

Research Report – Update

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

Air Industries Group

Speculative Buy

John Nobile

October 1, 2015

AIRI \$8.85 — (NYSE MKT)

	<u>2013A*</u>	<u>2014A</u>	<u>2015E</u>	<u>2016E</u>
Revenues (millions)	\$62.8	\$64.3	\$85.3	\$96.0
Earnings (loss) per share	\$0.63	\$0.10	\$0.19	\$0.52

52-Week range	\$12.24 – \$6.57	Fiscal year ends:	December
Common shares out as/of 8/3/15	7.6 million	Revenue per share (TTM)	\$9.72
Approximate float	6.9 million	Price/Sales (TTM)	0.9X
Market capitalization	\$67 million	Price/Sales (FY2016)E	0.7X
Tangible book value/share	\$2.27	Price/Earnings (TTM)	NMF
Price/tangible book value	3.9X	Price/Earnings (FY2016)E	17.0X
Annual Dividend	\$0.60	Dividend Yield	6.8%

* Includes \$1.2 million tax benefit of approximately \$0.21 per share.

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.airindustriessgroup.com)

Key investment considerations:

Reiterate Speculative Buy rating and maintaining twelve-month price target of \$12.50.

Strategic acquisitions and a growing commercial business underlie growth potential in 2015 and 2016.

In September 2015, Air Industries announced it acquired Compac Development Corporation and certain assets used to produce landing gear and related components for the Blackhawk UH-60 and Chinook CH-47 helicopters.

2015 sales should benefit from US Navy contracts totaling \$7 million and a full year's contribution from the acquisitions of Woodbine, Eur-Pac, ECC and AMK, and four months of revenue from Compac and ten months of revenue from Sterling. 2016 sales should benefit from a full year's contribution from Sterling and Compac, and an anticipated 7% increase in Department of Defense (DoD) operation and maintenance (O&M) spending.

Our 2015 revenue projection is up slightly to \$85.3 million from \$84.3 million due primarily to a higher US Navy electronics contract than previously projected and recent acquisitions. Our EPS projection has been reduced to \$0.19 from \$0.37 to reflect IH15 results.

We project 2016 revenue of \$96 million and EPS of \$0.52 per share, up from previously projected revenue of \$95.4 million but down from EPS of \$0.54 to primarily reflect recent acquisitions and higher operating expenses.

2Q15 revenue (10-Q released 8/12/15) increased 43% to \$19.1 million. The net loss was (\$0.08) per share versus EPS of \$0.09 in 2Q14. We projected 2Q15 revenue of \$20.7 million and EPS of \$0.09. 2Q15 sales were aided by acquisitions that were completed in 2014.

****Please view our disclosures on pages 14 - 16.***

Recommendation and Valuation

We are reiterating our **Speculative Buy** rating on Air Industries Group (AIRI) and maintaining our **twelve-month price target of \$12.50 per share**.

Shares of AIRI are currently trading at a multiple of 17X forward earnings. The aerospace & defense industry multiple is currently 18X trailing earnings (excludes market caps over \$100 million), a level consistent with 2014 versus AIRI's average multiple of approximately 22X trailing earnings in 2014 (excludes 4Q14 multiple of over 100X). We believe the market will accord the stock a multiple of 25X earnings, a premium over the industry, based largely on the strong earnings growth we project for AIRI (2016 earnings growth of approximately 175% vs. 8% for the industry). We applied a multiple of 25X (same as prior update) to our 2016 EPS of \$0.52, discounted to account for potential delays in defense contracts, to obtain a year ahead value of approximately \$12.50 per share.

Air Industries' valuation is likely to remain higher than the aerospace and defense industry due to higher earnings growth stemming from recent acquisitions and recovering organic sales as revenue from commercial contracts ramp.

Recent Developments

In September 2015, Air Industries announced the acquisition of Compac Development Corporation for \$1.2 million. Compac, located in Bay Shore, New York, provides specialized radio-frequency interference/electromagnetic interference (RFI/EMI) shielded enclosures to customers in the aerospace and other industries.

Compac will be part of AIRI's Aerostructures and Electronics segment and is expected to complement the products of Decimal Industries (acquired July 2013) and Woodbine Products (acquired April 2014) to include shielded enclosures. In collaboration with Miller Stuart (acquired December 2013), which produces wiring harnesses and other electronics cabling, Compac will expand its product line to include shielded enclosures complete with cabling.

Compac will continue in its current location on Long Island which is within one mile of AIRI's Complex Machining segment and within twenty minutes of its Aerostructures and Electronics segment.

Also in September 2015, Air Industries announced it reached an agreement with an undisclosed seller to acquire certain assets used to produce landing gear and landing gear components for the Sikorsky Blackhawk UH-60 and the Boeing Chinook CH-47 helicopters.

This acquisition of a new production line enables Air Industries to quickly enter a number of markets without the typical barriers of developing tooling, engineering and the delays inherent in acquiring long-lead time raw materials. With this purchase and other additional contract wins, Air Industries now produces complete landing gear or components for the F-15, F-16, F-18 US Fighter Aircraft, the E2-D Naval Reconnaissance aircraft, the Blackhawk UH-60 and Chinook CH-47 helicopters, as well as the C-130 and other aircraft.

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. 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.

AIRI operates in three segments: Complex Machining, Aerostructures and Electronics, and Turbine Engine Components.

Complex Machining accounted for 69% of 2014 revenue. 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.

AIRI’s Complex Machining segment also manufactures complete landing gear assemblies and landing gear components for the US Air Force F-16 Fighting Falcon and the US Navy’s F-18 Hornet aircraft. 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.

Aerostructures and Electronics accounted for 28% of total revenue in 2014. This segment provides specialty welding services and metal fabrications, electromechanical systems and assemblies, and wire harness and cable assemblies to the defense and commercial aerospace industry.

