

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

December 9, 2014

AIRI \$10.06 — (NYSE MKT)

	<u>2012A</u>	<u>2013A*</u>	<u>2014E</u>	<u>2015E</u>
Revenues (millions)	\$64.2	\$62.8	\$63.7	\$78.5
Earnings (loss) per share	\$0.54	\$0.63	\$0.32	\$0.50

52-Week range	\$13.12 – \$7.77	Fiscal year ends:	December
Common shares out a/o 11/12/14	7.1 million	Revenue per share (TTM)	\$9.49
Approximate float	6.3 million	Price/Sales (TTM)	1.1X
Market capitalization	\$71 million	Price/Sales (FY2015)E	0.9X
Tangible book value/share	\$3.18	Price/Earnings (TTM)	32.5X
Price/tangible book value	3.2X	Price/Earnings (FY2015)E	20.1X
Annual Dividend	\$0.60	Dividend Yield	6.0%

* 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.airindustriessgroup.com)

Key investment considerations:

Reiterate Speculative Buy rating. Lowering twelve-month price target to \$12.50 per share (previously \$13.00) due to a reduction in our earnings estimates.

With its strategic acquisitions and a growing commercial business, we believe the company is poised for strong growth in 2015.

Acquisitions made in 2013 and 2014 should contribute approximately \$8.7 million in annual revenue in 2014 and over \$18 million in 2015. Although defense spending has decreased by 6% since 2012, acquisitions have helped to keep revenue relatively flat over that time frame. A full year of revenue contribution from 2014 acquisitions with an increase in defense spending should help drive revenue growth in 2015.

In November 2014, Air Industries announced the retirement of Peter D. Rettaliata as president and CEO effective January 1st, 2015 and announced Daniel Godin as its new CEO. In October 2014, Air Industries announced it acquired AMK Technical Services of South Windsor, Connecticut.

We lowered our 2014 revenue projection to \$63.7 million from \$67.8 million and EPS projection to \$0.32 from \$0.40 to reflect 3Q14 results and the adverse effects from delayed Navy orders. Our 2015 revenue projection is unchanged at \$78.5 million but our EPS projection has been lowered to \$0.50 from \$0.53 to reflect AMK's lower margins.

3Q14 revenue decreased 6% to \$15.2 million due to primarily due to continuing reductions in defense spending and a delay in US Navy orders for landing gear. EPS fell to \$0.05 from \$0.43 as a \$0.31 per share tax benefit was realized in 3Q13. We projected 3Q14 sales of \$18.3 million and EPS of \$0.09.

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

Recommendation and Valuation

We are reiterating our **Speculative Buy** rating on Air Industries Group, Inc. (AIRI). We are lowering our **twelve-month price target to \$12.50 per share** (previously \$13.00) due to a reduction in our earnings estimates.

Shares of AIRI are currently trading at a multiple of 33X TTM earnings. 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 54% vs. 7% for the industry). Applying a multiple of 25X to our 2015 earnings of \$0.50 per share values the stock at \$12.50 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

Retirement of Peter Rettaliata and Appointment of Daniel Godin as President & CEO – November 2014, Air Industries announced the retirement of Peter D. Rettaliata as President and CEO effective January 1st, 2015.

Air Industries announced Daniel Godin as its new CEO. Most recently, Godin was employed by the Merex Group, as president of MRO (Maintenance, Repair and Overhaul) Solutions. Prior to Merex, was employed at Circor Aerospace & Defense as North America as VP and general manager. Prior, Godin was employed as a VP at Sermatech and United Technologies' Pratt & Whitney aircraft engines division. BS in Manufacturing Engineering from University of Southern Maine and completed Executive Business Program at Darden School at the University of Virginia.

Acquisition of AMK Technical Services – October 2014, Air Industries announced it acquired AMK Technical Services of South Windsor, Connecticut. AMK is a provider of sophisticated welding and machining services for diversified aerospace and industrial customers. The management and employees of AMK will remain and AMK will be operated as a separate subsidiary.

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, influencing many different aspects of aircraft performance. 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 of reductions in defense spending which have adversely affected AIRI's revenue.



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.

