraft parts. AIRI'S customers began shifting to defense after September 2011 resulting in approximately 90% of AIRI'S total revenue coming from defense and less than 10% from the commercial aircraft market in 2012. Although all three of the company's product lines primarily serve the defense market, they also serve the commercial markets. However, defense budgets are forecasted to decline over the next four years. In an effort to combat the decline in defense spending, prime contractors are beginning to shift their focus to the commercial sector with its more promising outlook. AIRI's customers (such as Boeing and United Technologies' Sikorsky and Goodrich divisions) typically build to both military and commercial specifications.

According to the Federal Aviation Administration's (FAA) Aerospace Forecast 2013-2022, the number of passengers flying US commercial air carriers is projected to increase steadily throughout its forecast horizon. However, the number of passenger is projected to remain flat in 2013. The FAA is forecasting US carrier passenger growth over the next ten years to average 2.2 percent per year (see chart above). Driving this growth will be a rise in economic activity. The FAA cited economic forecasts from IHS Global Insight, Inc. for average annual US GDP growth of 2.9% from 2014 to 2018 slowing to 2.5% from 2018 to 2022.

In PricewaterhouseCoopers' (PWC) Aerospace & Defense 2012 year in review and 2013 forecast, the long-term forecast for commercial aircraft is about 34,000 deliveries valued at about $4.5 trillion over the next 20 years. PWC said that long-term demand for commercial aircraft is for more than 1,500 aircraft per year with current production rates at about 1,200 per year.

The US commercial airline industry posted an increase in traffic growth over the past four years as measured by revenue passenger miles (RPM'S). Total RPM's grew one percent in the trailing twelve months ended August 2012 and 2013 while the average annual load factor (amount of utilization of total available capacity) increased a half percent.

Competition

The aerospace industry is dominated by a small number of large prime contractors and equipment manufacturers who seek subcontractors that can supply and are qualified to integrate the fabrication of complete subassemblies.

Winning a new contract is highly competitive and is usually obtained through competitive bidding against other qualified subcontractors. Follow-on contracts are usually obtained by successfully performing initial contracts. The company's long term business generally benefits from barriers to entry such as advanced quality approvals and certifications, and tooling investments that are difficult and expensive to duplicate. Despite these barriers to entry, many of the company's competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers.

Air Industries' competitors are mostly private companies and include Sterling Machine, Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group (TTM revenues of $3.8B), Heroux-Devtek (TTM revenues of $261.1M), and Ellanef Manufacturing, a division of Magellan Corporation.

Strategy

With future reductions in defense spending looming, the company aims to focus on the commercial and foreign military markets in an effort to reduce its dependence on sales to the US military. The company also intends to continue to seek accretive acquisition candidates. Although this is fairly common in the industry, the value of merger and acquisition deals were 15% below the ten-year average of $22.9 billion in 2012 due primarily to the level of uncertainty in defense spending which continues into 2013.

Since the 1990s, the aerospace and defense industries have undergone consolidation. The largest prime contractors have either merged or been acquired resulting in fewer, much larger, entities. Some examples include Boeing, which acquired McDonnell Douglas; Lockheed Martin, formed by Lockheed's acquisition of Martin Marietta, together with the aerospace divisions of General Dynamics; and Northrop Grumman, which fused together Northrop, Grumman, Westinghouse and Litton Industries into one entity. Where once there were nine companies, there are now just three.

The consolidation of the prime contractors has caused a similar consolidation of their suppliers. Major contractors seek to streamline supply chains by buying both larger quantities and more complete sub-assemblies from fewer suppliers. Air Industries' acquisition of Welding Metallurgy (August 2007), Nassau Tool Works (June 2012), Decimal Industries (July 2013), and Miller Stuart (November 2013) are part of the company's strategy to grow in this market.

AIRI's sales have grown at a compound annual growth rate of 7% over the past five years due to strategic acquisitions. AIRI is now producing more complete sub-assemblies sought after by major contractors and is currently the single source supplier for approximately 80% of the parts its supplies to customers.

Economic Outlook

In October 2013, the International Monetary Fund (IMF) reduced its US economic growth forecast to 1.6% in 2013 and 2.6% in 2014, down from an earlier (July 2013) growth forecast of 1.7% for 2013 and 2.8% for 2014. The IMF said that sharp fiscal tightening in 2013 has taken its toll on economic growth. With fiscal tightening expected to ease in 2014, the IMF is projecting economic growth to increase in 2014.