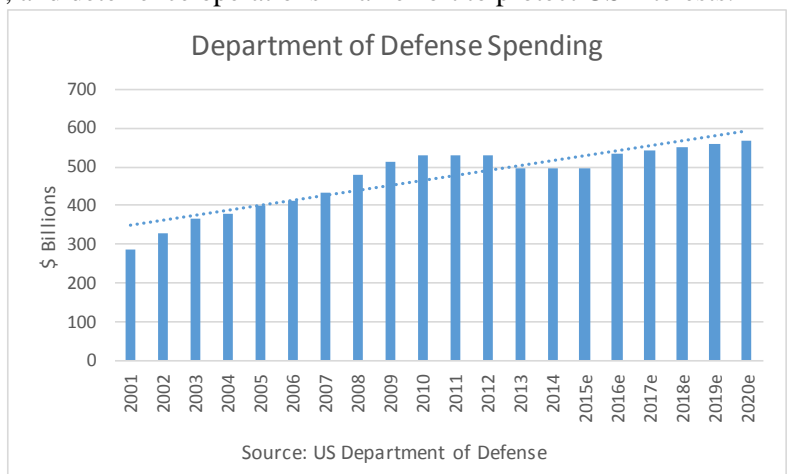
Turbine Engine Components accounted for 3% of total revenue in 2014. This segment provides complex machining and welding services with a focus on aircraft jet engines and ground turbines.



Defense Spending Overview

For much of the past decade, the Department of Defense (DoD) focused on fighting terrorism and countering violent insurgencies and will continue to do so as long as these threats exist. Today, US forces are postured globally, conducting counter-terrorism, stability, and deterrence operations in an effort to protect US interests.

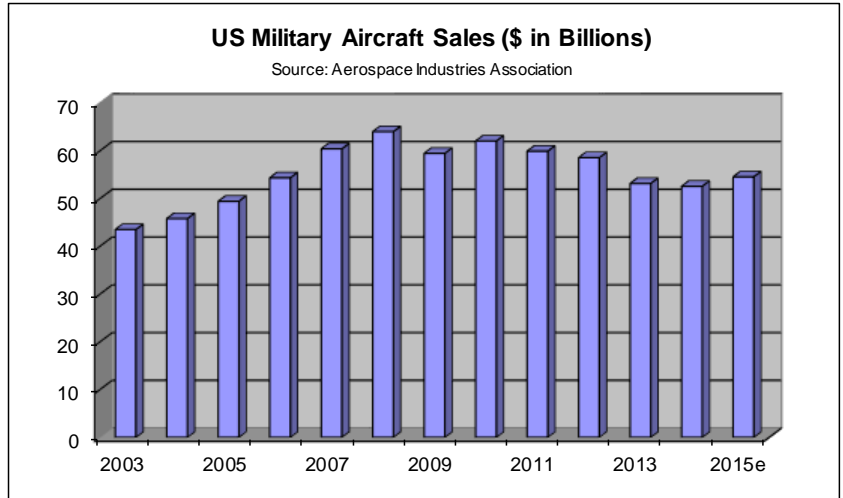
Changes in defense spending are likely to directly impact AIRI’s revenues. US defense spending increased through much of the post-9/11 decade and peaked in 2012 at over \$530 billion. However, budget cuts reduced defense spending by 7% to \$495.5 billion in 2013 and the spending budget for 2014 and 2015 remained flat. The last (February 2015) DoD budget request for 2016 aims to increase spending by 8%. Defense spending is projected to increase through 2020 (see chart at right).



Although DoD spending was flat in 2014, Air Industries’ revenues grew by 2% due to the acquisitions of Decimal Industries (July 2013), MSI (November 2013), Woodbine (April 2014), Eur-Pac (June 2014), ECC (September 2014), and AMK (October 2014). Excluding acquisitions, sales from existing operations shrunk by 7% to \$58.4 million.

Military Aircraft Market and Forecast

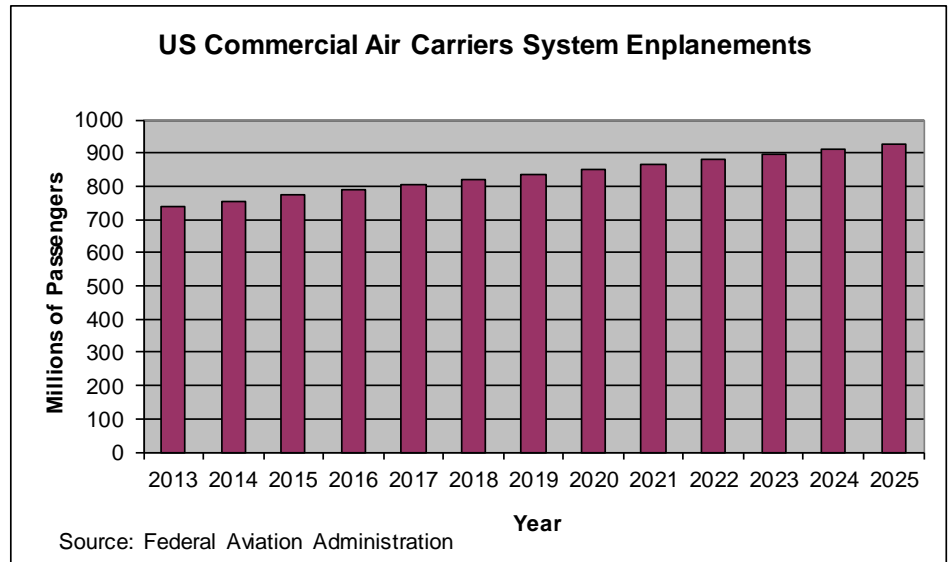
Over 90% of Air Industries’ revenue is derived from sales to the US military aircraft market. The Aerospace Industries Association (AIA) forecasts US military aircraft sales will total \$54.5 billion in 2015, up 4% from 2014 but down 15% from the peak in 2008 (see chart at right). The AIA said the large drop in US military aircraft sales since 2012 was due to budget cuts caused in large part by the Budget Control Act of 2011 which resulted in reductions in military spending and a drop in overseas contingency operations funding.



