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Research Report – Update

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

Air Industries Group, Inc.

Speculative Buy

John Nobile
August 21, 2014

AIRI $9.24 — (NYSE MKT)

	2012A	2013A*	2014E	2015E
Revenues (millions)	$64.2	$62.8	$67.8	$78.4
Earnings (loss) per share	$0.54	$0.63	$0.40	$0.53

52-Week range	$13.12 – $5.97	Fiscal year ends:	December
Common shares out as of 8/11/14	7.1 million	Revenue per share (TTM)	$10.23
Approximate float	5.3 million	Price/Sales (TTM)	0.9X
Market capitalization	$65 million	Price/Sales (FY2015)E	0.9X
Tangible book value/share	$3.10	Price/Earnings (TTM)	13.6X
Price/tangible book value	3.0X	Price/Earnings (FY2015)E	17.4X
Annual Dividend	$0.60	Dividend Yield	6.5%

* Includes $1.2 million tax benefit of approximately $0.21 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:

Reiterate Speculative Buy rating and maintaining twelve-month price target of $13.00.

With its strategic acquisitions and a growing commercial business, we believe the company is poised for strong growth.

Acquisitions made in the first half of 2014 should contribute approximately $7.7 million in annual revenue. The company's strategic acquisitions have resulted in a compound annual growth rate for sales of 10% over the past five years while defense spending has declined by 3% over the same time frame.

We raised our FY14 revenue projection to $67.8 million from $67.1 million and our EPS projection to $0.40 from $0.30 per share to reflect 2Q14 results. We raised our FY15 revenue projection to $78.4 million from $77.4 million and our EPS projection to $0.53 from $0.48 to reflect the acquisition of Electronic Connection Corporation (estimated annual revenue of approximately $1 million).

2Q14 total revenue decreased 9% to $13.4 million due to primarily due to continuing reductions in defense spending and a delay in receiving expected US Navy orders for landing gear. EPS rose to $0.09 from $0.04 as a $0.7 million or $0.11 per share tax benefit was realized in 2Q14. We projected 2Q14 sales of $12.7 million and EPS of $0.00 per share.

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

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Recommendation and Valuation

We are reiterating our **Speculative Buy** rating on Air Industries Group, Inc. (AIRI) and maintaining our **twelve-month price target of $13.00 per share.**

Shares of AIRI are currently trading at a multiple of 14X TTM earnings (excluding non-recurring gain, TTM earnings multiple is 20X). We believe the market will accord the stock a multiple of 25X, a premium over the aerospace & defense industry multiple of 18X based largely on the strong growth projected for 2015 (AIRI earnings growth of approximately 34% vs. 13% for the industry). Applying a multiple of 25X to our 2015 earnings of $0.53 per share values the stock at approximately $13.00 per share.

Air Industries' valuation is likely to remain higher than aerospace and defense industry due to higher earnings growth stemming from recent acquisitions.

Recent Development

<u>*Agreement to acquire Electronic Connection Corporation*</u> – In August 2014, Air Industries announced an agreement to acquire Electronic Connection Corporation (ECC) of Bloomfield, CT. Air Industries anticipates closing this transaction in a few weeks and anticipates combining its operations into Air Industries' Eur-Pac facility in Waterbury, CT. ECC is a custom manufacturer of processed wire, cable and wire harnesses and is not expected to materially impact the financial results of Air Industries.

Air Industries also said that it was in various stages of discussions with five potential acquisition candidates.

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.

<u>Mixer Assembly – Blackhawk</u>

<u>E-2D Landing Gear</u>

Source: Air Industries Group, Inc.

Components and subassemblies for defense and aerospace applications accounted for 56% of 2013 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.

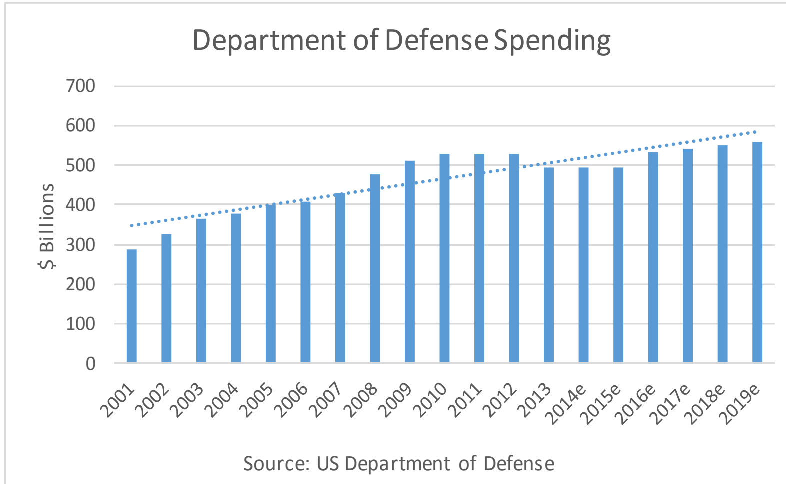
The company provides specialty welding services, and metal fabrications that were responsible for 22% of total revenue in 2013. Products include the inlet housing and auxiliary long and short beams for the Sikorsky Blackhawk helicopter and various welded door and panel assemblies for the Boeing CH-47 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 23% of total revenue in 2013. 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

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.

