

Research Note

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

Air Industries Group

John Nobile
July 28, 2017

AIRI \$1.38 — (NYSE MKT)

	<u>2013A</u>	<u>2014A</u>	<u>2015A</u>	<u>2016A</u>
Revenues (millions)	\$62.8	\$64.3	\$80.4	\$66.9
Earnings (loss) per share	\$0.63	\$0.10	(\$0.11)	(\$2.06)

52-Week range	\$4.98 – \$1.25	Fiscal year ends:	December
Common shares out*	24.3 million	Revenue per share (TTM)	\$8.94
Approximate float	6.5 million	Price/Sales (TTM)	0.2X
Market capitalization	\$34 million	Price/Sales (FY2018)E	NA
Tangible book value/share	\$1.78	Price/Earnings (TTM)	NMF
Price/tangible book value	0.8X	Price/Earnings (FY2018)E	NA

*Upon consummation of restructuring transactions.

Air Industries Group, headquartered in Hauppauge, 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, jet engines and other components. Air Industries also provides sheet metal fabrication of aerostructures, tube bending and welding services. (www.airindustriestgroup.com)

Key investment considerations:

On July 12, 2017, Air Industries announced it closed a public offering of its common stock. The company sold 5,175,000 shares of common stock at a public offering price of \$1.50 per share for net proceeds of \$6.8 million after deducting underwriting fees and offering expenses.

The proceeds from the offering will be used to pay a portion of AIRI's outstanding trade payables, redeem a portion of its outstanding convertible notes, and for general corporate purposes.

Air Industries' 1Q17 revenue increased 6% to \$16.2 million. The net loss in 1Q17 was \$1.2 million or \$(0.15) per share versus a net loss of \$1.4 million or \$(0.19) per share in 1Q16.

On July 5, 2017, the company announced it expects to report 2Q17 revenue of approximately \$17 million for a 13% increase from 1Q17. Air Industries generated revenue in excess of \$7 million in June 2017.

****Please view our disclosures on pages 8 - 10.***

Recent Developments

Air Industries Closes Public Offering – On July 12, 2017, Air Industries announced it closed on a public offering of its common stock. The company sold 5,175,000 shares of common stock at a public offering price of \$1.50 per share for net proceeds of \$6.8 million after deducting underwriting fees and offering expenses.

The proceeds from the offering will be used to pay a portion of AIRI’s outstanding trade payables, redeem a portion of its outstanding convertible notes, and for general corporate purposes.

As part of the offering, 1,294,441 shares of Series A convertible preferred stock were to be converted into 8,629,606 shares of common stock at a conversion price of \$1.50 per share. The company intends to solicit the holders of its common stock to approve the Series A preferred stock conversion.

In order to complete the offering, the company filed an amendment to its Certificate of Designation relating to its Series A Preferred Stock to eliminate the liquidation preference and dividends and to provide for the preferred stock’s automatic conversion.

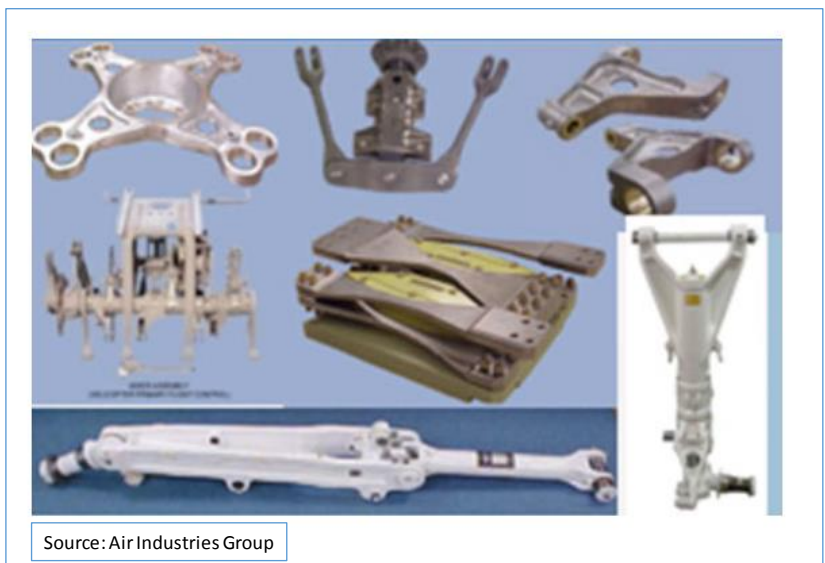
The company also issued a total of 1,240,606 shares of common stock to holders of its subordinated convertible notes due May 12, 2018. The principal amount converted was \$1,860,907.