The four largest components of the DoD’s spending budget are in operation and maintenance (largest component), military personnel, procurement, and research, development, test & evaluation (RDT&E). As over 90% of AIRI’s military sales are for the repair and maintenance of existing aircraft, the category with the greatest impact on AIRI’s sales is operation and maintenance spending. The latest (February 2015) DoD budget for operation and maintenance (O&M) spending is for a 1% increase in 2015 followed by a 7% increase in 2016. However, recent contracts should boost AIRI’s military sales by 12% in 2015 (excluding acquisitions) and increased O&M spending should boost sales by 7% in 2016. We project AIRI’s organic military sales increasing to approximately \$65.4 million in 2015 (we expect commercial sales from a 2013 order to be minimal at approximately \$750,000), increasing to \$70 million in 2016.

Commercial Aircraft Market and Forecast

In 2000, commercial aircraft parts accounted for approximately 60% of AIRI’s total revenue. AIRI’S customers began shifting to defense after September 11, 2001 resulting in approximately 90% of AIRI’S total revenue coming from defense and less than 10% from the commercial aircraft market in 2014. Although the company’s product lines primarily serve the defense market, they also serve the commercial markets. With defense budgets being under pressure over the last three years, prime contractors began to shift their focus to the commercial sector. 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 2015-2025, the number of passengers flying US commercial air carriers is projected to increase steadily throughout its forecast horizon. The FAA is forecasting US carrier passenger growth over the next ten years to average two percent per year (see chart at lower right on previous page). Driving this growth will be a rise in economic activity. The FAA cited economic forecasts from IHS Global Insight, Inc. for US GDP growth of 2.2% in 2015 and for growth to average 2.6% annually from 2016 to 2019, slowing to 2.4% from 2020 to 2025.

Although passenger boarding is projected to increase over the next ten years, airlines have been imposing capacity controls in an effort to increase plane utilization. This could limit the number of flights an airline offers and put pressure on future commercial aircraft sales. However, AIRI’s commercial aircraft sales should benefit from a 2013 commercial contract totaling \$38 million over six years with deliveries expected to start in 2H15.

Competition

The aerospace industry is dominated by a small number of large prime contractors and equipment manufacturers who seek subcontractors capable of integrating the fabrication of complete subassemblies.

A new contract 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. But, 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 include Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group (TTM revenues of \$4B), Heroux-Devtek (TTM revenues of \$287M), and Ellanef Manufacturing, a division of Magellan Corporation.

Strategy

The company aims to focus on the commercial market in an effort to reduce its dependence on sales to the US military. The company also intends to continue to seek accretive acquisition candidates. Air Industries acquired privately held Woodbine Products, Inc. of Deer Park, New York (April 2014), Eur-Pac of Waterbury, Connecticut (June 2014), Electronic Connection Corporation of Bloomfield, Connecticut (September 2014), AMK Technical Services of South Windsor, Connecticut (October 2014), Sterling Engineering Corporation of Barkhamsted, Connecticut (March 2015), and Compac Development Corporation of Bay Shore, New York (September 2015).

Woodbine is a manufacturer of aerospace components whose customers include major aircraft component suppliers. Eur-Pac specializes in parts kits, hose assemblies, hydraulic, mechanical and electrical assemblies for all branches of the US Defense Department. Electronic Connection Corporation (ECC) is a custom manufacturer of processed wire, cable and wire harnesses. AMK is a provider of sophisticated welding and machining services for diversified aerospace and industrial customers. Sterling Engineering is a manufacturer of components for aircraft and land-based gas turbines. Compac provides specialized RFI/EMI shielded enclosures to customers in the aerospace and other industries.

2014 revenue contribution from these acquisitions can be seen in the table at right along with AIRI’s organic sales and our projections for 2015 and 2016. Sterling Engineering and Compac did not contribute to AIRI’s 2014 results they were acquired in 2015.

	Sales (in thousands \$)		
	<u>2014A</u>	<u>2015E</u>	<u>2016E</u>
Woodbine	1,047	712	762
Eur-Pac	2,756	3,810	4,077
ECC	281	714	764
Compac	-	467	1,498
AMK	1,838	4,308	5,830
Sterling	-	9,100	11,556
Organic	<u>58,409</u>	<u>66,159</u>	<u>71,540</u>
Total sales	\$64,331	\$85,270	\$96,027

Source: 2014 total sales are actual, remainder are Taglich Brothers' estimates

The aerospace and defense industries have consolidated since the 1990s. 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' acquisitions are part of the company's strategy to grow in this market. AIRI is now producing more complete sub-assemblies sought after by major contractors and sales have grown at a compound annual growth rate of 9% over the past six years due to strategic acquisitions.

Economic Outlook

In July 2015, the International Monetary Fund (IMF) lowered its economic growth estimate for the US to 2.5% in 2015 and 3% in 2016, down from 3.1% in both 2015 and 2016 previously (April 2015). The IMF said that the US economy in the first quarter of 2015 was derailed by unfavorable weather, a sharp contraction in oil sector investment, the West Coast port strike, and the effects of the stronger dollar. While these developments represent a temporary drag on the US economy, the IMF said that a solid labor market, accommodative financial conditions, and cheaper oil should support a more dynamic path for the remainder of the year. The IMF said that oil prices have rebounded in the second quarter of 2015 reflecting higher demand and expectations that oil production growth in the US will slow faster than previously forecast. However, although US oil production has fallen since April 2015, oil prices have also fallen and are down almost 10% in September alone. This is due to a rise in OPEC's output since April 2015 which is offsetting US production declines.