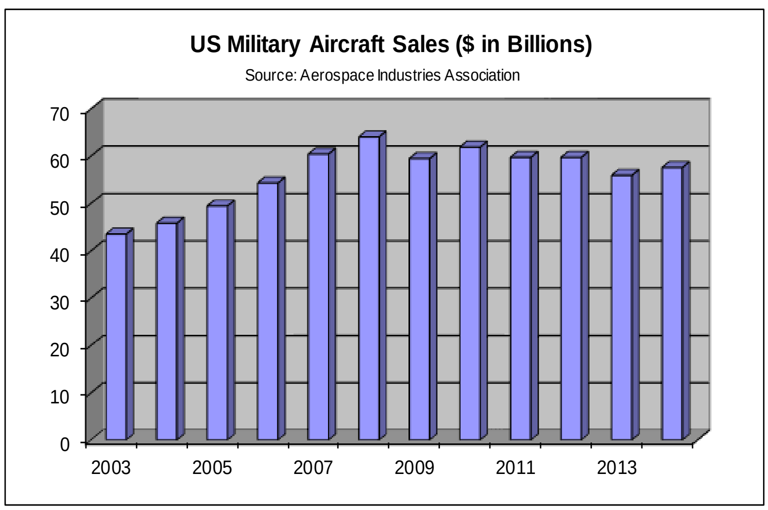
Changes in defense spending are likely to directly impact AIRI's revenues. US defense spending increased through much of the post-9/11 decade and peaked in 2012 at over $530 million. However, budget cuts reduced defense spending by 7% to $495.5 billion in 2013 and the 2014 spending budget is for spending to remain flat. The current (March 2014) DOD budget request for 2015 is for spending to remain at the 2014 level. Growth in defense spending is projected to start beginning in 2016 (see chart at right).



Although DOD spending declined by 7% in 2013, Air Industries' revenues only dropped by 2% due to the June 2012 acquisition of the landing gear products line (Nassau Tool Works).

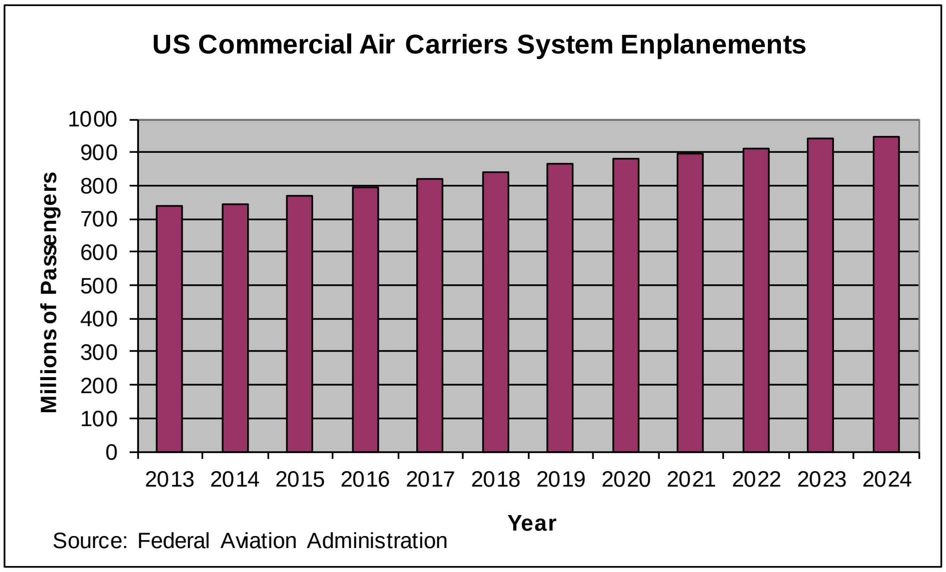
Military Aircraft Market and Forecast

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 $57.6 billion in 2014, up 3% from 2013 but down 10% from the peak in 2008. The AIA said the drop in 2013 US military aircraft sales 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 are in operation and maintenance spending. The latest (March 2014) DOD budget for operation and maintenance spending is for an 8% decrease in 2014 followed by a 3% increase in 2015. This should translate into reduced AIRI military sales in 2014 (excluding acquisitions) followed by an increase in 2015.

