TAGLICH BROTHERS

MEMBER: FINRA, SIPC | WWW.TAGLICHBROTHERS.COM

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
December 14, 2018

AIRI $0.91 — (NYSE MKT)

	2016A	2017A	2018E	2019E
Revenues (millions)*	$51.3	$49.9	$46.7	$59.0
Earnings (loss) per share*	$(1.96)	($1.20)	($0.22)	($0.09)

52-Week range	$1.95 – $0.84	Fiscal year ends:	December
Common shares out as/of 11/16/18	27.7 million	Revenue per share (TTM)	$1.96
Approximate float	21.2 million	Price/Sales (TTM)	0.5X
Market capitalization	$25 million	Price/Sales (FY2019)E	0.5X
Tangible book value/share	$0.63	Price/Earnings (TTM)	NMF
Price/tangible book value	1.4X	Price/Earnings (FY2019)E	NMF

** Continuing operations. Excludes results of WMI.*

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. (www.airindustriesgroup.com)

Key investment considerations:

Maintaining Speculative Buy rating on Air Industries Group and establishing a twelve-month price target of $2.00 per share.

The company has made significant steps in streamlining its operations and reducing costs over the past year. While sales are down year-to-date, the cash infusion from the sale of WMI (expected in December 2018) should make a significant improvement in the company's balance sheet and allow AIRI to pay down debt and make the necessary investments in inventory to help satisfy its growing backlog ($113 million as of 10/31/2018).

In 9M18, the company's sales have suffered from bottlenecks in production related to the consolidation of two subsidiaries (AIM and NTW). With the consolidation completed at the end of October 2018, and the anticipated cash infusion from the sale of WMI, we project sales growth of over 26% and a return to positive cash flow in 2019 with cash earnings of nearly $2.3 million.

In November 2018, Air Industries announced it received a major award for landing gear components for the F-35 and F-15 aircraft. The value of the award is estimated at $22 million with deliveries to begin in 1Q19.

For 2018, we project revenue of $46.7 million and a loss from continuing operations of $5.8 million or ($0.22) per share. Gross margins should improve to 13.8% from 9.8% in 2017 reflecting improved manufacturing efficiencies.

For 2019, we project revenue of $59 million and a loss from continuing operations of $2.5 million or ($0.09) per share. Gross margins should improve to 16.4% from 13.8% in 2018 reflecting increased manufacturing overhead coverage and a full year of cost savings from the consolidation of AIM and NTW.

3Q18 revenue (10-Q released 11/19/18) decreased 19.3% to $11 million. The net loss from continuing operations was $3.1 million or ($0.05) per share versus a loss of $2.9 million or ($0.22) per share in 3Q17.

****Please view our disclosures on pages 14 - 17.***

790 New York Avenue, Huntington, N.Y. 11743
(800) 383-8464 • Fax (631) 757-1333

Recommendation and Valuation

We are maintaining our Speculative Buy rating on Air Industries Group (AIRI) and establishing a twelve-month price target of $2.00 per share.

The company has made significant steps in streamlining its operations and reducing costs over the past year. While sales are down year-to-date, the potential cash infusion from the pending sale of WMI (expected to close in December 2018) should make a significant improvement in the company's balance sheet and allow AIRI to pay down debt and make the necessary investments in inventory to help satisfy its growing backlog ($113 million as of October 31, 2018). Sales have suffered from bottlenecks in production as the company worked to consolidate two subsidiaries (AIM and NTW) over the past year. We project sales growth of over 26% and a return to positive cash flow in 2019 with cash earnings of $2.3 million should be supported by the efficiencies created by the consolidation of AIM and NTW and the cash infusion from the sale of WMI.

Shares of AIRI are trading at a multiple of 0.5X 2019 sales while the aerospace & defense industry trades at multiple of 1.3X 2019 sales. We believe AIRI's depressed multiple compared to the industry is due to disappointing sales over the past year (down 13%) versus 8% sales growth for the industry. In 2019, we project sales growth of 26.3% compared to 11.5% growth projected for the industry. We anticipate investors are likely to accord AIRI a price to sales multiple in line with the industry. We applied a multiple of 1.3X to our 2019 sales projection of $2 per share, discounted to account for execution risks, to obtain a year ahead value of approximately $2.00 per share.