The IMF said that following the sharp fiscal tightening earlier in 2013, activity in the US is starting to increase. This can be evidenced by a recovering real estate sector, higher household wealth, easier bank lending conditions, and increased borrowing. However, downside risks remain such as a tightening of US monetary policy in the midst of a weak recovery.

As economic growth has been revised downward, the impact on defense spending could result in steeper cuts to the US defense budget.

3Q and Nine-Month 2013 Financial Results

3Q13 - 3Q13 total revenue increased 3% to $16.1 million. Specialty welding services sales increased 31% to $3.8 million, components and subassembly sales increased 3% to $9.9 million, and landing gear and related components sales decreased 22% to $2.4 million. Net income rose to $2.5 million or $0.43 per share from $0.6 million or $0.11 per share. 3Q13 net income included a $1.8 million tax benefit from the reversal of a valuation allowance on certain deferred tax assets.

	Product Sales ($ in thousands)	
	3mos13A	3mos12A
Components and subassemblies	9,863	9,587
Specialty welding services	3,800	2,891
Landind gear and related components	2,389	3,080
Total	16,052	15,558

Source: Company filings

The increase in specialty welding services sales was primarily due the inclusion of sales from the July 1, 2013 acquisition of Decimal Industries. The effects of reduced defense spending affected sales of components and subassemblies. Landing gear and related components sales were adversely affected by delays in certain shipments which are expected to be made in 4Q13.

Gross margins decreased to 23.3% from 24.6% primarily due to the lower sales contribution of higher margin (36.1%) landing gear and related components. Operating (SG&A) expenses increased to $2.7 million from $2.4 with landing gear and related components accounting for all of the increase. These factors resulted in operating income decreasing to $1 million or 6.4% of revenue from $1.5 million or 9.4% of revenue.

Interest and financing costs decreased to $281,000 from $452,000 primarily due to the conversion of debt into common stock which reduced interest expense. The company realized a tax benefit of $1.8 million in 3Q13 from the reversal of a valuation allowance on certain deferred tax assets. The company paid $387,000 in taxes in 3Q12 for a tax rate of 38.7%.

Nine-months 2013 - Total revenue decreased 4% to $45 million. Components and subassembly sales decreased 23% to $25.5 million, specialty welding services sales increased 3% to $10.2 million, and landing gear and related components sales increased 157% to $9.2 million. Net income rose to $3 million or $0.52 per share from $1.8 million or $0.40 per share. 2013 net income included a $0.9 million tax benefit from the reversal of a valuation allowance on certain deferred tax assets.

	Product Sales ($ in thousands)	
	9mos13A	9mos12A
Components and subassemblies	25,528	33,314
Specialty welding services	10,246	9,929
Landind gear and related components	9,242	3,592
Total	45,016	46,835

Source: Company filings

The decrease in components and subassemblies sales was primarily due to reduced defense spending. Specialty welding services sales benefited from the July 1, 2013 acquisition of Decimal Industries. Landing gear and related components sales included a full nine months worth of sales versus a little over three months worth in 2012. Air Industries acquired this product line on June 20, 2012.

Gross margins increased to 24.5% from 22.5% primarily due to a nine-month contribution from sales of higher margin (36.1%) landing gear and related components. But operating (SG&A) expenses increased to $7.7 million from $6.2 million primarily due to the inclusion of the landing gear and related components product line. These factors resulted in operating income decreasing to $3.3 million or 7.3% of revenue from $4.4 million or 9.3% of revenue.

Interest and financing costs decreased to $1 million from $1.4 million primarily due to the conversion of debt into common stock which reduced interest expense. The company realized a tax benefit of $0.9 million from the reversal of a valuation allowance on certain deferred tax assets. The company paid $1 million in taxes in the first nine months of 2012 for a tax rate of 37.1%.

Liquidity

As of September 31, 2013, the company had $0.8 million cash and a current ratio of 1.4X versus 1.3X for the aerospace and defense industry. Total debt was $21.1 million for a debt/equity ratio of 1.0X versus 0.9X for the aerospace and defense industry. By our forecasts, the company should have sufficient capital to meets its operational needs for the next twelve months.

Cash provided by operations for the first nine months of 2013 was $3.6 million consisting primarily of cash earnings of $4.2 million and a $0.6 million increase in working capital. The change in working capital was primarily due to a $1.3 million increase in inventory offset in part by a $0.8 million decrease in accounts receivable. Cash used in investing was $0.9 million consisting of $468,000 paid for acquisitions, $316,000 of capitalized engineering costs and $136,000 of capital expenditures. Cash used in financing was $2.4 million and consisted primarily of debt and dividend payments. Cash increased by $281,000 to $0.8 million at September 30, 2013.