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 11, 2001 resulting in approximately 90% of AIRI'S total revenue coming from defense and less than 10% from the commercial aircraft market in 2013. 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 remain flat over the next two years. In an effort to grow revenue, 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 2014-2024, 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 2.3 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 3% from 2014 to 2018 slowing to 2.4% from 2018 to 2024.

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 $3.7B), Heroux-Devtek (TTM revenues of $295M), and Ellanef Manufacturing, a division of Magellan Corporation.

Strategy

With reduced levels of defense spending, 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. In this regard, Air Industries recently acquired privately held Woodbine Products, Inc. of Deer Park, New York in April 2014 and Eur-Pac of Waterbury, Connecticut in June 2014. 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. 2013 revenue for Woodbine was approximately $2.2 million and $5.5 million for Eur-Pac.

The recently announced acquisition of Electronic Connection Corporation in Bloomfield Connecticut is expected to close in a few weeks. Electronic Connection Corporation is a custom manufacturer of processed wire, cable and wire harnesses and is not expected to materially impact the financial results of Air Industries.

Since the 1990s, the aerospace and defense industries have undergone consolidation. 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 is now producing more complete sub-assemblies sought after by major contractors and sales have grown at a compound annual growth rate of 10% over the past five years due to strategic acquisitions.

Economic Outlook

In July 2014, the International Monetary Fund (IMF) lowered its 2014 economic growth estimate for the US to 1.7%, down from its April 2014 estimate of 2.8% and the US Bureau of Economic Analysis (BEA) released its GDP estimate showing the US economy expanded 4% in 2Q14. The IMF's projections predate the latest GDP estimate.

The IMF said the US inventory overhang at the end of 2013 turned out to be larger than expected, leading to a stronger correction. Further, a harsh winter dampened demand, exports declined sharply after a strong fourth quarter, and output contracted in 1Q14. The IMF's growth estimate for 2015 remained unchanged at 3.0%.

2Q and 1H14 Financial Results

2Q14 - 2Q14 total revenue decreased 9% to $13.4 million. Components and subassembly sales decreased 13% to $7.1 million, specialty welding services sales increased 14% to $3.8 million, landing gear and related components sales decreased 31% to $2.2 million, and kitting sales were $277,000 (no sales reported for 2Q13 as this segment was acquired in 2Q14). Net income rose to $0.6 million or $0.09 per share from $226,000 or $0.04 per share. We projected 2Q14 sales of $12.7 million and net income of $30,000 or $0.00 per share.

Product Sales
($ in thousands)

	2Q14A	2Q13A
Components	7,135	8,188
Specialty welding	3,763	3,307
Landing gear	2,185	3,144
Kitting	277	-
Total	13,360	14,639

Source: Company filings

The decrease in total sales was primarily due to continuing reductions in defense spending and a delay in receiving expected US Navy orders for landing gear. AIRI has begun to receive these orders in 3Q14 and a growing backlog suggests a stronger 2H14. Gross margins increased to 25.1% from 24.8% primarily due to a tilt in sales to higher margin specialty welding and kitting sales. Operating (SG&A) expenses increased to $3.1 million or 23.2% of sales from $2.6 million or 17.4% of sales.

Interest and financing costs decreased to $304,000 from $393,000 primarily due to lower debt levels and lower interest rates. The company realized a $0.7 million tax benefit in 2Q14 from a reversal of over accruals from 2013 taxes.

1H14 - Total revenue decreased 1% to $28.8 million. Components and subassembly sales decreased 9% to $14.3 million, specialty welding services sales increased 10% to $7.1 million, landing gear and related components sales increased 5% to $7.2 million, and kitting sales were $277,000 (no sales reported for 1H13 as this segment was acquired in 2Q14). Net income rose to $1 million or $0.15 per share from $0.5 million or $0.09 per share.

The decrease in sales was primarily due to continuing reductions in defense spending and a delay in receiving expected US Navy orders for landing gear (in components segment). These reductions were partially offset by accretive sales from acquisitions. Air has begun to receive the delayed orders in 3Q14 and a growing backlog suggests a stronger 2H14.

Gross margins increased to 25.7% from 25.1% primarily due to primarily due to a tilt in sales to higher margin specialty welding and kitting sales. Operating (SG&A) expenses increased to $5.9 million or 20.5% of sales from $5 million or 17.3% of sales.

Interest and financing costs decreased to $0.6 million from $0.8 million primarily due to lower debt levels and lower interest rates. The company realized a $141,000 tax benefit in 1H14 from a reversal of over accruals from 2013 taxes.