Recent Developments

Major Award for F-35 and F-15 Aircraft – In November 2018, Air Industries announced it received a major award for landing gear components for the F-35 and F-15 aircraft. The value of the award is estimated at $22 million (at the mid-point of projected aircraft production). Deliveries are to begin in 1Q19 and continue for 3-years. Air Industries has already received fully funded purchase orders against this award totaling $15.5 million.

Sale of WMI – In October 2018, Air Industries and CPI Aerostructures agreed to complete (before the end of 2018) the sale of Welding Metallurgy, Inc. (WMI) to CPI Aerostructures Inc. for $9 million in cash. The results of WMI are considered to be discontinued operations under GAAP and have been presented as such in the financial statements for all periods of 2018 and 2017.

Eur-Pac Corporation Debarment – Air Industries' Eur Pac subsidiary received a notice of proposed debarment from the US Navy, its principal customer, in April 2018. Air Industries' appeal of the proposed debarment was denied in November 2018. Since the Proposed Debarment was issued, Eur Pac has been unable to take on additional contracts and has only completed contracts already in process. This has resulted in EBITDA losses at Eur Pac of approximately $(211,000) and $($361,000) for the three and nine months ended September 2018.

Management is considering several alternatives available to Eur Pac including the closing of operations. The estimated loss from disposing of the assets of Eur Pac would be immaterial.

Business Overview

Air Industries Group, headquartered in Hauppauge, New York, designs and manufactures structural aircraft parts and assemblies, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants, jet engines and other components (see picture at top right on next page).

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.

Source: Air Industries Group

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

Complex Machining accounted for 77% of 2017 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 9% of total revenue in 2017. This segment provides electromechanical systems and assemblies, and wire harness and cable assemblies to the defense and commercial aerospace industry.

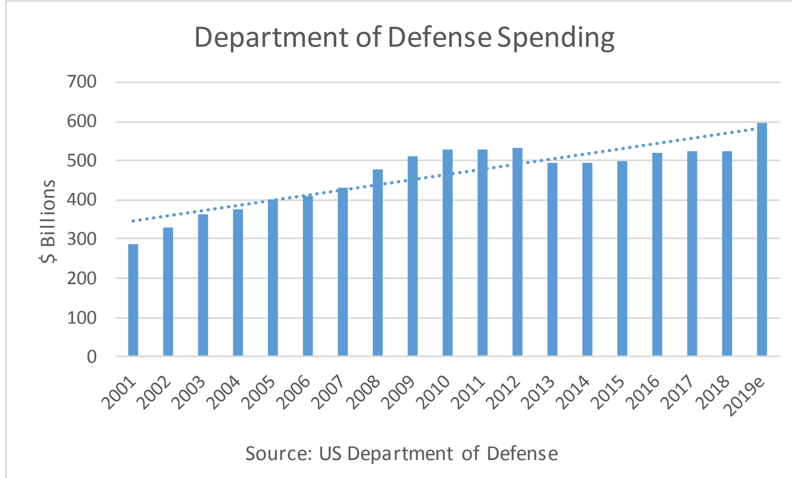
Turbine Engine Components accounted for 14% of total revenue in 2017. This segment makes components for jet engines that are used on the USAF F-15 and F-16, the Airbus A-330 and A-380, and the Boeing 777, in addition to a number of ground-power turbine applications.

Defense Spending Overview

Since 2001, 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 positioned 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 spending for 2014 and 2015 remained flat. Years of budget cuts have led to a depleted US military. In an effort to address the war readiness shortfalls and to help fund the fight against ISIS, defense spending started increasing in 2016 and is projected to continue growing through 2019 (see chart at top right on next page).