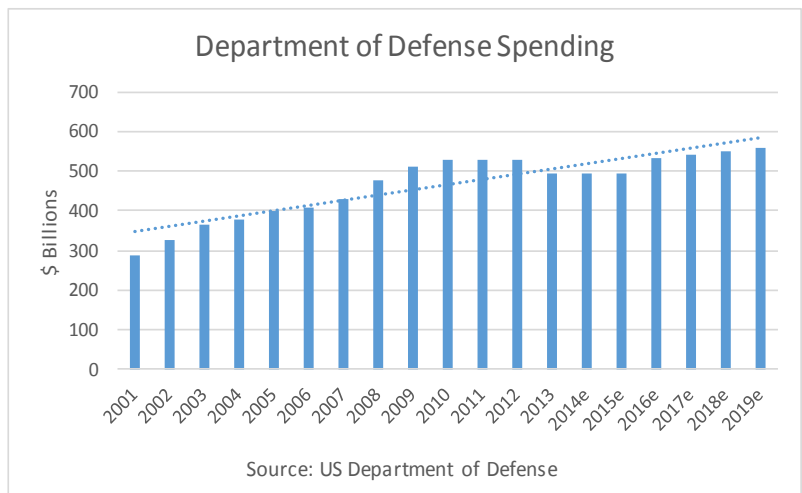
The company provides specialty welding services, and metal fabrications that were responsible for 22% of total revenue in 2013. Products include the inlet housing and auxiliary long and short beams for the Sikorsky Blackhawk helicopter and various welded door and panel assemblies for the Boeing CH-47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

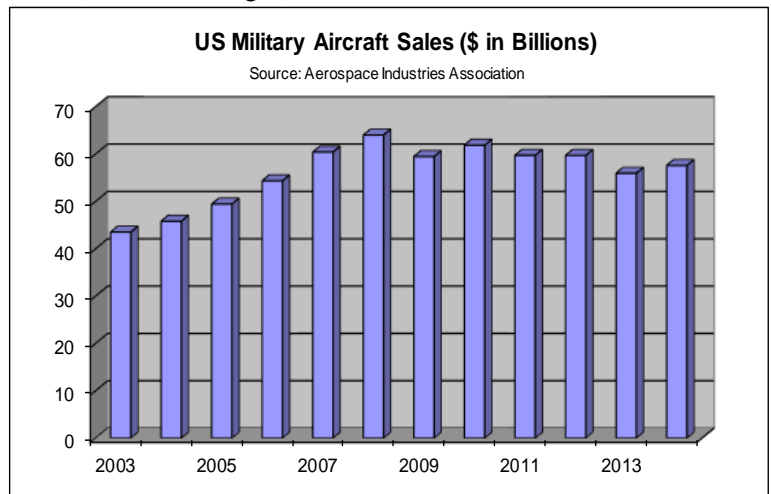
Changes in defense spending are likely to directly impact AIRI's revenues. US defense spending increased through much of the post-9/11 decade and peaked in 2012 at over \$530 billion. However, budget cuts reduced defense spending by 7% to \$495.5 billion in 2013 and the 2014 spending budget was for spending to remain flat. The last (March 2014) DOD budget request for 2015 was for spending to remain at the 2014 level. However, in December 2014, Congress reached an agreement for a 5% increase in military spending in 2015 in order to expand the US mission in Iraq to counter Islamic State militants. Growth in defense spending is projected to increase through 2019 (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

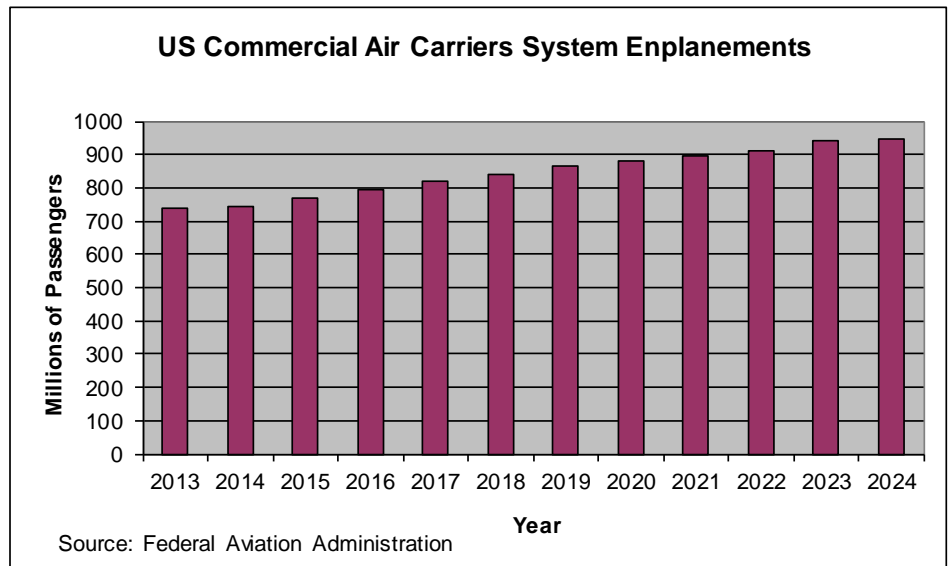


said the drop in 2013 US military aircraft sales was due to budget cuts caused in large part by the Budget Control Act of 2011 which resulted in reductions in military spending and a drop in overseas contingency operations funding.

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 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 two 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 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 \$285M), 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 (April 2014), Eur-Pac of Waterbury, Connecticut (June 2014), Electronic Connection Corporation of Bloomfield Connecticut (September 2014), and AMK Technical Services of South Windsor, Connecticut (October 2014).