Air Industries has a revolving credit line and term loan with PNC bank. The credit line provides for maximum borrowings of $18 million (current outstanding balance of $16.4 million) and the term loan provides for a maximum borrowing of $2.8 million (current outstanding balance of $2.4 million). Air Industries pays an annual interest rate of 5% on the term loan and 4% on the credit line. As of September 30, 2013, Air Industries was in compliance with all debt covenants.

Projections

Organic growth - AIRI showed organic growth of 6% to $57 million in 2012 when the June 2012 acquisition of the company's landing gear and related components product line which added $7.2 million is excluded. This growth was in light of a 10% reduction in US DoD procurement spending in 2012. Reductions in US DoD procurement spending are projected to decline 17% in 2013 and we project AIRI's organic growth to be down 15% to $48.5 million. With US DoD procurement spending expected to level off in 2014 and foreign defense spending to increase 20%, we project moderate organic growth of 3% to $50 million.

FY13 - We project AIRI's revenue will decrease 4% to $61.4 million primarily due to significant cuts in the defense budget. As mentioned above, we project organic revenue at $48.5 million. A full year of landing gear and related components revenue is projected at $12.4 million (near TTM rate) and the recent acquisition (November 7, 2013) of Miller Stuart is projected to add $0.5 million. We project net income of $3.6 million or $0.62 per share. At an effective income tax rate of 40%, i.e., excluding the effect of an income tax benefit, 2013 earnings are estimated at approximately $0.32 per share.

We project gross margins to improve to 24.6% from 23.1% primarily from a full year's contribution (approximately 20% of total revenue) from the landing gear and related components product line with its higher margins (36.1% year-to-date versus 19.5% for components and subassemblies and 26.3% for specialty welding services). The full year inclusion of the landing gear and related components product line should increase operating expenses to $10.5 million from $8.9 million while decreasing operating margins to 7.4% from 9.3%. The added expense from the landing gear and related components product line combined with the reduction in sales are the primary reasons for the reduction in operating margins.

Interest expense should decrease to $1.3 million from $1.8 million on lower debt levels. The company should realize a $486,000 or 15% tax benefit in 2013 primarily from a valuation allowance reversal.

We project $7.6 million cash from operations consisting of cash earnings of $5.7 million and decreases in working capital of $1.9 million. The decrease in working capital is primarily due to decreases in inventory and accounts receivable. Cash from operations and the issuance of stock should cover capital expenditures, debt repayments and dividends, increasing cash by $2.4 million to $2.9 million at year-end 2013.

	FY11A	1Q12A	2Q12A	3Q12A	4Q12A	FY12A	1Q13A	2Q13A	3Q13A	4Q13E	FY13E	1Q14E	2Q14E	3Q14E	4Q14E	FY14E
Sales ($ in thousands)																
Components	42,668	12,143	11,585	9,587	8,760	42,075	7,478	8,188	9,863	8,550	34,079	9,250	9,350	9,450	9,550	37,600
Specialty welding	11,077	3,895	3,142	2,891	4,979	14,907	3,139	3,307	3,800	4,150	14,396	4,150	4,250	4,350	4,450	17,200
Landing gear	-	-	513	3,080	3,640	7,233	3,708	3,144	2,389	3,200	12,441	3,200	3,250	3,350	3,400	13,200
Miller Stuart	-	-	-	-	-	-	-	-	-	450	450	675	725	775	825	3,000
Total	53,745	16,038	15,240	15,558	17,379	64,215	14,325	14,639	16,052	16,350	61,366	17,275	17,575	17,925	18,225	71,000
Gross Profit ($ in thousands)																
Components	8,013	2,246	2,193	1,788	1,991	8,218	1,460	1,599	1,926	1,668	6,653	1,812	1,830	1,847	1,865	7,354
Specialty welding	2,915	1,025	1,044	850	1,111	4,030	849	894	953	1,121	3,817	1,126	1,152	1,177	1,204	4,659
Landing gear	-	-	199	1,196	1,215	2,610	1,338	1,137	864	1,155	4,494	1,162	1,178	1,211	1,229	4,780
Miller Stuart	-	-	-	-	-	-	-	-	-	111	111	167	181	192	204	744
Total	10,928	3,271	3,436	3,834	4,317	14,858	3,647	3,630	3,743	4,055	15,075	4,267	4,341	4,427	4,502	17,537
Gross Margin																
Components	18.8%	18.5%	18.9%	18.7%	22.7%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%
Specialty welding	26.3%	26.3%	33.2%	29.4%	22.3%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%
Landing gear			38.8%	38.8%	33.4%	36.1%	36.1%	36.2%	36.1%	36.1%	36.1%	36.1%	36.1%	36.1%	36.1%	36.1%
Miller Stuart										24.6%	24.6%	24.6%	24.6%	24.6%	24.6%	24.6%
Total	20.3%	20.4%	22.5%	24.6%	24.8%	23.1%	25.5%	24.8%	23.3%	24.8%	24.8%	24.7%	24.7%	24.7%	24.7%	24.7%