Income Statement
(in thousands $)

	6mos14A	6mos13A
Components	14,266	15,666
Specialty welding	7,076	6,446
Landing gear	7,194	6,853
Kitting	277	-
Total sales	28,813	28,965
Cost of sales	21,415	21,687
Gross profit	7,398	7,278
Operating expenses	5,912	5,021
Operating income	1,486	2,257
Interest and financing costs	(607)	(775)
Other (expense) income	(63)	(58)
Income before taxes	816	1,424
Income tax (benefit)	(141)	919
Net income / (loss)	957	505
EPS	0.15	0.09
Shares Outstanding	6,371	5,799
Margin Analysis		
Gross margin	25.7%	25.1%
Operating margin	5.2%	7.8%
Tax rate	(17.3)%	64.5%
Year / Year Growth		
Total Revenues	(0.5)%	
Net Income	89.5%	
EPS	72.5%	

Source: Company filings

Liquidity

As of June 30, 2014, the company had $1.2 million cash and a current ratio of 1.8X versus 1.3X for the aerospace and defense industry. Total debt was $15.2 million for a debt/equity ratio of 0.5X versus 0.6X 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 used in operations in the first six months of 2014 was $384,000 consisting of cash earnings of $2.4 million and a $2.8 million increase in working capital stemming primarily from an increase in inventory. Cash used in investing was $4.6 million consisting of $4.2 million for acquisitions, $128,000 of capitalized engineering costs and $302,000 of capital expenditures. Cash provided by financing was $5.6 million and consisted primarily of $8.6 million net proceeds from a registered offering, offset in part by a $1.1 million pay down of debt and $1.6 million in dividend payments. Cash increased by $0.6 million to $1.2 million at June 30, 2014.

Air Industries has a revolving credit line and term loan with PNC bank. The credit line provides for maximum borrowings of $23 million (current outstanding balance of $10.6 million) and a term loan of $2.6 million. Air Industries pays an annual interest rate of 4% on the credit facility. As of June 30, 2014, Air Industries was in compliance with all debt covenants.

In June 2014, Air Industries raised $10.5 million ($8.6 million after fees and conversion of debt) by selling 1,170,000 shares of its common stock at $9.00 per share in a registered direct offering. Taglich Brothers acted as the exclusive placement agent for the offering.

Projections

The chart at right provides a breakdown of Air Industries' organic sales and the effect of recent acquisitions. AIRI's FY14 organic sales are projected to decline with the anticipated 8% decline in O&M spending. Helping to offset this anticipated decline should be a full year's contribution from the 2013 acquisitions of Decimal Industries and Miller Stuart, 9 months of sales from the April 2014 acquisition of Woodbine Products, and 7 months of sales from the June 2014 acquisition of Eur-Pac. FY14 organic growth should benefit from the 4Q13 commercial contracts (totaling $38 million over six years). AIRI's FY15 organic sales reflect the anticipated 3% increase in O&M spending and a ramp up in commercial sales from the 2013 contracts. FY15 sales should benefit from a full year's contribution from Eur-Pac and Electronic Connection Corporation.

Sales (in thousands $)

	2013	2014E	2015E
Decimal	1,250	2,500	2,600
Miller Stuart	450	2,800	2,900
Woodbine	-	1,650	2,300
Eur-Pac	-	2,300	5,700
ECC	-	250	1,000
Organic	61,133	58,300	63,900
Total sales	$62,833	$67,800	$78,400

Source: 2013 total sales are actual, remainder are Taglich Brothers' estimates

The following chart provides a segmented breakdown of Air Industries' 2013 actual sales and gross margins along with our projections for 2014 and 2015. Eur-Pac and Electronic Connection Corporation are classified under the kitting segment.

Sales ($ in thousands)

	1Q13A	2Q13A	3Q13A	4Q13A	FY13A	1Q14A	2Q14A	3Q14E	4Q14E	FY14E	1Q15E	2Q15E	3Q15E	4Q15E	FY15E
Components	7,478	8,188	9,863	9,469	34,998	7,131	7,135	11,400	12,000	37,666	10,600	10,700	10,900	11,000	43,200
Specialty welding	3,139	3,307	3,800	3,384	13,630	3,313	3,763	3,700	3,900	14,676	3,600	3,700	3,800	3,900	15,000
Landing gear	3,708	3,144	2,389	4,964	14,205	5,009	2,185	2,200	3,500	12,894	3,300	3,350	3,400	3,450	13,500
Kitting	-	-	-	-	-	-	277	1,000	1,300	2,577	1,600	1,650	1,700	1,750	6,700
Total	14,325	14,639	16,052	17,817	62,833	15,453	13,360	18,300	20,700	67,813	19,100	19,400	19,800	20,100	78,400