The third estimate of US GDP growth (released on September 25, 2015) showed the US economy grew at an annual rate of 3.9% in 2Q15, up from a growth estimate of 3.7% (August 27, 2015). The upward revision to GDP growth reflected upward revisions to consumer spending and business and residential investment.

The latest fiscal 2016 Pentagon budget request is higher than the cap set in the Budget Control Act of 2011 (roughly \$500 billion). In March 2015, the House of Representatives approved a bill that calls for balancing the federal budget in 10 years but contains a proposal for approximately \$576 billion in military spending. In June 2015, that bill was blocked by the Senate Democrats in an effort to hold up legislation until a majority of Republicans agree to overall budget talks.

2Q and 1H15 Financial Results

2Q15 - Total revenue increased 43% to \$19.1 million. The increase in total sales was primarily due to acquisitions completed in 2014. The net loss was \$601,000 or (\$0.08) per share versus net income of \$616,000 or \$0.09 per share. We projected 2Q15 revenue of \$20.7 million and net income of \$674,000 or \$0.09 per share.

Complex machining sales increased 2% to \$9.5 million, aerostructures and electronics sales increased 55% to \$6.3 million, and turbine engine components sales were \$3.3 million (no sales reported for 2014 as this segment was acquired in 4Q14).

Gross margins decreased to 20.4% from 25.1 % primarily due to lower margin turbine engine component sales which were absent in 1Q14. Operating (SG&A) expenses increased to \$3.8 million from \$3.1 million primarily due to the additional expense from acquisitions. AIRI reported operating income of \$72,000 versus \$257,000.

1H15 - Total revenue increased 24% to \$35.9 million. The net loss was \$497,000 or (\$0.07) per share versus net income of \$957,000 or \$0.15 per share.

The increase in total sales was primarily due to acquisitions completed in 2014.

Air Industries Group

Complex machining sales decreased 13% to \$18.6 million, aerostructures and electronics sales increased 64% to \$12.1 million, and turbine engine components sales were \$5.2 million (no sales reported for 2014 as this segment was acquired in 4Q14).

Gross margins decreased to 23% from 25.7 % primarily due to low margin sales of the acquired turbine engine components segment. Operating (SG&A) expenses increased to \$7.7 million from \$5.9 million primarily due to the additional expense from acquisitions. AIRI reported operating income of \$538,000 versus \$1.5 million.

Liquidity

As of June 30, 2015, the company had \$1.2 million cash and a current ratio of 1.1X versus 1.2X for the aerospace and defense industry. Total debt increased by approximately \$9.7 million in 1H15 to \$37.4 million for a debt/equity ratio of 1.3X versus 0.8X for the aerospace and defense industry. With AIRI's recent acquisition of Compac, the company should need to raise approximately \$1 million to meet its operational needs through 2016.

Cash used in operations in the first six months of 2015 was \$224,000 consisting \$2.1 million cash earnings and a \$2.3 million increase in working capital. The change in working capital was primarily due to an increase in inventory partly offset by a decrease in accounts receivable. Cash used in investing was \$5.5 million consisting primarily of cash paid for acquisitions. Cash provided by financing was \$5.6 million and consisted primarily of net proceeds from additional borrowings partly offset by dividend payments. Cash decreased by \$204,000 to \$1.2 million at June 30, 2015.

Air Industries has a revolving credit line and term loan with PNC bank. The credit line provides for maximum borrowings of \$34 million (June 30, 2015 outstanding balance was \$23 million) and term loans of \$11 million. Air Industries pays an annual interest rate of 4% on the credit facility. As of June 30, 2015, Air Industries was not in compliance with the fixed charge coverage ratio covenant of its loan facility but was granted a waiver in August 2015.

Projections

The chart at right provides a breakdown of Air Industries' organic sales and the effect of recent acquisitions. 2015 sales should benefit from a full year's contribution from Woodbine, Eur-Pac, ECC and AMK, four months of sales from Compac, and ten months from Sterling. AIRI's FY15 organic sales reflect US Navy contracts totaling \$7 million and the start of deliveries associated with commercial contracts that were awarded in 2013 for nacelle thrust struts (structural members that attach to aircraft engine housings) totaling \$38 million over six years. Deliveries are expected to start in 2H15 and ramp over the next five and a half years.

	Income Statement (in thousands \$)	
	6mos15	6mos14
Complex Machining	18,595	21,460
Aerostructures & Electronics	12,059	7,353
Turbine Engine Components	5,214	-
Total sales	35,868	28,813
Cost of sales	27,602	21,415
Gross profit	8,266	7,398
Operating expenses	7,728	5,912
Operating income	538	1,486
Interest and financing costs	(890)	(607)
Other (expense) income	62	(63)
Income before taxes	(290)	816
Income tax (benefit)	207	(141)
Net income / (loss)	(497)	957
EPS	(0.07)	0.15
Shares Outstanding	7,397	6,371
<u>Margin Analysis</u>		
Gross margin	23.0%	25.7%
Operating margin	1.5%	5.2%
Tax rate	(71.4)%	(17.3)%
<u>Year / Year Growth</u>		
Total Revenues	24.5%	
Net Income	(151.9)%	
EPS	(144.7)%	
Source: Company filings		

	Sales (in thousands \$)		
	2014A	2015E	2016E
Woodbine	1,047	712	762
Eur-Pac	2,756	3,810	4,077
ECC	281	714	764
Compac	-	467	1,498
AMK	1,838	4,308	5,830
Sterling	-	9,100	11,556
Organic	58,409	66,159	71,540
Total sales	\$ 64,331	\$ 85,270	\$ 96,027
Source: Company reports and Taglich Brothers' estimates			

Air Industries Group

2016 sales should benefit from a full year's contribution from Sterling and Compac and an anticipated 7% increase in O&M spending by the DoD. Changes in O&M spending have the greatest impact on AIRI's sales as most of AIRI's contracts involve the repair and maintenance of existing military aircraft. AIRI's 2016 organic sales reflect increased O&M spending and a ramp up in commercial sales from the 2013 contracts.