Air Industries Announces Preliminary 2Q17 Revenue - On July 5, 2017, Air Industries announced preliminary revenue results for its second quarter ended June 30, 2017.

For the quarter, the company expects to report approximately \$17 million in revenue for a 13% increase from \$16.2 million in 1Q17. Air Industries generated revenue in excess of \$7 million in June 2017.

Business Overview

Air Industries Group, headquartered in Hauppauge, New York, designs and manufactures structural aircraft parts and assemblies, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants, jet engines and other components (see picture at right). Air Industries also provides sheet metal fabrication of aerostructures, tube bending and welding services.



Many of the company’s products influence critical aspects of aircraft performance. Air Industries is required to have advanced certifications for these products as a condition to being a supplier. 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 of reductions in defense spending which have adversely affected AIRI’s revenue.

Risks

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

Going concern issues – The company suffered net losses of \$1.2 million and \$15.6 million for 1Q17 and FY16 respectively, and also had negative cash flows from operations for FY16 and is dependent on future issuances of equity or other financing to fund operations. These issues raise substantial doubt about the company's ability to continue as a going concern.

Reliance on government spending – A large percentage of AIRI's sales are to the US military. Potential reductions in US government spending on defense could have a materially adverse effect on AIRI's financial results.

Reliance on a small number of customers – Air Industries derives most of its revenues from a small number of customers. In 2016, four customers accounted for 56% 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.

Reliance on a few aircraft platforms – 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.

Competition - 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.

Competitive bidding – 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.

Regulations – 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.

Material weakness in disclosure controls and procedures – As of March 31, 2017, AIRI's disclosure controls and procedures were not effective due to certain deficiencies over financial reporting.

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 6.5 million shares in the float and the average daily volume is approximately 105,000 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.

Air Industries Group

Consolidated Balance Sheets
(in thousands \$)

	<u>2014A</u>	<u>2015A</u>	<u>2016A</u>	<u>1Q17A</u>
Cash and cash equivalents	1,418	529	1,304	1,043
Accounts receivable	11,916	13,662	8,050	7,486
Inventory	28,391	36,923	39,851	38,132
Deferred tax asset	1,421	1,725	-	-
Prepaid expenses and other current assets	875	1,048	557	659
Assets held for sale	-	1,700	6,050	-
Prepaid taxes	-	535	409	231
Total current assets	44,021	56,122	56,221	47,551
Property and equipment, net	9,557	15,299	12,219	11,580
Capitalized engineering costs	712	1,027	1,627	1,791
Deferred financing costs	825	1,094	1,096	1,372
Intangible assets	4,513	3,852	1,754	1,450
Deferred tax asset	858	338	-	-
Goodwill	5,434	10,518	9,883	9,883
Total assets	<u>65,920</u>	<u>88,250</u>	<u>82,800</u>	<u>73,627</u>
Notes payable and capitalized lease obligations	19,508	40,895	33,999	28,342
Accounts payable and accrued expenses	6,948	12,046	16,160	15,333
Lease impairment	56	-	-	-
Deferred gain on sale	38	38	38	38
Deferred revenue	158	958	946	722
Dividends payable	1,066	-	-	-
Liabilities associated with assets held for sale	-	-	2,155	-
Income taxes payable	71	14	20	20
Total current liabilities	27,845	53,951	53,318	44,455
Long-term debt	8,213	3,917	2,971	2,644
Lease impairment	4	-	-	-
Deferred gain on sale	409	371	333	323
Deferred rent	1,177	1,206	1,288	1,294
Total liabilities	37,648	59,445	57,910	48,716
Preferred stock	-	-	1	1
Total stockholders' equity	<u>28,272</u>	<u>28,805</u>	<u>24,890</u>	<u>24,911</u>
Total liabilities & stockholders' equity	<u>65,920</u>	<u>88,250</u>	<u>82,800</u>	<u>73,627</u>