Source: Company filings and Taglich Brothers' estimates

FY14 - We project AIRI's revenue will increase 16% to $71 million primarily from 3% organic growth to $50 million, landing gear and related components revenue of $13 million, a full year's inclusion from 2013 acquisitions of Decimal Industries (approx. $2.5 million) and Miller Stuart (approx. $3 million), and the recent commercial contracts (approx. $2.5 million). We project net income of $2.7 million or $0.44 per share.

We project gross margins will increase to 24.7% due to a greater percentage of revenue from higher-margin welding services. The increase in sales and the inclusion of Miller Stuart should increase operating expenses to $12 million from $10.5 million. Operating margins are projected to increase to 7.8% from 7.4% as the increased sales more than offset the effects of inflation on expenses and a full year's inclusion from Decimal Industries.

Interest expense should decrease to $1 million from $1.3 million on lower debt levels. The company estimates a 40% tax rate.

We project $2 million cash from operations consisting of cash earnings of $6.5 million and increases in working capital of $4.5 million. The increase in working capital is primarily due to increases in inventory and accounts receivable, offset in part by an increase in accounts payable and accrued expenses. Cash from operations and the issuance of stock will not be sufficient to cover capital expenditures, debt repayments and dividends, decreasing cash by $2.3 million to $0.6 million at year-end 2014.

Management

<u>Peter D. Rettaliata, President and Chief Executive Officer since November 2005</u> - Previously was President of Air Industries Machining Corp. (AIM) since 1994. Previously employed by Grumman Aerospace Corporation for twenty-two years. BA History Niagara University. Completed PMD program at Harvard Business School.

<u>Scott Glassman, Chief Accounting Officer since December 2008</u> - Controller of the company since February 2007. Was Accounting Manager for First Data Corporation from June 2005 to January 2007, SEC Reporting Specialist for Veeco Instruments Inc. from January 2004 to May 2005, and worked in a variety of positions for Grant Thornton LLP from June 1999 to December 2003.

<u>Dario Peragallo, President of AIM since December 2008</u> – Held several positions for Air Industries over a 25 year period including Executive Vice President of Manufacturing and Director of Manufacturing. BA in Manufacturing Engineering from SUNY Farmingdale.

<u>Gary Settoducato, President of Welding Metallurgy, Inc. since August 2007</u> – Previously a senior executive of Air Industries. Graduate of Northrop Grumman's procurement training program. Held senior management positions at several other aerospace manufacturers prior to Air Industries. Graduated Summa Cum Laude and Valedictorian C.W. Post Center of Long Island University with a double major in marketing and management.

Risks

In our view, these are the principal risks underlying the stock.

<u>Reliance on government spending</u> - Approximately 90% of AIRI's revenue is derived from products for US military aviation. FY13 financial results experienced a reduction in sales as a result of a slowing of orders from reduced military spending. Further reductions in defense spending could materially adversely impact AIRI's financial results.

<u>Reliance on a small number of customers</u> – Air Industries derives most of its revenues from a small number of customers. In FY12, two customers accounted for 54% of net sales and three customers accounted for 65% of net sales. The loss of one or more of the company's largest customers will likely have a materially adverse impact on AIRI's financial results.

<u>Reliance on a few aircraft platforms</u> – The company derives most of its revenues from components for a few aircraft platforms, specifically the Sikorsky BlackHawk helicopter, the Northrop Grumman E-2 Hawkeye naval aircraft, the McDonnell Douglas (Boeing) C-17 Globemaster, the F-16 Falcon and the F-18 Hornet. A reduction in the production of new aircraft or a reduction in the use of existing aircraft in the fleet (reducing after-market demand) would have a material adverse effect on AIRI's financial results.