Woodbine is a manufacturer of aerospace components whose customers include major aircraft component suppliers. 2013 revenue for Woodbine was approximately \$2.2 million. Eur-Pac specializes in parts kits, hose assemblies, hydraulic, mechanical and electrical assemblies for all branches of the US Defense Department. 2013 revenue for Eur-PAC was approximately \$5.5 million. 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. AMK is a provider of sophisticated welding and machining services for diversified aerospace and industrial customers. 2013 revenue for AMK was approximately \$7.5 million.

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' acquisitions of Welding Metallurgy (August 2007), Nassau Tool Works (June 2012), Decimal Industries (July 2013), and Miller Stuart (November 2013), along with the acquisitions mentioned above, 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 October 2014, the International Monetary Fund (IMF) revised upward its US economic growth estimate to 2.2% from 1.7% (July 2014). The current projection is flat with US GDP growth of 2.2% in 2013. In November 2014, the US Bureau of Economic Analysis revised upward its 3Q14 GDP growth estimate to 3.9% from 3.5% (October 2014). The IMF's US growth estimate for 2015 remained unchanged at 3.1%. The IMF said that US employment growth has been strong and household balance sheets have improved amid favorable financial conditions and a recovering housing market.

3Q and Nine Months 2014 Financial Results

3Q14 - 3Q14 total revenue decreased 6% to \$15.2 million. Net income fell to \$380,000 or \$0.05 per share from \$2.5 million or \$0.43 per share. We projected 3Q14 sales of \$18.3 million and net income of \$0.6 million or \$0.09 per share. Components and subassembly sales decreased 2% to \$9.7 million, specialty welding services sales decreased 12% to \$3.3 million, landing gear and related components sales decreased 69% to \$0.7 million, and kitting sales were \$1.4 million (no sales reported for 3Q13 as this segment was acquired in 2Q14). Net income for 3Q14 included an \$81,000 tax benefit from a reversal of over accruals from 2013 taxes. Net income for 3Q13 included a \$1.8 million or \$0.31 per share tax benefit related to the reversal of a valuation allowance on certain deferred tax assets.

	Product Sales (\$ in thousands)	
	3Q14A	3Q13A
Components	9,678	9,863
Specialty welding	3,339	3,800
Landing gear	731	2,389
Kitting	1,406	-
Total	15,154	16,052

Source: Company filings

Air Industries Group, Inc.

The decrease in total sales was primarily due to reduced defense spending and a delay in receiving expected US Navy orders for landing gear. The company began receiving these orders in 4Q14 which resulted in delivery dates shifting from 3Q14 into 4Q14 and 2015. Gross margins increased to 23.5% from 23.3% primarily due to the inclusion of higher margin kitting sales. Operating (SG&A) expenses increased to \$3 million from \$2.7 million primarily due to 2014 acquisitions resulting in operating margins of 3.7% versus 6.4%. Interest and financing costs decreased to \$260,000 from \$281,000 primarily due to lower debt levels and lower interest rates.

Nine months 2014 - Total revenue decreased 2% to \$44 million. Net income fell to \$1.3 million or \$0.20 per share from \$3 million or \$0.52 per share. Net income for 2014 included a \$222,000 or \$0.03 per share tax benefit related to the reversal of over accruals from 2013 taxes. Net income for 2013 included a \$0.9 million or \$0.15 per share tax benefit related to the reversal of a valuation allowance on certain deferred tax assets. Components and subassembly sales decreased 6% to \$23.9 million, specialty welding services sales increased 2% to \$10.4 million, landing gear and related components sales decreased 14% to \$7.9 million, and kitting sales were \$1.7 million (no sales reported for 1H13 as this segment was acquired in 2Q14).

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 4Q14 and a growing backlog suggests a stronger 2015.

Gross margins increased to 24.9% from 24.5% primarily due to primarily due to a tilt in sales to higher margin specialty welding and kitting sales. Operating (SG&A) expenses increased to \$8.9 million from \$7.7 million primarily due to 2014 acquisitions resulting in operating margins of 4.7% versus 7.3%.

	Income Statement (in thousands \$)	
	<u>9mos14A</u>	<u>9mos13A</u>
Components	23,944	25,528
Specialty welding	10,414	10,246
Landing gear	7,926	9,242
Kitting	<u>1,683</u>	<u>-</u>
Total sales	43,967	45,016
Cost of sales	<u>33,012</u>	<u>33,996</u>
Gross profit	10,955	11,020
Operating expenses	<u>8,909</u>	<u>7,733</u>
Operating income	2,046	3,287
Interest and financing costs	(867)	(1,027)
Other (expense) income	<u>(64)</u>	<u>(97)</u>
Income before taxes	1,115	2,163
Income tax (benefit)	<u>(222)</u>	<u>(876)</u>
Net income / (loss)	<u>1,337</u>	<u>3,039</u>
EPS	<u>0.20</u>	<u>0.52</u>
Shares Outstanding	6,712	5,828
<u>Margin Analysis</u>		
Gross margin	24.9%	24.5%
Operating margin	4.7%	7.3%
Tax rate	(19.9)%	(40.5)%
<u>Year / Year Growth</u>		
Total Revenues	(2.3)%	
Net Income	(56.0)%	
EPS	(61.8)%	
Source: Company filings		

Interest and financing costs decreased to \$0.9 million from \$1 million primarily due to lower debt levels and lower interest rates.