In August 2018, the US President signed into law a fiscal 2019 defense budget of $717 billion, $31 billion higher than what was originally requested. In December 2018, the US President backed plans to request $750 billion from Congress for defense spending in 2020. The $750 billion budget would be more than the $733 billion request that the Pentagon had been expected to make for fiscal 2020. This boost in defense spending over the next few years should bode well for AIRI's sales.



Military Aircraft Market and Forecast

The company operates primarily in the US military aircraft market. IBISWorld estimated the US military aircraft, engine and parts manufacturing market at $50.5 billion in 2018. IBISWorld observed that the US has the largest defense budget in the world and as a result, is the biggest consumer of defense related products.

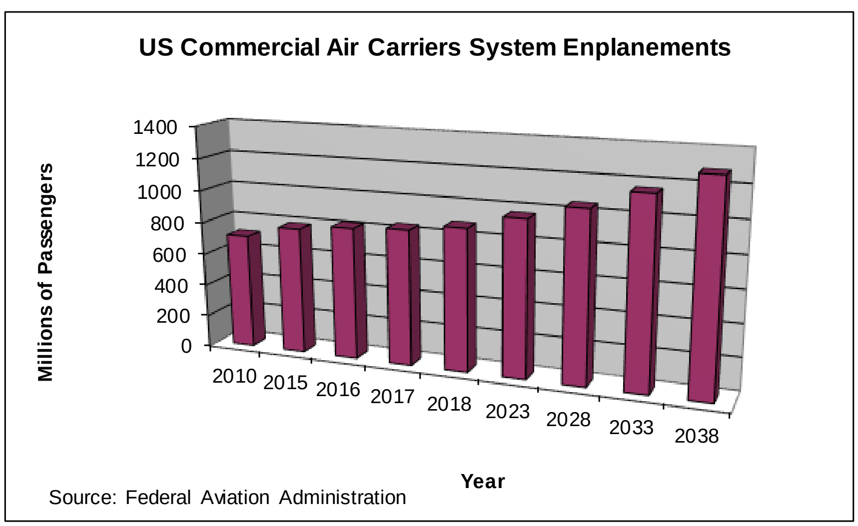
Most US defense manufacturers derive more than half of their revenue from sales to the DoD or defense-related government organizations. The US Navy is currently the largest domestic defense market as it invests in F/A-18 and F-35 fighters, maritime patrol craft, helicopters and unmanned aerial vehicles (UAVs) for both itself and the Marine Core. The US Air Force (USAF) is the second largest market for industry domestic defense sales.

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. As most of AIRI's military sales are for the repair and maintenance of existing aircraft, the category with the greatest impact on its sales is operation and maintenance spending. The latest DoD budget is for operation and maintenance (O&M) spending is expected to increase 7.7% to $215 billion in 2019 from $199.7 billion in 2018.

Commercial Aircraft Market and Forecast

Although the company's product lines primarily serve the defense market, they also serve the commercial markets. With defense budgets being under pressure since 2013, prime contractors began to shift their focus to the commercial sector. AIRI's customers (such as Boeing, United Technologies' Goodrich division, and Lockheed Martin's Sikorsky division) typically build to both military and commercial specifications.

According to the Federal Aviation Administration's (FAA) Aerospace Forecast 2018-2038, the number of passengers flying US commercial air carriers is projected to increase steadily throughout its forecast horizon. The FAA is forecasting steady US carrier passenger growth of 1.8% per year on average over the next ten years (see chart at right). Driving this growth will be a rise in economic activity. The FAA cited economic forecasts from IHS Global Insight, Inc. for US GDP growth to average 2% annually from 2018 to 2028.



Competition

The company's ability to obtain contracts requires providing quality products at competitive prices. In an effort to effectively compete, AIRI strives to continuously improve its capabilities and develop long-term relationships with its customers through establishing and maintaining advanced quality approvals, 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 include Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group, Heroux Aerospace, and Ellanef Manufacturing, a division of Magellan Corporation.