<u>Competition</u> - The defense and aerospace component manufacturing market is highly competitive. Many of the company's competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers. Air Industries' prime competitors include Sterling Machine, Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group, Heroux Aerospace, and Ellanef Manufacturing, a division of Magellan Corporation.

<u>Competitive bidding</u> – The company obtains many contracts through a competitive bidding process. There can be no assurance that the prices bid will be sufficient to allow Air Industries to generate a profit.

<u>Regulations</u> – Air Industries may be subject to US government inquiries and investigations because of its participation in government procurement. Any inquiry or investigation can result in fines or limitations on the company's ability to continue to bid for government contracts and fulfill existing contracts.

Liquidity risk - Shares of Air Industries Group have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. There are 4.7 million shares in the float and the average daily volume is approximately 500 shares.

Miscellaneous risk - The company's financial results and equity values are subject to other risks and uncertainties including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Consolidated Balance Sheets
(in thousands $)

	2011A	2012A	9/13A	2013E	2014E
Cash and cash equivalents	577	490	771	2,916	582
Accounts receivable	6,042	11,631	10,548	11,115	12,860
Inventory	22,521	26,739	28,135	25,078	28,963
Prepaid expenses and other current assets	330	546	186	248	248
Deposits - customers	2	133	8	8	8
Total current assets	29,472	39,539	39,648	39,365	42,662
Property and equipment, net	3,971	5,883	5,652	5,863	5,846
Capitalized engineering costs	969	802	801	801	801
Deferred financing costs	671	590	591	591	591
Intangible assets	1,607	5,889	5,017	4,727	4,565
Deferred tax asset	-	-	1,625	1,625	-
Goodwill	291	453	453	453	453
Total assets	**36,981**	**53,156**	**53,787**	**53,425**	**54,918**
Notes payable and capitalized lease obligations	14,055	19,211	19,626	19,626	19,013
Accounts payable and accrued expenses	7,432	7,077	7,222	6,637	7,666
Lease impairment	85	85	75	75	75
Deferred gain on sale	38	38	38	38	38
Dividends payable	-	-	716	-	-
Income taxes payable	41	1,448	1,199	1,199	1,199
Total current liabilities	21,651	27,859	28,876	27,575	27,991
Long-term debt	8,992	4,640	2,661	2,661	2,861
Lease impairment	175	127	72	72	72
Deferred gain on sale	523	485	456	456	456
Deferred rent	974	1,057	1,113	1,113	1,113
Total liabilities	**32,315**	**34,168**	**33,178**	**31,877**	**32,493**
Total stockholders' equity	**4,666**	**18,988**	**20,609**	**21,547**	**22,425**
Total liabilities & stockholders' equity	**36,981**	**53,156**	**53,787**	**53,425**	**54,918**

Source: Company filings and Taglich Brothers' estimates

Income Statements for the Fiscal Years Ended
(in thousands $)

	2011A	2012A	2013E	2014E
Net sales	53,745	64,215	61,366	71,000
Cost of sales	42,817	49,357	46,291	53,463
Gross profit	10,928	14,858	15,075	17,537
Operating expenses	6,549	8,874	10,533	12,000
Operating income	4,379	5,984	4,542	5,537
Interest and financing costs	(2,102)	(1,843)	(1,309)	(1,000)
Other (expense) income	27	(146)	(94)	(116)
Income before taxes	2,304	3,995	3,139	4,421
Income tax (benefit)	57	1,447	(486)	1,768
Net Income / (Loss)	2,247	2,548	3,624	2,653
EPS	0.63	0.54	0.62	0.44
Shares Outstanding	3,579	4,759	5,844	6,050
Margin Analysis				
Gross margin	20.3%	23.1%	24.6%	24.7%
Operating margin	8.1%	9.3%	7.4%	7.8%
Net margin	4.2%	4.0%	5.9%	3.7%
Tax rate	2.5%	36.2%	(15.5)%	40.0%
Year / Year Growth				
Total Revenues		19.5%	(4.4)%	15.7%
Net Income		13.4%	42.2%	(26.8)%
EPS		(14.7)%	15.8%	(29.3)%

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statements 2012A -2014E
(in thousands $)