Source: Company filings

Air Industries Group

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

	<u>2014A</u>	<u>2015A</u>	<u>2016A</u>
Net sales	64,331	80,442	66,915
Cost of sales	<u>50,233</u>	<u>63,161</u>	<u>60,195</u>
Gross profit	14,098	17,281	6,720
Operating expenses	<u>12,363</u>	<u>16,655</u>	<u>17,509</u>
Operating income	1,735	626	(10,789)
Interest and financing costs	(1,295)	(1,858)	(2,596)
Gain on sale of subsidiary		-	-
Other (expense) income	<u>(141)</u>	<u>114</u>	<u>(126)</u>
Income before taxes	299	(1,118)	(13,511)
Income tax (benefit)	<u>(368)</u>	<u>(286)</u>	<u>2,112</u>
Net Income / (Loss)	<u>667</u>	<u>(832)</u>	<u>(15,623)</u>
EPS	<u>0.10</u>	<u>(0.11)</u>	<u>(2.06)</u>
Shares Outstanding	6,916	7,478	7,579
<u>Margin Analysis</u>			
Gross margin	21.9%	21.5%	10.0%
Operating margin	2.7%	0.8%	(16.1)%
Net margin	1.0%	(1.0)%	(23.3)%
Tax rate	(123.1)%	25.6%	(15.6)%
<u>Year / Year Growth</u>			
Total Revenues	2.4%	25.0%	(16.8)%
Net Income	(82.2)%	NMF	NMF
EPS	(84.7)%	NMF	NMF

Source: Company filings

Air Industries Group

Quarterly Income Statements 2015A -1Q17A
(in thousands \$)

	3/15A	6/15A	9/15A	12/15A	2015A	3/16A	6/16A	9/16A	12/16A	2016A	3/17A
Net sales	16,811	19,057	21,076	23,498	80,442	15,184	19,363	15,710	16,658	66,915	16,153
Cost of sales	12,442	15,160	16,898	18,661	63,161	12,363	15,208	13,713	18,911	60,195	13,451
Gross profit	4,369	3,897	4,178	4,837	17,281	2,821	4,155	1,997	(2,253)	6,720	2,702
Operating expenses	3,903	3,825	4,152	4,775	16,655	4,412	4,182	4,302	4,613	17,509	3,221
Operating income	466	72	26	62	626	(1,591)	(27)	(2,305)	(6,866)	(10,789)	(519)
Interest and financing costs	(346)	(544)	(451)	(517)	(1,858)	(505)	(372)	(894)	(825)	(2,596)	(893)
Gain on sale of subsidiary	-	-	-	-	-	-	-	-	-	-	451
Other (expense) income	8	54	36	16	114	10	21	(168)	11	(126)	(193)
Income before taxes	128	(418)	(389)	(439)	(1,118)	(2,086)	(378)	(3,367)	(7,680)	(13,511)	(1,154)
Income tax (benefit)	24	183	(726)	233	(286)	(656)	(126)	(1,320)	4,214	2,112	-
Net Income / (Loss)	104	(601)	337	(672)	(832)	(1,430)	(252)	(2,047)	(11,894)	(15,623)	(1,154)
EPS	0.01	(0.08)	0.04	(0.09)	(0.11)	(0.19)	(0.03)	(0.27)	(1.43)	(2.06)	(0.15)
Shares Outstanding	7,521	7,557	7,686	7,478	7,478	7,585	7,588	7,610	8,325	7,579	7,650
<u>Margin Analysis</u>											
Gross margin	26.0%	20.4%	19.8%	20.6%	21.5%	18.6%	21.5%	12.7%	(13.5)%	10.0%	16.7%
Operating margin	2.8%	0.4%	0.1%	0.3%	0.8%	(10.5)%	(0.1)%	(14.7)%	(41.2)%	(16.1)%	(3.2)%
Net margin	0.6%	(3.2)%	1.6%	(2.9)%	(1.0)%	(9.4)%	(1.3)%	(13.0)%	(71.4)%	(23.3)%	(7.1)%
Tax rate	18.8%	(43.8)%	186.6%	(53.1)%	25.6%	31.4%	33.3%	39.2%	(54.9)%	(15.6)%	40.0%
<u>Year / Year Growth</u>											
Total Revenues	8.8%	42.6%	39.1%	15.4%	25.0%	(9.7)%	1.6%	(25.5)%	(29.1)%	(16.8)%	6.4%
Net Income	(69.5)%	(197.6)%	(11.3)%	0.3%	NMF	NMF	NMF	NMF	NMF	NMF	NMF
EPS	(75.2)%	(185.2)%	(14.7)%	(7.2)%	NMF	NMF	NMF	NMF	NMF	NMF	NMF