Gross Profit ($ in thousands)

	1Q13A	2Q13A	3Q13A	4Q13A	FY13A	1Q14A	2Q14A	3Q14E	4Q14E	FY14E	1Q15E	2Q15E	3Q15E	4Q15E	FY15E
Components	1,460	1,599	1,926	1,320	6,305	1,285	1,285	2,052	2,160	6,782	1,908	1,926	1,962	1,980	7,776
Specialty welding	849	894	953	786	3,482	838	1,108	1,088	1,147	4,180	1,058	1,088	1,117	1,147	4,410
Landing gear	1,338	1,137	864	2,109	5,448	1,922	819	825	1,313	4,879	1,238	1,256	1,275	1,294	5,063
Kitting	-	-	-	-	-	-	141	509	662	1,312	814	840	865	891	3,410
Total	3,647	3,630	3,743	4,215	15,235	4,045	3,353	4,474	5,281	17,153	5,018	5,110	5,220	5,311	20,659

Gross Margin

	1Q13A	2Q13A	3Q13A	4Q13A	FY13A	1Q14A	2Q14A	3Q14E	4Q14E	FY14E	1Q15E	2Q15E	3Q15E	4Q15E	FY15E
Components	19.5%	19.5%	19.5%	13.9%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Specialty welding	27.0%	27.0%	27.0%	23.2%	25.5%	25.3%	29.4%	29.4%	29.4%	28.5%	29.4%	29.4%	29.4%	29.4%	29.4%
Landing gear	36.1%	36.2%	36.1%	42.5%	38.4%	38.4%	37.5%	37.5%	37.5%	37.8%	37.5%	37.5%	37.5%	37.5%	37.5%
Kitting	-	-	-	-	-	-	50.9%	50.9%	50.9%	50.9%	50.9%	50.9%	50.9%	50.9%	50.9%
Total	25.5%	24.8%	23.3%	23.7%	24.2%	26.2%	25.1%	24.4%	25.5%	25.3%	26.3%	26.3%	26.4%	26.4%	26.4%

Source: Company filings and Taglich Brothers' estimates

FY14 - We raised our revenue projection to $67.8 million from $67.1 million and our net income projection to $2.7 million or $0.40 per share from $2.1 million or $0.30 per share to reflect 2Q14 results. We project gross margins of 25.3%, up from 24.2% in 2013 due to the inclusion of higher margin kitting sales.

The recent acquisitions should increase operating expenses to $12.1 million from $10.6 million. However, the higher projected gross margins should offset the increase in operating expenses leaving operating margins near 2013 levels at 7.4%.

Interest expense is projected to decrease to $1.2 million from $1.3 million as the company pays off debt. The tax rate is estimated at 27.6% to reflect the $0.7 million tax benefit realized in 2Q14.

We project $4.1 million cash from operations consisting of cash earnings of $5.7 million and increases in working capital of $1.7 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. The recent private placement proceeds should cover acquisition costs, debt pay downs, and dividend payments, resulting in a $2.1 million increase in cash to $2.6 million at year-end 2014.

FY15 – We raised our revenue projection to $78.4 million from $77.4 million and our net income projection to $4 million or $0.53 per share from $3.6 million or $0.48 per share to reflect the acquisition of Electronic Connection Corporation (estimated annual revenue of approximately $1 million).

We project gross margins increasing to 26.4% from 25.3% due to a favorable product mix. Operating margins are projected to increase to 10% from 7.4% as Woodbine's operations are consolidated into AIRI's helping to keep SG&A expenses relatively low.

We project interest expense of $1.2 million and a tax rate of 40%.

We project $2.8 million cash from operations consisting of cash earnings of $7.1 million and increases in working capital of $4.3 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 will not be sufficient to cover capital expenditures and dividend payments, requiring another common stock sale to raise an additional $1 million. Cash should decrease by $1.3 million to $1.3 million at year-end 2015.

Risks

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

Reliance on government spending - 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.