	3/12A	6/12A	9/12A	12/12A	2012A	3/13A	6/13A	9/13A	12/13E	2013E	3/14E	6/14E	9/14E	12/14E	2014E
Net sales	16,038	15,240	15,558	17,379	64,215	14,325	14,639	16,052	16,350	61,366	17,275	17,575	17,925	18,225	71,000
Cost of sales	12,767	11,804	11,724	13,062	49,357	10,678	11,009	12,309	12,295	46,291	13,008	13,234	13,498	13,723	53,463
Gross profit	3,271	3,436	3,834	4,317	14,858	3,647	3,630	3,743	4,055	15,075	4,267	4,341	4,427	4,502	17,537
Operating expenses	1,674	2,140	2,379	2,681	8,874	2,469	2,552	2,712	2,800	10,533	3,000	3,000	3,000	3,000	12,000
Operating income	1,597	1,296	1,455	1,636	5,984	1,178	1,078	1,031	1,255	4,542	1,267	1,341	1,427	1,502	5,537
Interest and financing costs	(497)	(472)	(452)	(422)	(1,843)	(385)	(393)	(281)	(250)	(1,309)	(250)	(250)	(250)	(250)	(1,000)
Other (expense) income	6	(142)	(2)	(8)	(146)	(25)	(29)	(11)	(29)	(94)	(29)	(29)	(29)	(29)	(116)
Income before taxes	1,106	682	1,001	1,206	3,995	768	656	739	976	3,139	988	1,062	1,148	1,223	4,421
Income tax (benefit)	286	363	387	411	1,447	489	430	(1,795)	390	(486)	395	425	459	489	1,768
Net Income / (Loss)	820	319	614	795	2,548	279	226	2,534	585	3,624	593	637	689	734	2,653
EPS	0.23	0.08	0.11	0.14	0.54	0.05	0.04	0.43	0.10	0.62	0.10	0.11	0.11	0.12	0.44
Shares Outstanding	3,579	3,783	5,791	5,882	4,759	5,810	5,789	5,854	5,922	5,844	6,050	6,050	6,050	6,050	6,050
Margin Analysis															
Gross margin	20.4%	22.5%	24.6%	24.8%	23.1%	25.5%	24.8%	23.3%	24.8%	24.6%	24.7%	24.7%	24.7%	24.7%	24.7%
Operating margin	10.0%	8.5%	9.4%	9.4%	9.3%	8.2%	7.4%	6.4%	7.7%	7.4%	7.3%	7.6%	8.0%	8.2%	7.8%
Net margin	5.1%	2.1%	3.9%	4.6%	4.0%	1.9%	1.5%	15.8%	3.6%	5.9%	3.4%	3.6%	3.8%	4.0%	3.7%
Tax rate	25.9%	53.2%	38.7%	34.1%	36.2%	63.7%	65.5%	(242.9)%	40.0%	(15.5)%	40.0%	40.0%	40.0%	40.0%	40.0%
Year / Year Growth															
Total Revenues					19.5%	(10.7)%	(3.9)%	3.2%	(5.9)%	(4.4)%	20.6%	20.1%	11.7%	11.5%	15.7%
Net Income					13.4%	(66.0)%	(29.2)%	312.7%	(26.4)%	42.2%	112.5%	182.0%	(72.8)%	25.3%	(26.8)%
EPS					(14.7)%	(79.0)%	(53.7)%	308.3%	(26.9)%	15.8%	104.0%	169.8%	(73.7)%	22.6%	(29.3)%

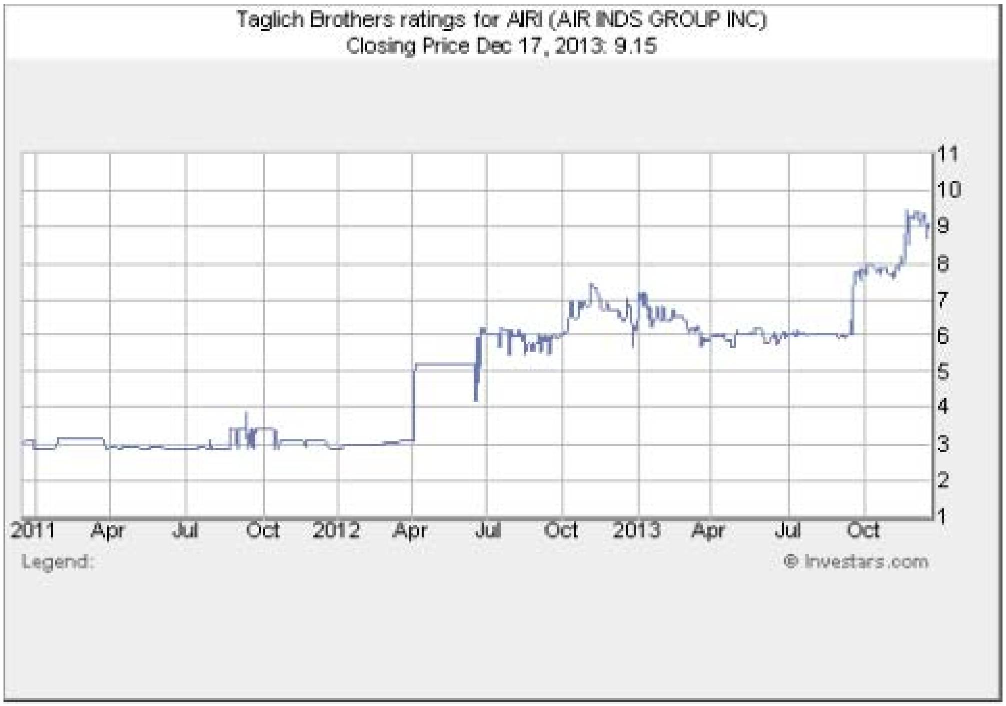
Source: Company filings and Taglich Brothers' estimates