Liquidity

As of September 30, 2014, the company had \$1.6 million cash and a current ratio of 1.8X versus 1.3X for the aerospace and defense industry. Total debt was \$19.5 million for a debt/equity ratio of 0.6X, in line with the aerospace and defense industry. By our forecasts, the company should have sufficient capital to meet its operational needs for the next twelve months.

Cash used in operations in the first nine months of 2014 was \$2.7 million consisting of cash earnings of \$3.5 million and a \$6 million increase in working capital stemming primarily from an increase in inventory and a decrease in taxes payable. Cash used in investing was \$5.1 million consisting of \$4.5 million for acquisitions, \$247,000 of capitalized engineering costs and \$384,000 of capital expenditures. Cash provided by financing was \$8.8 million and consisted primarily of net proceeds from a registered offering. Cash increased by \$1 million to \$1.6 million at September 30, 2014.

Air Industries Group, Inc.

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 \$15.2 million) and term loans of \$2.5 million. Air Industries pays an annual interest rate of 4% on the credit facility. As of September 30, 2014, Air Industries was in compliance with all debt covenants.

In October 2014, AIRI borrowed \$3.5 million under a five year term loan from PNC Bank for the acquisition of AMK. The loan is due November 2019 and carries an annual interest rate of 4%.

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 and the adverse effects from the delayed Navy orders (AIRI begun receiving these orders in 4Q14). 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, 7 months of sales from the June 2014 acquisition of Eur-Pac, 4 months of sales from the September 2014 acquisition of Electronic Connection Corporation (ECC), and 3 months of sales from the October 2014 acquisition of AMK. 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 (totaling \$38 million over six years). FY15 sales should benefit from a full year's contribution from Woodbine, Eur-Pac, ECC and AMK.

	Sales (in thousands \$)		
	2013	2014E	2015E
Decimal	1,250	2,300	2,400
Miller Stuart	450	250	300
Woodbine	-	1,200	1,650
Eur-Pac	-	2,800	5,000
ECC	-	400	1,250
AMK	-	1,700	7,700
Organic	<u>61,133</u>	<u>55,000</u>	<u>60,150</u>
Total sales	\$62,833	\$63,650	\$78,450

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 and AMK under the engine segment.

Components	Sales (\$ in thousands)														
	1Q13A	2Q13A	3Q13A	4Q13A	FY13A	1Q14A	2Q14A	3Q14A	4Q14E	FY14E	1Q15E	2Q15E	3Q15E	4Q15E	FY15E
Components	7,478	8,188	9,863	9,469	34,998	7,131	7,135	9,678	9,966	33,910	8,200	8,700	9,700	10,500	37,100
Specialty welding	3,139	3,307	3,800	3,384	13,630	3,313	3,763	3,339	3,600	14,015	3,700	3,750	3,800	3,850	15,100
Landing gear	3,708	3,144	2,389	4,964	14,205	5,009	2,185	731	2,900	10,825	3,000	3,050	3,100	3,150	12,300
Engine	-	-	-	-	-	-	-	-	1,700	1,700	1,850	1,900	1,950	2,000	7,700
Kitting	-	-	-	-	-	-	277	1,406	1,517	3,200	1,525	1,550	1,575	1,600	6,250
Total	14,325	14,639	16,052	17,817	62,833	15,453	13,360	15,154	19,683	63,650	18,275	18,950	20,125	21,100	78,450

Components	Gross Profit (\$ in thousands)														
	1Q13A	2Q13A	3Q13A	4Q13A	FY13A	1Q14A	2Q14A	3Q14A	4Q14E	FY14E	1Q15E	2Q15E	3Q15E	4Q15E	FY15E
Components	1,460	1,599	1,926	1,320	6,305	1,285	1,285	1,744	1,794	6,108	1,476	1,566	1,746	1,890	6,678
Specialty welding	849	894	953	786	3,482	838	1,108	815	954	3,715	981	994	1,007	1,020	4,002
Landing gear	1,338	1,137	864	2,109	5,448	1,922	819	284	1,128	4,153	1,167	1,186	1,206	1,225	4,785
Engine	-	-	-	-	-	-	-	-	287	287	324	342	361	380	1,407
Kitting	-	-	-	-	-	-	141	714	772	1,627	776	789	802	814	3,181
Total	3,647	3,630	3,743	4,215	15,235	4,045	3,353	3,557	4,935	15,890	4,723	4,877	5,121	5,330	20,052