Reliance on a small number of customers – Air Industries derives most of its revenues from a small number of customers. In FY13, 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 5.3 million shares in the float and the average daily volume is approximately 24,800 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 $)

	2012A	2013A	6/14A	2014E	2015E
Cash and cash equivalents	490	561	1,169	2,615	1,275
Accounts receivable	11,631	8,584	9,474	9,264	10,711
Inventory	26,739	26,222	29,268	27,909	31,810
Deferred tax asset	-	1,051	1,220	1,220	1,220
Prepaid expenses and other current assets	546	510	465	465	465
Deposits - vendors	133	-	-	-	-
Total current assets	39,539	36,928	41,596	41,474	45,481
Property and equipment, net	5,883	6,523	6,095	7,344	6,410
Capitalized engineering costs	802	752	666	324	-
Deferred financing costs	590	605	630	630	630
Intangible assets	5,889	4,726	4,144	3,562	2,398
Deferred tax asset	-	185	762	744	744
Goodwill	453	453	4,514	4,514	4,514
Total assets	**53,156**	**50,172**	**58,407**	**58,592**	**60,177**
Notes payable and capitalized lease obligations	19,211	14,969	11,840	11,840	11,840
Accounts payable and accrued expenses	7,077	6,855	7,780	7,296	8,316
Lease impairment	85	71	64	64	64
Deferred gain on sale	38	38	38	38	38
Customer deposits	-	251	174	174	174
Dividends payable	-	717	1,064	1,064	1,064
Income taxes payable	1,448	1,496	1,770	1,770	1,770
Total current liabilities	27,859	24,397	22,730	22,246	23,266
Long-term debt	4,640	2,527	3,388	3,388	3,388
Lease impairment	127	56	25	25	25
Deferred gain on sale	485	447	428	428	248
Deferred rent	1,057	1,132	1,170	1,170	1,170
Total liabilities	**34,168**	**28,559**	**27,741**	**27,257**	**28,097**
Total stockholders' equity*	**18,988**	**21,613**	**30,666**	**31,335**	**32,080**
Total liabilities & stockholders' equity	**53,156**	**50,172**	**58,407**	**58,592**	**60,177**

*2014 includes $2.2 M add'tl paid-in-capital related to acquisitions and debt conversions
Source: Company filings and Taglich Brothers' estimates

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

	2012A	2013A	2014E	2015E
Net sales	64,215	62,833	67,813	78,400
Cost of sales	49,357	47,598	50,660	57,741
Gross profit	14,858	15,235	17,153	20,659
Operating expenses	8,874	10,622	12,112	12,800
Operating income	5,984	4,613	5,041	7,859
Interest and financing costs	(1,843)	(1,340)	(1,207)	(1,200)
Other (expense) income	(146)	296	(63)	-
Income before taxes	3,995	3,569	3,771	6,659
Income tax (benefit)	1,447	(170)	1,041	2,664
Net Income / (Loss)	2,548	3,739	2,730	3,995
EPS	0.54	0.63	0.40	0.53
Shares Outstanding	4,759	5,933	6,881	7,500
Margin Analysis				
Gross margin	23.1%	24.2%	25.3%	26.4%
Operating margin	9.3%	7.3%	7.4%	10.0%
Net margin	4.0%	6.0%	4.0%	5.1%
Tax rate	36.2%	(4.8)%	27.6%	40.0%
Year / Year Growth				
Total Revenues	19.5%	(2.2)%	7.9%	15.6%
Net Income	13.4%	46.7%	(27.0)%	46.4%
EPS	(14.7)%	17.7%	(37.0)%	34.3%

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statements 2013A -2015E
(in thousands $)