The following table provides a segmented breakdown of Air Industries' 2014 actual sales and gross margins and our projections for 2015 and 2016. Woodbine, Eur-Pac ECC and Compac are classified under AIRI's Aerostructures & Electronics segment while AMK and Sterling are classified under AIRI's Turbine Engine Components segment.

	Sales (\$ in thousands)										
	2014A	1Q15A	2Q15A	3Q15E	4Q15E	2015E	1Q16E	2Q16E	3Q16E	4Q16E	2016E
Complex Machining	44,220	9,064	9,530	11,700	13,000	43,294	10,500	11,500	12,500	13,500	48,000
Aerostructures & Electronics	18,273	5,782	6,277	7,800	8,500	28,359	6,650	7,500	8,350	9,200	31,700
Turbine Engine Components	1,838	1,965	3,250	3,900	4,502	13,617	3,250	3,800	4,350	4,927	16,327
Total	64,331	16,811	19,057	23,400	26,002	85,270	20,400	22,800	25,200	27,627	96,027
	Gross Profit (\$ in thousands)										
Complex Machining	8,691	2,091	2,229	2,714	3,016	10,050	2,436	2,668	2,900	3,132	11,136
Aerostructures & Electronics	4,812	2,162	1,396	2,301	2,508	8,367	1,962	2,213	2,463	2,714	9,352
Turbine Engine Components	595	116	272	585	1,013	1,986	894	1,045	1,196	1,355	4,490
Total	14,098	4,369	3,897	5,600	6,536	20,403	5,292	5,926	6,560	7,201	24,977
	Gross Margin										
Complex Machining	19.7%	23.1%	23.4%	23.2%	23.2%	23.2%	23.2%	23.2%	23.2%	23.2%	23.2%
Aerostructures & Electronics	26.3%	37.4%	22.2%	29.5%	29.5%	29.5%	29.5%	29.5%	29.5%	29.5%	29.5%
Turbine Engine Components	32.4%	5.9%	8.4%	15.0%	22.5%	14.6%	27.5%	27.5%	27.5%	27.5%	27.5%
Total	21.9%	26.0%	20.4%	23.9%	25.1%	23.9%	25.9%	26.0%	26.0%	26.1%	26.0%

Source: Company filings and Taglich Brothers' estimates

Our gross margin projections for 2015 remain unchanged, but we have raised our 2016 gross margin projections to 26% from 24.1% to reflect the increase in Complex Machining (1H15) segment margins. AIRI's Complex Machining segment margins typically remain consistent throughout a given year as pricing for contract bids is prepared to predetermined margins. We believe the 1H15 drop in the Turbine Engine Component segment margins will be temporary as AMK's sales ramp in 2H15 to levels similar to 2014.

2015 – We have raised our revenue projection to \$85.3 million from \$84.3 million due primarily to a higher US Navy electronics contract than previously projected (currently \$4.5 million from \$3.75 million previously) and recent acquisitions. Our net income projection has been reduced to \$1.4 million or \$0.19 per share from \$2.9 million or \$0.37 per share to reflect 1H15 results.

We project gross margins of 23.9%, up from 21.9% in 2014 due primarily to a greater percentage of sales coming from AIRI's higher margin Aerostructures & Electronics segment (33% in 2015 versus 28% in 2014). Operating margins are projected to increase to 5.5% from 2.7% as the increase in sales more than offsets higher SG&A expenses primarily from the acquisition of Sterling. We project interest expense of \$1.8 million and a tax rate of 51%.

We project \$2.6 million cash from operations consisting of cash earnings of \$6 million and increases in working capital of \$3.4 million. The increase in working capital is primarily due to increases in inventory offset in part by an increase in accounts payable and accrued expenses and a decrease in accounts receivable. Cash from operations and \$3.7 million cash from financing activities (primarily from increased debt and equity offset in part by dividend payments) will be insufficient to cover \$7.1 million cash used in investing (primarily for Sterling and Compac acquisitions), resulting in a \$790,000 decrease in cash to \$715,000 at year-end 2015.

2016 – We project revenue of \$96 million and net income of \$4.1 million or \$0.52 per share. Our revenue projection is up from \$95.4 million previously to primarily reflect the contribution from recent acquisitions offset in part by continued delays in defense contracts. Our net income projection is down from \$4.2 million or \$0.54 per share previously due primarily to higher operating expenses than previously estimated stemming from the acquisitions of Sterling and Compac.

Gross margins are projected to increase to 26% from 23.9% as margins in the Turbine Engine Component segment recover as its sales increase. Operating margins are projected to increase to 8.9% from 5.5% due primarily to gross margin improvement. We project interest expense of \$1.8 million and a tax rate of 40%.

We project \$4.9 million cash from operations consisting of cash earnings of \$9 million and increases in working capital of \$4.1 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 proceeds from the sale of stock should be insufficient to cover capital expenditures and dividend payments resulting in a \$413,000 decrease in cash to \$302,000 at year-end 2016.

Risks

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

Reliance on government spending - Approximately 90% of AIRI's sales are to US military and commercial aviation. In 2014, AIRI's Complex Machining segment 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.