Components	Gross Margin														
	1Q13A	2Q13A	3Q13A	4Q13A	FY13A	1Q14A	2Q14A	3Q14A	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%	24.4%	26.5%	26.5%	26.5%	26.5%	26.5%	26.5%	26.5%
Landing gear	36.1%	36.2%	36.1%	42.5%	38.4%	38.4%	37.5%	38.9%	38.9%	38.4%	38.9%	38.9%	38.9%	38.9%	38.9%
Engine	-	-	-	-	-	-	-	-	16.9%	16.9%	17.5%	18.0%	18.5%	19.0%	18.3%
Kitting	-	-	-	-	-	-	50.9%	50.8%	50.9%	50.8%	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%	23.5%	25.1%	25.0%	25.8%	25.7%	25.4%	25.3%	25.6%

Source: Company filings and Taglich Brothers' estimates

FY14 - We lowered our revenue projection to \$63.7 million from \$67.8 million and our net income projection to \$2.2 million or \$0.32 per share from \$2.7 million or \$0.40 per share to reflect 3Q14 results and the adverse effects from the delayed Navy orders. The reduction should be offset in part by the contribution from the 4Q14 acquisition of AMK. We project gross margins of 25%, up from 24.2% in 2013 due primarily to the inclusion of higher margin kitting sales.

The recent acquisitions should increase operating expenses to \$12.1 million from \$10.6 million resulting in operating margins of 5.9%. 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 14% to reflect the \$0.8 million total tax benefits realized in 2Q14 and 3Q14.

We project \$5.3 million cash from operations consisting of cash earnings of \$6.4 million and increases in working capital of \$1.1 million. The increase in working capital is primarily due to decreased taxes payable. Private placement proceeds and the recent loan (October 2014) should cover acquisition costs and dividend payments, resulting in a \$4.2 million increase in cash to \$4.7 million at year-end 2014.

FY15 – Our revenue projection is relatively unchanged at \$78.5 million as a full year's inclusion from AMK offsets lower organic sales and reduced expectations from Miller Stuart. While our revenue projection is unchanged, our net income projection has been lowered to \$3.7 million or \$0.50 per share from \$4 million or \$0.53 per share to reflect AMK's lower margins.

Although AMK sales will put pressure on margins, a greater mix of higher margin kitting sales should boost margins to 25.6% from 25%. Operating margins are projected to increase to 9.2% from 5.9% 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 million cash from operations consisting of cash earnings of \$8.3 million and increases in working capital of \$6.3 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, resulting in a \$3.1 million decrease in cash to \$1.6 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 6.3 million shares in the float and the average daily volume is approximately 9,600 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, Inc.

Consolidated Balance Sheets
(in thousands \$)

	2012A	2013A	9/14A	2014E	2015E
Cash and cash equivalents	490	561	1,568	4,725	1,576
Accounts receivable	11,631	8,584	8,806	8,696	10,718
Inventory	26,739	26,222	30,686	26,311	32,172
Deferred tax asset	-	1,051	1,310	1,310	1,310
Prepaid expenses and other current assets	546	510	209	209	209
Deposits - vendors	133	-	-	-	-
Total current assets	39,539	36,928	42,579	41,251	45,985
Property and equipment, net	5,883	6,523	5,743	12,653	10,417
Capitalized engineering costs	802	752	693	324	-
Deferred financing costs	590	605	680	680	680
Intangible assets	5,889	4,726	3,854	3,562	2,398
Deferred tax asset	-	185	947	947	969
Goodwill	453	453	4,620	4,620	4,620
Total assets	53,156	50,172	59,116	64,037	65,069
Notes payable and capitalized lease obligations	19,211	14,969	16,315	16,315	16,315
Accounts payable and accrued expenses	7,077	6,855	6,280	6,878	8,410
Lease impairment	85	71	60	60	60
Deferred gain on sale	38	38	38	38	38
Customer deposits	-	251	174	174	174
Dividends payable	-	717	-	1,064	1,064
Income taxes payable	1,448	1,496	382	382	382
Total current liabilities	27,859	24,397	23,249	24,911	26,443
Long-term debt	4,640	2,527	3,191	6,691	6,691
Lease impairment	127	56	12	12	12
Deferred gain on sale	485	447	418	418	418
Deferred rent	1,057	1,132	1,189	1,189	1,189
Total liabilities	34,168	28,559	28,059	33,221	34,753
Total stockholders' equity*	18,988	21,613	31,057	30,815	30,315
Total liabilities & stockholders' equity	53,156	50,172	59,116	64,037	65,069

*2014 includes \$2.2 M add'l paid-in-capital related to acquisitions and debt conversions

Source: Company filings and Taglich Brothers' estimates

Air Industries Group, Inc.