Source: Company filings

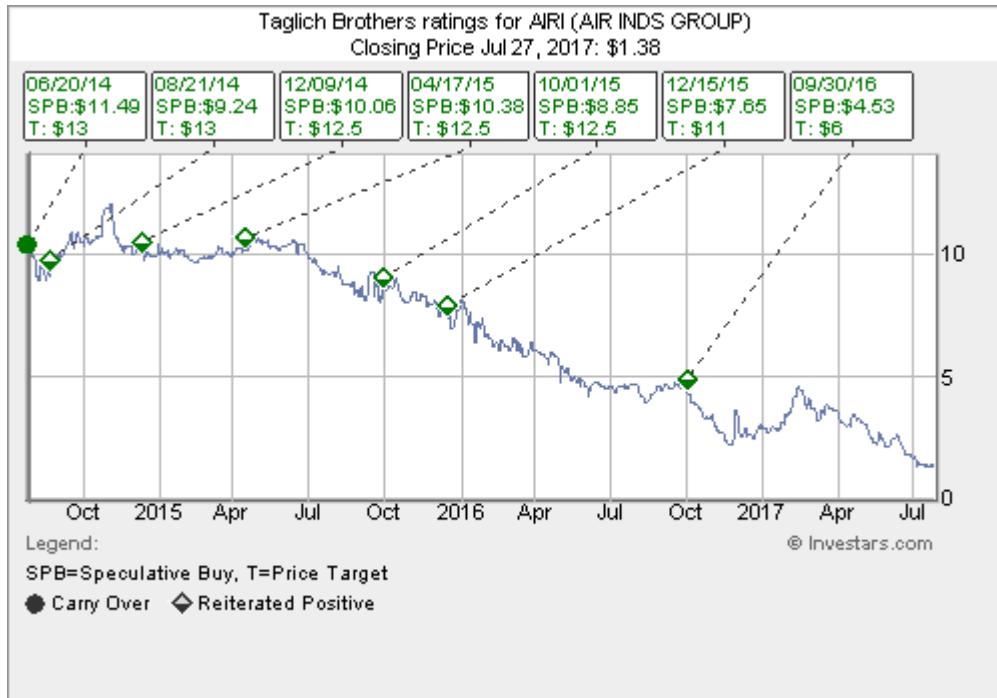
Air Industries Group

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

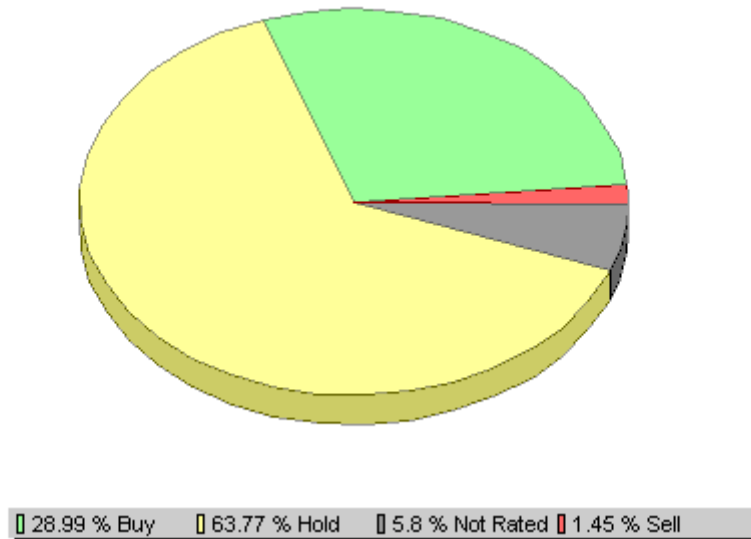
	2014A	2015A	2016A	3m17A
Net income (loss)	667	(832)	(15,623)	(1,154)
Depreciation	2,364	3,090	3,347	728
Amortization of intangible assets	1,163	1,262	1,279	304
Amortization of capitalized engineering costs	375	341	362	81
Bad debt expense	299	176	274	(14)
Stock compensation expense	42	100	167	(73)
Amortization of deferred financing costs	49	204	371	55
Gain on sale of real estate	(38)	(38)	(38)	(10)
Loss on sale of assets held for sale	-	-	5	-
Gain on sale of subsidiary	-	-	-	(451)
Deferred income taxes	(1,043)	(215)	2,063	-
Loss on extinguishment of debt	-	-	172	-
Amortization of convertible notes payable	-	-	217	176
Cash earnings (loss)	3,878	4,088	(7,404)	(358)
<i>Changes in assets and liabilities</i>				
Assets held for sale	-	-	(39)	-
Accounts receivable	(2,417)	91	4,616	578
Inventory	(1,802)	(8,412)	(2,902)	1,719
Prepaid expenses and other current assets	(244)	(748)	394	(102)
Prepaid taxes	-	-	126	178
Deposits and other assets	(164)	(18)	(150)	(276)
Accounts payable and accrued expenses	(577)	3,593	4,495	(621)
Deferred rent	45	29	82	6
Income taxes payable	(1,425)	(57)	6	-
Deferred revenue	(93)	540	84	(224)
(Increase) decrease in working capital	(6,677)	(4,982)	6,712	1,258
Net Cash Provided by Operations	(2,799)	(894)	(692)	900
Cash paid for acquisitions, net	(8,757)	(6,340)	-	-
Capitalized engineering costs	(335)	(656)	(963)	(245)
Purchase of property and equipment	(571)	(1,564)	(1,632)	(89)
Proceeds from sale of fixed assets	-	-	1,671	-
Proceeds from sale of subsidiary	-	-	-	4,260
Net Cash Used in Investing	(9,663)	(8,560)	(924)	3,926
Proceeds from sales of common stock	9,530	-	-	-
Costs to raise capital	(968)	-	-	-
Proceeds from capital lease refinance	-	500	-	-
Notes payable - sellers	(691)	(41)	-	-
Capital lease obligations	(143)	(717)	(1,226)	(173)
Notes payable - revolver	3,142	11,933	(5,211)	(5,545)
Proceeds from notes payable - term loan	7,328	3,500	-	-
Payments of notes payable - term loan	(913)	(2,030)	(3,184)	(2,069)
Proceeds from notes payable - related party	-	350	4,500	850
Proceeds from notes payable	-	-	3,695	1,850
Deferred financing costs	(151)	(402)	(223)	-
Payments related to lease impairment	(67)	(60)	-	-
Expense for issuance of preferred stock	-	-	(663)	-
Expense for issuance of convertible debt	-	-	(547)	-