Reliance on a small number of customers – Air Industries derives most of its revenues from a small number of customers. In 2014, three 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.

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 6.9 million shares in the float and the average daily volume is approximately 7,300 shares.

Air Industries Group

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 \$)

	<u>2012A</u>	<u>2013A</u>	<u>2014A</u>	<u>6/15A</u>	<u>2015E</u>	<u>2016E</u>
Cash and cash equivalents	490	561	1,418	1,214	715	302
Accounts receivable	11,631	8,584	11,916	11,749	11,649	13,119
Inventory	26,739	26,222	28,391	33,283	36,662	40,156
Deferred tax asset	-	1,051	1,421	1,358	558	558
Prepaid expenses and other current assets	546	510	875	761	761	761
Deposits - vendors	<u>133</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total current assets	39,539	36,928	44,021	48,365	50,346	54,896
Property and equipment, net	5,883	6,523	9,557	14,494	15,385	12,796
Capitalized engineering costs	802	752	712	911	711	711
Deferred financing costs	590	605	825	1,153	553	553
Intangible assets	5,889	4,726	4,513	3,899	3,285	2,057
Deferred tax asset	-	185	858	1,038	168	455
Goodwill	<u>453</u>	<u>453</u>	<u>5,434</u>	<u>8,719</u>	<u>9,224</u>	<u>9,224</u>
Total assets	<u>53,156</u>	<u>50,172</u>	<u>65,920</u>	<u>78,579</u>	<u>79,672</u>	<u>80,692</u>
Notes payable and capitalized lease obligations	19,211	14,969	19,508	34,676	34,676	34,676
Accounts payable and accrued expenses	7,077	6,855	6,948	8,132	8,972	9,827
Lease impairment	85	71	56	25	25	25
Deferred gain on sale	38	38	38	38	38	38
Deferred revenue	-	251	158	453	453	453
Dividends payable	-	717	1,066	1,134	1,134	1,134
Income taxes payable	<u>1,448</u>	<u>1,496</u>	<u>71</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total current liabilities	27,859	24,397	27,845	44,458	45,298	46,153
Long-term debt	4,640	2,527	8,213	2,768	2,768	2,768
Lease impairment	127	56	4	4	4	4
Deferred gain on sale	485	447	409	390	390	390
Deferred rent	<u>1,057</u>	<u>1,132</u>	<u>1,177</u>	<u>1,194</u>	<u>1,194</u>	<u>1,194</u>
Total liabilities	34,168	28,559	37,648	48,814	49,654	50,509
Total stockholders' equity*	<u>18,988</u>	<u>21,613</u>	<u>28,272</u>	<u>29,765</u>	<u>30,017</u>	<u>30,183</u>
Total liabilities & stockholders' equity	<u>53,156</u>	<u>50,172</u>	<u>65,920</u>	<u>78,579</u>	<u>79,672</u>	<u>80,692</u>

* 2015 includes \$4.2 million of additional paid-in capital from the issuance of 425,005 shares for Sterling
Source: Company filings and Taglich Brothers' estimates

Air Industries Group

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

	<u>2012A</u>	<u>2013A</u>	<u>2014A</u>	<u>2015E</u>	<u>2016E</u>
Net sales	64,215	62,833	64,331	85,270	96,027
Cost of sales	<u>49,357</u>	<u>47,598</u>	<u>50,233</u>	<u>64,867</u>	<u>71,050</u>
Gross profit	14,858	15,235	14,098	20,403	24,977
Operating expenses	<u>8,874</u>	<u>10,622</u>	<u>12,363</u>	<u>15,728</u>	<u>16,400</u>
Operating income	5,984	4,613	1,735	4,675	8,577
Interest and financing costs	(1,843)	(1,340)	(1,295)	(1,790)	(1,800)
Other (expense) income	<u>(146)</u>	<u>296</u>	<u>(141)</u>	<u>62</u>	<u>-</u>
Income before taxes	3,995	3,569	299	2,947	6,777
Income tax (benefit)	<u>1,447</u>	<u>(170)</u>	<u>(368)</u>	<u>1,502</u>	<u>2,711</u>
Net Income / (Loss)	<u>2,548</u>	<u>3,739</u>	<u>667</u>	<u>1,445</u>	<u>4,066</u>
EPS	<u>0.54</u>	<u>0.63</u>	<u>0.10</u>	<u>0.19</u>	<u>0.52</u>
Shares Outstanding	4,759	5,933	6,916	7,620	7,800
<u>Margin Analysis</u>					
Gross margin	23.1%	24.2%	21.9%	23.9%	26.0%
Operating margin	9.3%	7.3%	2.7%	5.5%	8.9%
Net margin	4.0%	6.0%	1.0%	1.7%	4.2%
Tax rate	36.2%	(4.8)%	(123.1)%	51.0%	40.0%
<u>Year / Year Growth</u>					
Total Revenues	19.5%	(2.2)%	2.4%	32.5%	12.6%
Net Income	13.4%	46.7%	(82.2)%	116.7%	181.4%
EPS	(14.7)%	17.7%	(84.7)%	96.7%	174.9%

Source: Company filings and Taglich Brothers' estimates

Air Industries Group

Quarterly Income Statements 2014A -2016E (in thousands \$)