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

	<u>2012A</u>	<u>2013A</u>	<u>2014E</u>	<u>2015E</u>
Net sales	64,215	62,833	63,650	78,450
Cost of sales	<u>49,357</u>	<u>47,598</u>	<u>47,760</u>	<u>58,398</u>
Gross profit	14,858	15,235	15,890	20,052
Operating expenses	<u>8,874</u>	<u>10,622</u>	<u>12,109</u>	<u>12,800</u>
Operating income	5,984	4,613	3,781	7,252
Interest and financing costs	(1,843)	(1,340)	(1,162)	(1,180)
Other (expense) income	<u>(146)</u>	<u>296</u>	<u>(54)</u>	<u>40</u>
Income before taxes	3,995	3,569	2,565	6,112
Income tax (benefit)	<u>1,447</u>	<u>(170)</u>	<u>358</u>	<u>2,445</u>
Net Income / (Loss)	<u>2,548</u>	<u>3,739</u>	<u>2,207</u>	<u>3,667</u>
EPS	<u>0.54</u>	<u>0.63</u>	<u>0.32</u>	<u>0.50</u>
Shares Outstanding	4,759	5,933	6,878	7,400
<u>Margin Analysis</u>				
Gross margin	23.1%	24.2%	25.0%	25.6%
Operating margin	9.3%	7.3%	5.9%	9.2%
Net margin	4.0%	6.0%	3.5%	4.7%
Tax rate	36.2%	(4.8)%	14.0%	40.0%
<u>Year / Year Growth</u>				
Total Revenues	19.5%	(2.2)%	1.3%	23.3%
Net Income	13.4%	46.7%	(41.0)%	66.1%
EPS	(14.7)%	17.7%	(49.1)%	54.4%

Source: Company filings and Taglich Brothers' estimates

Air Industries Group, Inc.

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

	<u>3/13A</u>	<u>6/13A</u>	<u>9/13A</u>	<u>12/13A</u>	<u>2013A</u>	<u>3/14A</u>	<u>6/14A</u>	<u>9/14A</u>	<u>12/14E</u>	<u>2014E</u>	<u>3/15E</u>	<u>6/15E</u>	<u>9/15E</u>	<u>12/15E</u>	<u>2015E</u>
Net sales	14,325	14,639	16,052	17,817	62,833	15,453	13,360	15,154	19,683	63,650	18,275	18,950	20,125	21,100	78,450
Cost of sales	<u>10,678</u>	<u>11,009</u>	<u>12,309</u>	<u>13,602</u>	<u>47,598</u>	<u>11,408</u>	<u>10,007</u>	<u>11,597</u>	<u>14,748</u>	<u>47,760</u>	<u>13,552</u>	<u>14,073</u>	<u>15,004</u>	<u>15,770</u>	<u>58,398</u>
Gross profit	3,647	3,630	3,743	4,215	15,235	4,045	3,353	3,557	4,935	15,890	4,723	4,877	5,121	5,330	20,052
Operating expenses	<u>2,469</u>	<u>2,552</u>	<u>2,712</u>	<u>2,889</u>	<u>10,622</u>	<u>2,816</u>	<u>3,096</u>	<u>2,997</u>	<u>3,200</u>	<u>12,109</u>	<u>3,200</u>	<u>3,200</u>	<u>3,200</u>	<u>3,200</u>	<u>12,800</u>
Operating income	1,178	1,078	1,031	1,326	4,613	1,229	257	560	1,735	3,781	1,523	1,677	1,921	2,130	7,252
Interest and financing costs	(385)	(393)	(281)	(281)	(1,340)	(303)	(304)	(260)	(295)	(1,162)	(295)	(295)	(295)	(295)	(1,180)
Other (expense) income	<u>(25)</u>	<u>(29)</u>	<u>(11)</u>	<u>361</u>	<u>296</u>	<u>(1)</u>	<u>(62)</u>	<u>(1)</u>	<u>10</u>	<u>(54)</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>40</u>
Income before taxes	768	656	739	1,406	3,569	925	(109)	299	1,450	2,565	1,238	1,392	1,636	1,845	6,112
Income tax (benefit)	<u>489</u>	<u>430</u>	<u>(1,795)</u>	<u>706</u>	<u>(170)</u>	<u>584</u>	<u>(725)</u>	<u>(81)</u>	<u>580</u>	<u>358</u>	<u>495</u>	<u>557</u>	<u>655</u>	<u>738</u>	<u>2,445</u>
Net Income / (Loss)	<u>279</u>	<u>226</u>	<u>2,534</u>	<u>700</u>	<u>3,739</u>	<u>341</u>	<u>616</u>	<u>380</u>	<u>870</u>	<u>2,207</u>	<u>743</u>	<u>835</u>	<u>982</u>	<u>1,107</u>	<u>3,667</u>
EPS	<u>0.05</u>	<u>0.04</u>	<u>0.43</u>	<u>0.12</u>	<u>0.63</u>	<u>0.06</u>	<u>0.09</u>	<u>0.05</u>	<u>0.12</u>	<u>0.32</u>	<u>0.10</u>	<u>0.11</u>	<u>0.13</u>	<u>0.15</u>	<u>0.50</u>
Shares Outstanding	5,810	5,789	5,854	5,933	5,933	6,125	6,598	7,389	7,400	6,878	7,400	7,400	7,400	7,400	7,400
<u>Margin Analysis</u>															
Gross margin	25.5%	24.8%	23.3%	23.7%	24.2%	26.2%	25.1%	23.5%	25.1%	25.0%	25.8%	25.7%	25.4%	25.3%	25.6%
Operating margin	8.2%	7.4%	6.4%	7.4%	7.3%	8.0%	1.9%	3.7%	8.8%	5.9%	8.3%	8.9%	9.5%	10.1%	9.2%
Net margin	1.9%	1.5%	15.8%	3.9%	6.0%	2.2%	4.6%	2.5%	4.4%	3.5%	4.1%	4.4%	4.9%	5.2%	4.7%
Tax rate	63.7%	65.5%	(242.9)%	50.2%	(4.8)%	63.1%	665.1%	(27.1)%	40.0%	14.0%	40.0%	40.0%	40.0%	40.0%	40.0%
<u>Year / Year Growth</u>															
Total Revenues	(10.7)%	(3.9)%	3.2%	2.5%	(2.2)%	7.9%	-8.7%	-5.6%	10.5%	1.3%	18.3%	41.8%	32.8%	7.2%	23.3%
Net Income	(66.0)%	(29.2)%	312.7%	(11.9)%	46.7%	22.2%	172.6%	(85.0)%	24.3%	(41.0)%	117.9%	35.6%	158.4%	27.2%	66.1%
EPS	(79.0)%	(53.7)%	308.3%	(12.7)%	17.7%	15.9%	139.1%	(88.1)%	(0.3)%	(49.1)%	80.4%	20.9%	158.0%	27.2%	54.4%