Proceeds from issuance of preferred stock	-	-	5,250	-
Dividends paid	(3,748)	(4,468)	-	-
Net Cash Provided by (Used in) Financing	13,319	8,565	2,391	(5,087)
Net Change in Cash	857	(889)	775	(261)
Cash - Beginning of Period	561	1,418	529	1,304
Cash - End of Period	1,418	529	1,304	1,043

Source: Company filings

Price Chart



Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	2	10
Hold	1	33
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, owns or has a controlling interest in 391,223 shares of AIRI common stock, 298,968 shares of preferred stock, 1,120,912 shares that may be acquired upon the conversion of convertible notes, 395,245 warrants, and 15,250 stock options. In September 2015, April, May, and August 2016, and in March and May 2017, Michael Taglich loaned the company monies. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 408,639 shares of AIRI common stock, 105,696 shares of preferred stock, 765,270 shares that may be acquired upon the conversion of convertible notes, 271,397 warrants, and 15,250 stock options. In April and May 2016, and in February, March, and May 2017, Robert Taglich loaned the company monies. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 56,042 shares of AIRI common stock, 14,000 stock options, and 4,400 warrants. Robert Schroeder, Vice President of Investment Banking at Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 36,437 shares of AIRI common stock, 15,250 stock options, and 70,520 warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 13,054 shares of AIRI common stock and 5,000 warrants. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 10,500 AIRI options and 29,820 warrants. Taglich Brothers, Inc. owns 17,990 shares of AIRI common 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 and May 2014, Taglich Brothers, Inc. served as the placement agent in the sale of common stock for the company. In May and June 2016, Taglich Brothers, Inc. served as the placement agent in the sale of convertible preferred stock for the company. In August, November and December 2016, and in February and March 2017, Taglich Brothers, Inc. served as the placement agent in the sale of convertible notes for the company. In May 2017, Taglich Brothers, Inc. served as a placement agent in the sale of convertible notes and warrants 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 pays 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.