	<u>3/14A</u>	<u>6/14A</u>	<u>9/14A</u>	<u>12/14A</u>	<u>2014A</u>	<u>3/15A</u>	<u>6/15A</u>	<u>9/15E</u>	<u>12/15E</u>	<u>2015E</u>	<u>3/16E</u>	<u>6/16E</u>	<u>9/16E</u>	<u>12/16E</u>	<u>2016E</u>
Net sales	15,453	13,360	15,154	20,364	64,331	16,811	19,057	23,400	26,002	85,270	20,400	22,800	25,200	27,627	96,027
Cost of sales	<u>11,408</u>	<u>10,007</u>	<u>11,597</u>	<u>17,221</u>	<u>50,233</u>	<u>12,442</u>	<u>15,160</u>	<u>17,800</u>	<u>19,466</u>	<u>64,867</u>	<u>15,109</u>	<u>16,875</u>	<u>18,641</u>	<u>20,426</u>	<u>71,050</u>
Gross profit	4,045	3,353	3,557	3,143	14,098	4,369	3,897	5,600	6,536	20,403	5,292	5,926	6,560	7,201	24,977
Operating expenses	<u>2,816</u>	<u>3,096</u>	<u>2,997</u>	<u>3,454</u>	<u>12,363</u>	<u>3,903</u>	<u>3,825</u>	<u>4,000</u>	<u>4,000</u>	<u>15,728</u>	<u>4,100</u>	<u>4,100</u>	<u>4,100</u>	<u>4,100</u>	<u>16,400</u>
Operating income	1,229	257	560	(311)	1,735	466	72	1,600	2,536	4,675	1,192	1,826	2,460	3,101	8,577
Interest and financing costs	(303)	(304)	(260)	(428)	(1,295)	(346)	(544)	(450)	(450)	(1,790)	(450)	(450)	(450)	(450)	(1,800)
Other (expense) income	<u>(1)</u>	<u>(62)</u>	<u>(1)</u>	<u>(77)</u>	<u>(141)</u>	<u>8</u>	<u>54</u>	<u>-</u>	<u>-</u>	<u>62</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Income before taxes	925	(109)	299	(816)	299	128	(418)	1,150	2,086	2,947	742	1,376	2,010	2,651	6,777
Income tax (benefit)	<u>584</u>	<u>(725)</u>	<u>(81)</u>	<u>(146)</u>	<u>(368)</u>	<u>24</u>	<u>183</u>	<u>460</u>	<u>835</u>	<u>1,502</u>	<u>297</u>	<u>550</u>	<u>804</u>	<u>1,060</u>	<u>2,711</u>
Net Income / (Loss)	<u>341</u>	<u>616</u>	<u>380</u>	<u>(670)</u>	<u>667</u>	<u>104</u>	<u>(601)</u>	<u>690</u>	<u>1,252</u>	<u>1,445</u>	<u>445</u>	<u>825</u>	<u>1,206</u>	<u>1,591</u>	<u>4,066</u>
EPS	<u>0.06</u>	<u>0.09</u>	<u>0.05</u>	<u>(0.10)</u>	<u>0.10</u>	<u>0.01</u>	<u>(0.08)</u>	<u>0.09</u>	<u>0.16</u>	<u>0.19</u>	<u>0.06</u>	<u>0.11</u>	<u>0.15</u>	<u>0.20</u>	<u>0.52</u>
Shares Outstanding	6,125	6,598	7,389	6,916	6,916	7,521	7,557	7,700	7,700	7,620	7,800	7,800	7,800	7,800	7,800
<u>Margin Analysis</u>															
Gross margin	26.2%	25.1%	23.5%	15.4%	21.9%	26.0%	20.4%	23.9%	25.1%	23.9%	25.9%	26.0%	26.0%	26.1%	26.0%
Operating margin	8.0%	1.9%	3.7%	(1.5)%	2.7%	2.8%	0.4%	6.8%	9.8%	5.5%	5.8%	8.0%	9.8%	11.2%	8.9%
Net margin	2.2%	4.6%	2.5%	(3.3)%	1.0%	0.6%	-3.2%	2.9%	4.8%	1.7%	2.2%	3.6%	4.8%	5.8%	4.2%
Tax rate	63.1%	665.1%	(27.1)%	17.9%	(123.1)%	18.8%	(43.8)%	40.0%	40.0%	51.0%	40.0%	40.0%	40.0%	40.0%	40.0%
<u>Year / Year Growth</u>															
Total Revenues	7.9%	(8.7)%	(5.6)%	14.3%	2.4%	8.8%	42.6%	54.4%	27.7%	32.5%	21.3%	19.6%	7.7%	6.2%	12.6%
Net Income	22.2%	172.6%	(85.0)%	(195.7)%	(82.2)%	(69.5)%	(197.6)%	81.6%	(286.8)%	116.7%	327.8%	(237.3)%	74.7%	27.1%	181.4%
EPS	15.9%	139.1%	(88.1)%	(182.1)%	(84.7)%	(75.2)%	(185.2)%	74.3%	(267.8)%	96.7%	312.5%	(233.0)%	72.4%	25.4%	174.9%