Source: Company filings and Taglich Brothers' estimates

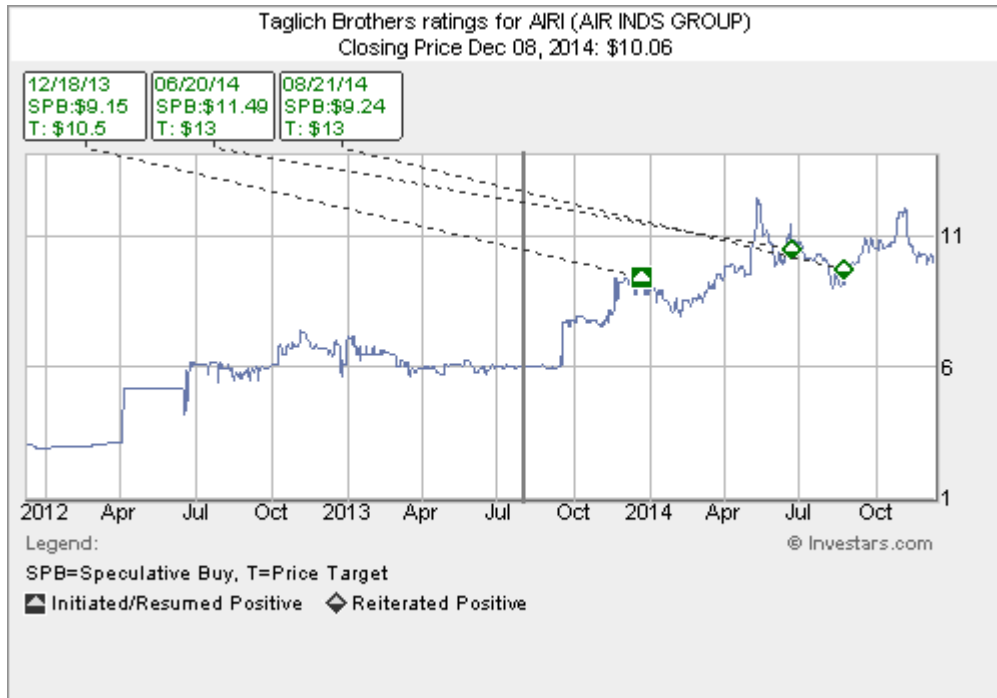
Air Industries Group, Inc.