Statement of Cash Flows for the Periods Ended
(in thousands $)

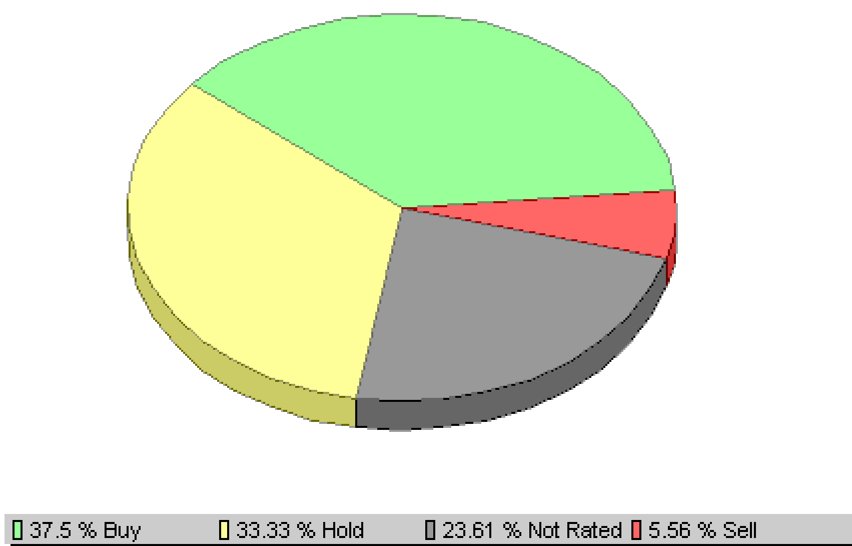
	2011A	2012A	9mos13A	2013E	2014E
Net income	2,247	2,548	3,039	3,624	2,653
Depreciation	1,503	1,557	1,242	1,520	1,517
Amortization of intangible assets	168	693	872	1,366	1,495
Amortization of capitalized engineering costs	580	459	316	421	421
Bad debt expense	427	80	275	275	275
Non-cash compensation expense	131	101	15	101	101
Amortization of deferred financing costs	136	52	46	61	61
Gain on sale of real estate	(38)	(38)	(28)	(28)	-
Deferred income taxes	-	-	(1,625)	(1,625)	
Adjustments to lease impairment	-	53	-	-	-
Changes in assets and liabilities					
Accounts receivable	(2,088)	(4,606)	807	516	(1,745)
Inventory	(1,078)	1,136	(1,295)	1,661	(3,885)
Prepaid expenses and other current assets	(123)	(216)	359	298	-
Deposits	57	(132)	125	125	-
Other assets	(87)	51	(37)	(37)	-
Accounts payable and accrued expenses	1,567	(1,534)	(362)	(440)	1,028
Deferred rent	174	82	56	56	56
Income taxes payable	57	1,408	(249)	(249)	-
Net Cash Provided by Operations	**3,633**	**1,694**	**3,556**	**7,646**	**1,977**
Cash paid for acquisition	-	(11,600)	(468)	(468)	-
Capitalized engineering costs	(510)	(292)	(316)	(421)	(421)
Purchase of property and equipment	(778)	(1,059)	(136)	(1,500)	(1,500)
Deposit for new property and equipment	-	(87)	-	-	-
Net Cash Used in Investing	**(1,288)**	**(13,038)**	**(920)**	**(2,389)**	**(1,921)**
Proceeds from private placement	-	7,115	-		-
Payment of issuance costs for private placement	-	(587)	-	-	-
Issuance of common stock	-	-	-	998	1,000
Payment of issuance costs for common stock	-	-	-	(20)	(20)
Notes payable - sellers	(377)	(601)	(479)	(479)	(500)
Capital lease obligations	(398)	(608)	(899)	(900)	(613)
Notes payable - jr. subordinated debt	(130)	(115)	-	-	-
Notes payable - revolver	(284)	4,787	1,164	1,164	1,200
Proceeds from notes payable - term loan	-	3,900	-	-	-
Payments of notes payable - term loan	(1,000)	(2,153)	(1,350)	(1,350)	(500)
Cash paid for deferred financing costs	(20)	(21)	(10)	(10)	(10)
Payments related to lease impairment	(96)	(101)	(65)	(90)	(90)
Dividends paid	-	(359)	(716)	(2,144)	(2,856)
Net Cash Provided by (Used in) Financing	**(2,305)**	**11,257**	**(2,355)**	**(2,831)**	**(2,389)**
Net Change in Cash	**40**	**(87)**	**281**	**2,426**	**(2,333)**
Cash - Beginning of Period	**537**	**577**	**490**	**490**	**2,916**
Cash - End of Period	**577**	**490**	**771**	**2,916**	**582**