Source: Company filings and Taglich Brothers' estimates

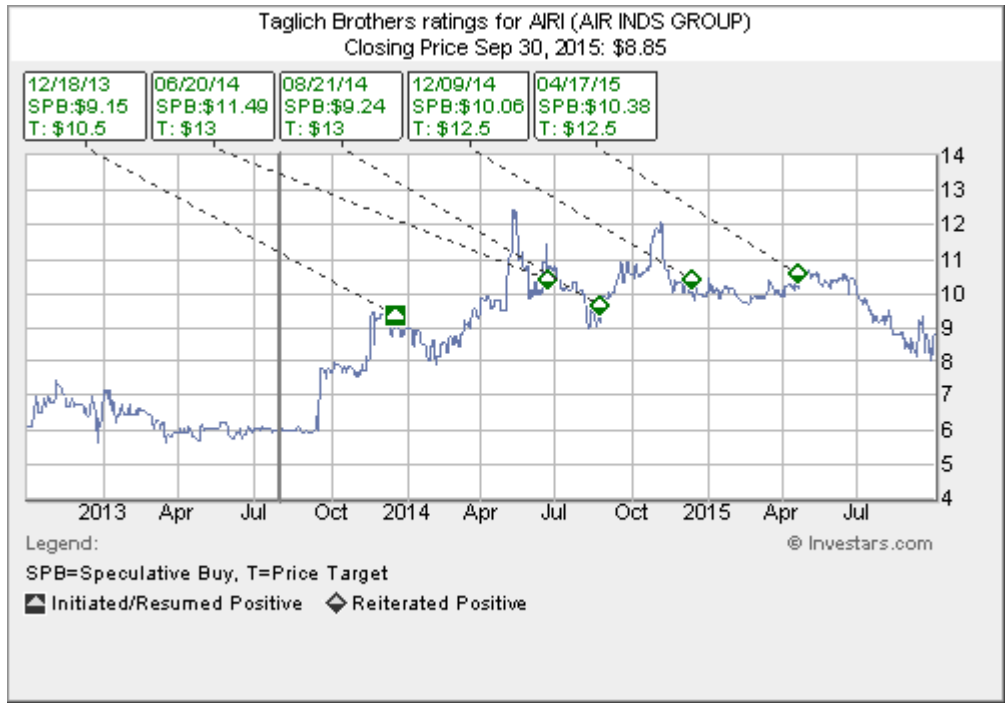
Air Industries Group

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

	2012A	2013A	2014A	6mos15A	2015E	2016E
Net income	2,548	3,739	667	(497)	1,445	4,066
Depreciation	1,557	1,709	2,364	1,634	3,844	3,189
Amortization of intangible assets	693	1,163	1,163	614	1,228	1,228
Amortization of capitalized engineering costs	459	430	375	151	302	302
Bad debt expense	80	394	299	55	55	55
Stock compensation expense	101	38	42	54	100	100
Amortization of deferred financing costs	52	69	49	83	160	160
Negative goodwill from acquisition	-	(361)	-	-	-	-
Gain on sale of real estate	(38)	(38)	(38)	(19)	(19)	-
Deferred income taxes	-	(1,236)	(1,043)	(17)	(1,074)	(117)
Adjustments to lease impairment	53	-	-	-	-	-
Cash earnings (loss)	5,505	5,907	3,878	2,058	6,041	8,983
<i>Changes in assets and liabilities</i>						
Accounts receivable	(4,606)	2,871	(2,417)	1,921	2,021	(1,470)
Inventory	1,136	440	(1,802)	(4,435)	(7,814)	(3,494)
Prepaid expenses and other current assets	(216)	35	(244)	70	114	-
Deposits and other assets	(81)	154	(164)	(45)	(45)	(45)
Accounts payable and accrued expenses	(1,534)	(892)	(577)	(34)	2,024	855
Deferred rent	82	75	45	17	34	34
Income taxes payable	1,408	48	(1,425)	(71)	(71)	-
Deferred revenue	-	251	(93)	295	295	-
(Increase) decrease in working capital	(3,811)	2,982	(6,677)	(2,282)	(3,442)	(4,120)
Net Cash Provided by Operations	1,694	8,889	(2,799)	(224)	2,599	4,864
Cash paid for acquisitions, net	(11,600)	(450)	(8,757)	(4,825)	(6,025)	-
Capitalized engineering costs	(292)	(380)	(335)	(350)	(350)	(350)
Purchase of property and equipment	(1,059)	(288)	(571)	(371)	(750)	(600)
Deposit for new property and equipment	(87)	-	-	-	-	-
Net Cash Used in Investing	(13,038)	(1,118)	(9,663)	(5,546)	(7,125)	(950)
Proceeds from sales of common stock	7,115	997	9,530	-	500	500
Costs to raise capital	(587)	-	(968)	-	-	-
Proceeds from capital lease refinance	-	-	-	500	500	-
Notes payable - sellers	(601)	(644)	(691)	(41)	(41)	-
Capital lease obligations	(608)	(996)	(143)	(267)	(267)	(267)
Notes payable - jr. subordinated debt	(115)	-	-	-	-	-
Notes payable - revolver	4,787	(3,637)	3,142	5,329	5,329	-
Proceeds from notes payable - term loan	3,900	-	7,328	3,500	3,500	-
Payments of notes payable - term loan	(2,153)	(1,800)	(913)	(903)	(903)	-
Cash paid for deferred financing costs	(21)	(102)	(151)	(322)	(322)	-
Payments related to lease impairment	(101)	(85)	(67)	(30)	(60)	(60)
Dividends paid	(359)	(1,433)	(3,748)	(2,200)	(4,500)	(4,500)
Net Cash Provided by (Used in) Financing	11,257	(7,700)	13,319	5,566	3,736	(4,327)
Net Change in Cash	(87)	71	857	(204)	(790)	(413)
Cash - Beginning of Period	664	577	648	1,418	1,505	715
Cash - End of Period	577	648	1,505	1,214	715	302

Source: Company filings and Taglich Brothers' estimates

Price Chart



Taglich Brothers' Current Ratings Distribution



■ 33.82 % Buy ■ 57.35 % Hold ■ 7.35 % Not Rated ■ 1.47 % Sell

Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	1	4
Hold		
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 411,223 shares of AIRI common stock, 15,250 stock options (right to purchase), and 41,190 warrants. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 428,724 shares of AIRI common stock, 15,250 stock options (right to purchase), and 41,190 warrants. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 56,042 shares of AIRI common stock and 14,000 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 50,554 shares of AIRI common stock, 15,250 stock options (right to purchase), and 27,585 warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 13,054 shares of AIRI common stock. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 356 shares of AIRI common stock and 10,500 AIRI 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.

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.