	3/13A	6/13A	9/13A	12/13A	2013A	3/14A	6/14A	9/14E	12/14E	2014E	3/15E	6/15E	9/15E	12/15E	2015E
Net sales	14,325	14,639	16,052	17,817	62,833	15,453	13,360	18,300	20,700	67,813	19,100	19,400	19,800	20,100	78,400
Cost of sales	10,678	11,009	12,309	13,602	47,598	11,408	10,007	13,826	15,419	50,660	14,082	14,290	14,581	14,789	57,741
Gross profit	3,647	3,630	3,743	4,215	15,235	4,045	3,353	4,474	5,281	17,153	5,018	5,110	5,220	5,311	20,659
Operating expenses	2,469	2,552	2,712	2,889	10,622	2,816	3,096	3,100	3,100	12,112	3,200	3,200	3,200	3,200	12,800
Operating income	1,178	1,078	1,031	1,326	4,613	1,229	257	1,374	2,181	5,041	1,818	1,910	2,020	2,111	7,859
Interest and financing costs	(385)	(393)	(281)	(281)	(1,340)	(303)	(304)	(300)	(300)	(1,207)	(300)	(300)	(300)	(300)	(1,200)
Other (expense) income	(25)	(29)	(11)	361	296	(1)	(62)	-	-	(63)	-	-	-	-	-
Income before taxes	768	656	739	1,406	3,569	925	(109)	1,074	1,881	3,771	1,518	1,610	1,720	1,811	6,659
Income tax (benefit)	489	430	(1,795)	706	(170)	584	(725)	430	752	1,041	607	644	688	724	2,664
Net Income / (Loss)	279	226	2,534	700	3,739	341	616	644	1,128	2,730	911	966	1,032	1,087	3,995
EPS	0.05	0.04	0.43	0.12	0.63	0.06	0.09	0.09	0.15	0.40	0.12	0.13	0.14	0.14	0.53
Shares Outstanding	5,810	5,789	5,854	5,933	5,933	6,125	6,598	7,400	7,400	6,881	7,500	7,500	7,500	7,500	7,500
Margin Analysis															
Gross margin	25.5%	24.8%	23.3%	23.7%	24.2%	26.2%	25.1%	24.4%	25.5%	25.3%	26.3%	26.3%	26.4%	26.4%	26.4%
Operating margin	8.2%	7.4%	6.4%	7.4%	7.3%	8.0%	1.9%	7.5%	10.5%	7.4%	9.5%	9.8%	10.2%	10.5%	10.0%
Net margin	1.9%	1.5%	15.8%	3.9%	6.0%	2.2%	4.6%	3.5%	5.5%	4.0%	4.8%	5.0%	5.2%	5.4%	5.1%
Tax rate	63.7%	65.5%	(242.9)%	50.2%	(4.8)%	63.1%	665.1%	40.0%	40.0%	27.6%	40.0%	40.0%	40.0%	40.0%	40.0%
Year / Year Growth															
Total Revenues	(10.7)%	(3.9)%	3.2%	2.5%	(2.2)%	7.9%	-8.7%	14.0%	16.2%	7.9%	23.6%	45.2%	8.2%	-2.9%	15.6%
Net Income	(66.0)%	(29.2)%	312.7%	(11.9)%	46.7%	22.2%	172.6%	(74.6)%	61.2%	(27.0)%	167.1%	56.8%	60.1%	(3.7)%	46.4%
EPS	(79.0)%	(53.7)%	308.3%	(12.7)%	17.7%	15.9%	139.1%	(79.9)%	29.3%	(37.0)%	118.2%	37.9%	58.0%	(5.0)%	34.3%

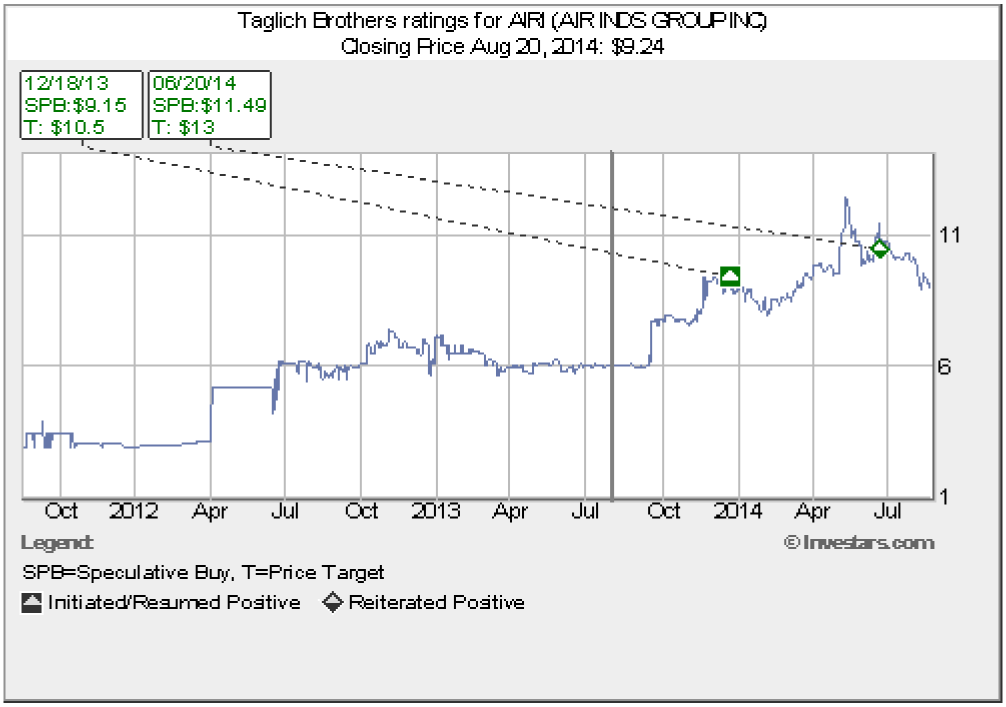
Source: Company filings and Taglich Brothers' estimates