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

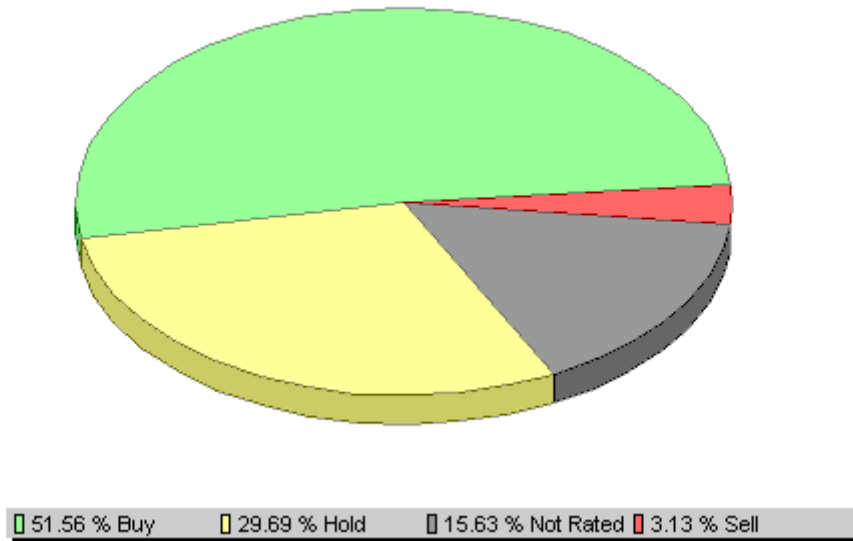
	2012A	2013A	9mos14A	2014E	2015E
Net income	2,548	3,739	1,337	2,207	3,667
Depreciation	1,557	1,709	1,680	3,323	2,736
Amortization of intangible assets	693	1,163	872	1,164	1,164
Amortization of capitalized engineering costs	459	430	306	428	324
Bad debt expense	80	394	299	299	299
Stock compensation expense	101	38	25	33	33
Amortization of deferred financing costs	52	69	33	44	44
Negative goodwill from acquisition	-	(361)	-	-	-
Gain on sale of real estate	(38)	(38)	(28)	(28)	-
Deferred income taxes	-	(1,236)	(1,021)	(1,050)	-
Adjustments to lease impairment	53	-	-	-	-
Cash earnings (loss)	5,505	5,907	3,503	6,420	8,267
<i>Changes in assets and liabilities</i>					
Accounts receivable	(4,606)	2,871	(119)	(112)	(2,022)
Inventory	1,136	440	(4,401)	(89)	(5,861)
Prepaid expenses and other current assets	(216)	35	332	301	-
Deposits	(132)	134	(1)	-	-
Other assets	51	20	(84)	(84)	-
Accounts payable and accrued expenses	(1,534)	(892)	(795)	23	1,532
Deferred rent	82	75	56	57	38
Income taxes payable	1,408	48	(1,114)	(1,114)	-
Customer deposits	-	251	(77)	(77)	-
(Increase) decrease in working capital	(3,811)	2,982	(6,203)	(1,094)	(6,313)
Net Cash Provided by Operations	1,694	8,889	(2,700)	5,326	1,955
Cash paid for acquisitions, net	(11,600)	(450)	(4,471)	(11,424)	-
Capitalized engineering costs	(292)	(380)	(247)	(330)	(330)
Purchase of property and equipment	(1,059)	(288)	(384)	(500)	(500)
Deposit for new property and equipment	(87)	-	-	-	-
Net Cash Used in Investing	(13,038)	(1,118)	(5,102)	(12,254)	(830)
Proceeds from private placement	7,115	997	9,530	9,530	-
Payment of issuance costs for private placement	(587)	-	(968)	(968)	-
Notes payable - sellers	(601)	(644)	(513)	(513)	-
Capital lease obligations	(608)	(996)	(248)	(330)	-
Notes payable - jr. subordinated debt	(115)	-	-	-	-
Notes payable - revolver	4,787	(3,637)	3,202	3,202	-
Proceeds from notes payable - term loan	3,900	-	1,328	4,828	-
Payments of notes payable - term loan	(2,153)	(1,800)	(759)	(759)	-
Cash paid for deferred financing costs	(21)	(102)	(25)	(25)	-
Payments related to lease impairment	(101)	(85)	(55)	(73)	(73)
Dividends paid	(359)	(1,433)	(2,683)	(3,800)	(4,200)
Net Cash Provided by (Used in) Financing	11,257	(7,700)	8,809	11,092	(4,273)
Net Change in Cash	(87)	71	1,007	4,164	(3,148)
Cash - Beginning of Period	577	490	561	561	4,725
Cash - End of Period	490	561	1,568	4,725	1,576

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	8
Hold	1	20
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, 12,250 stock options (right to purchase), and 41,190 warrants. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, Inc, owns or has a controlling interest in 369,998 shares of AIRI common stock, 95,715 shares of AIRI restricted stock, 12,250 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, Inc., owns or has a controlling interest in 50,554 shares of AIRI common stock, 11,500 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.