Source: Company filings and Taglich Brothers' estimates

Price Chart



Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	**1**	**4**
Hold	**1**	**14**
Sell		
Not Rated		

Important Disclosures

As of the date of this report, Taglich Brothers, Inc. and/or its affiliates, own more than 1% of AIRI common stock. Michael Taglich, President of Taglich Brothers, Inc. and Chairman of Air Industries Group, Inc., owns or has a controlling interest in 351,997 shares of AIRI common stock, 125,840 shares of AIRI restricted stock, 9,000 stock options (right to purchase), and 31,190 warrants. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, Inc, owns or has a controlling interest in 369,998 shares of AIRI common stock, 137,382 shares of AIRI restricted stock, 9,000 stock options (right to purchase), and 31,190 warrants. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 35,272 shares of AIRI common stock, 25,770 shares of AIRI restricted stock, and 14,000 warrants. Robert Schroeder, Vice President of Investment Banking at Taglich Brothers, Inc. and a Director of Air Industries Group, Inc., owns or has a controlling interest in 50,554 shares of AIRI common stock, 8,000 shares of AIRI restricted stock, 9,000 stock option(right to purchase), and 20,005 warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 10,413 shares of AIRI common stock and 6,700 warrants. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 3,680 shares of AIRI common stock and 13,700 warrants. Taglich Brothers, Inc. owns 44,648 shares of AIRI common stock and 1,332 shares of AIRI restricted stock. Taglich Brothers, Inc. had an investment banking relationship with the company mentioned in this report. In April and May of 2007, Taglich Brothers Inc. served as the placement agent in the sale of convertible preferred stock for the company. In June 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes for the company. In September and October of 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes and convertible preferred stock for the company. In October 2013, Taglich Brothers, Inc. served as the placement agent in the sale of common stock for the company.

All research issued by Taglich Brothers, Inc. is based on public information. The company paid a monetary fee of $1,500 (USD) in October 2013 for the creation and dissemination of research reports. After the initial publication, the company will pay a monthly monetary fee of $1,500 (USD) to Taglich Brothers, Inc., for a minimum of six months for the creation and dissemination of research reports.

General Disclosures

The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to changes in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is fully disclosed with its clearing firm, Pershing, LLC, is not a market maker and does not sell to or buy from customers on a principal basis. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. There may be instances when fundamental, technical and quantitative opinions contained in this report are not in concert. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. Analysts and members of the Research Department are prohibited from buying or selling securities issued by the companies that Taglich Brothers, Inc. has a research relationship with, except if ownership of such securities was prior to the start of such relationship, then an Analyst or member of the Research Department may sell such securities after obtaining expressed written permission from Compliance.

Analyst Certification

I, John Nobile, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be, directly, or indirectly, related to the specific recommendations or views contained in this report.

Public companies mentioned in this report:

Boeing (NYSE: BA)
Heroux-Devtek, Inc. (OTC: HERXF)
Lockheed Martin (NYSE: LMT)
Northrop Grumman (NYSE: NOC)
Triumph Group, Inc. (NYSE: TGI)

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.