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

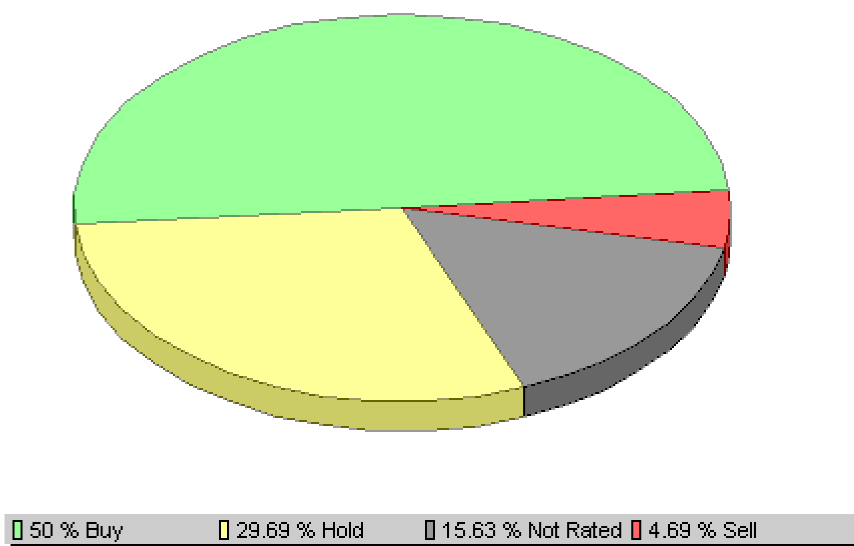
	2012A	2013A	6mos14A	2014E	2015E
Net income	2,548	3,739	957	2,730	3,995
Depreciation	1,557	1,709	1,168	1,929	1,684
Amortization of intangible assets	693	1,163	582	1,164	1,164
Amortization of capitalized engineering costs	459	430	214	428	324
Bad debt expense	80	394	189	189	189
Stock compensation expense	101	38	15	30	30
Amortization of deferred financing costs	52	69	23	46	46
Negative goodwill from acquisition	-	(361)	-	-	-
Gain on sale of real estate	(38)	(38)	(19)	(19)	-
Deferred income taxes	-	(1,236)	(746)	(765)	(377)
Adjustments to lease impairment	53	-	-	-	-
Changes in assets and liabilities					
Accounts receivable	(4,606)	2,871	(789)	(680)	(1,446)
Inventory	1,136	440	(2,920)	(1,687)	(3,901)
Prepaid expenses and other current assets	(216)	35	72	45	-
Deposits	(132)	134	(1)	-	-
Other assets	51	20	(23)	(23)	-
Accounts payable and accrued expenses	(1,534)	(892)	659	441	1,020
Deferred rent	82	75	38	38	38
Income taxes payable	1,408	48	274	274	-
Customer deposits	-	251	(77)	(77)	-
Net Cash Provided by Operations	**1,694**	**8,889**	**(384)**	**4,062**	**2,766**
Cash paid for acquisitions	(11,600)	(450)	(4,190)	(4,350)	-
Capitalized engineering costs	(292)	(380)	(128)	(128)	-
Purchase of property and equipment	(1,059)	(288)	(302)	(750)	(750)
Deposit for new property and equipment	(87)	-	-	-	-
Net Cash Used in Investing	**(13,038)**	**(1,118)**	**(4,620)**	**(5,228)**	**(750)**
Proceeds from private placement	7,115	997	9,530	9,530	1,000
Payment of issuance costs for private placement	(587)	-	(968)	(968)	(80)
Notes payable - sellers	(601)	(644)	(339)	(339)	-
Capital lease obligations	(608)	(996)	(172)	(344)	-
Notes payable - jr. subordinated debt	(115)	-	-	-	-
Notes payable - revolver	4,787	(3,637)	(1,422)	(1,422)	-
Proceeds from notes payable - term loan	3,900	-	1,328	1,328	-
Payments of notes payable - term loan	(2,153)	(1,800)	(664)	(664)	-
Cash paid for deferred financing costs	(21)	(102)	(25)	(25)	-
Payments related to lease impairment	(101)	(85)	(38)	(76)	(76)
Dividends paid	(359)	(1,433)	(1,618)	(3,800)	(4,200)
Net Cash Provided by (Used in) Financing	**11,257**	**(7,700)**	**5,612**	**3,220**	**(3,356)**
Net Change in Cash	**(87)**	**71**	**608**	**2,054**	**(1,340)**
Cash - Beginning of Period	**577**	**490**	**561**	**561**	**2,615**
Cash - End of Period	**490**	**561**	**1,169**	**2,615**	**1,275**

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	**2**	**7**
Hold	**1**	**17**
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, 41,667 shares of AIRI restricted stock, 9,750 stock options (right to purchase), and 41,190 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, 95,715 shares of AIRI restricted stock, 9,750 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 61,042 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, Inc., owns or has a controlling interest in 50,554 shares of AIRI common stock, 9,750 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 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

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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.