Strategy

Air Industries intends to increase its business through internal growth and accretive acquisitions that is dependent, in part, on its available cash and its ability to raise funds through debt or equity financing. While the company has effectively completed several acquisitions over the past few years, its current focus is to utilize cash to pay down debt and return operations to profitability. In an effort to increase efficiency and reduce costs, the company recently (October 2018) completed its consolidation of AIM and NTW.

The aerospace and defense industries have consolidated since the 1990s with the consolidation of the prime contractors causing a similar consolidation of their suppliers. Major contractors seek to streamline supply chains by buying more complete sub-assemblies from fewer suppliers. The acquisitions made by AIRI since 2012 has enabled it to produce more complete sub-assemblies sought after by major contractors.

Economic Outlook

In October 2018, the IMF lowered its global economic growth estimate to 3.7% for both 2018 and 2019, down 0.2% for both periods from its July 2018 estimate. The downward revision was due to rising trade barriers and a reversal of capital flows to emerging economies.

The IMF kept its economic growth estimate for the US at 2.9% for 2018 but lowered its 2019 estimate to 2.5%, down 0.2% from its July 2018 estimate. While the IMF believes that economic momentum is still strong as fiscal stimulus continues to rise, the downward revision for 2019 reflects $200 billion in tariffs on US imports from China.

The 2nd estimate of US GDP growth (released on November 28, 2018) showed the US economy grew at an annual rate of 3.5% in 3Q18, down from 4.2% in 2Q18. The 3Q18 US GDP growth estimate primarily reflects increases in consumer spending, inventory investment, government spending, and business investment.

3Q and Nine-month 2018 Financial Results

3Q18 - Total revenue decreased 19.3% to $11 million. AIRI reported a net loss from continuing operations of $1.4 million or $(0.05) per share versus a net loss of $2.9 million or $(0.22) per share in 3Q17.

The decrease in total sales reflects reductions in all three of the company's operating segments. Complex Machining sales decreased 5% to $9.7 million, Aerostructures & Electronics sales decreased 83.2% to $310,000, and Turbine Engine Components sales decreased 36.7% to $1 million.

The decrease in Complex Machining sales resulted from production disruptions from the ongoing consolidation of Nassau Tool Works (NTW) and Air Industries Machining (AIM). The decrease in Aerostructures and Electronics sales resulted from a decline at its Eur-Pac (EPC) operations. The decrease in Turbine Engine Components sales resulted from a lack of new bookings.

Gross profit decreased by $197,000 or 12.7% to $1.4 million while gross margins increased to 12.3% from 11.4%. Operating (SG&A) expenses decreased by 21.2% to $2 million due primarily to reduced salary, professional and amortization expenses. The decrease in operating expenses resulted in the operating loss narrowing to $615,000 from $950,000. Interest expense decreased to $833,000 from $1.9 million.

Nine-months 2018 - Total revenue decreased 12.5% to $35.2 million. AIRI reported a net loss from continuing operations of $4.6 million or $(0.17) per share versus a net loss of $7.2 million or $(0.47) per share in 9M17. The net loss in 9M17 included $913,000 or $(0.07) per share of preferred stock dividends.

The decrease in total sales was primarily due to reductions in all three of the company's operating segments. Complex Machining sales decreased 1.7% to $30 million, Aerostructures & Electronics sales decreased 62.3% to $1.6 million, and Turbine Engine Components sales decreased 34.3% to $3.6 million.

The reduced sales at the company's Aerostructures & Electronics segment was primarily due to reduced sales at Eur-Pac (EPC). In 2017, EPC delivered the majority of a single $3 million order. The decrease in Turbine Engine Components sales was partially due to the sale of AMK in January 2017, which had sales of $417,000 in 2017. The balance of the decrease resulted from a lack of new billings at Sterling Engineering.

Gross profit decreased by $580,000 or 10.5% to $5 million while gross margins increased to 14.1% from 13.7%. Operating (SG&A) expenses decreased by 14% to $7.2 million due primarily to reduced salary and amortization expenses. The decrease in operating expenses resulted in the operating loss narrowing to $2.3 million from $2.9 million. Interest expense decreased to $2.5 million from $3.6 million.

Income Statement
(in thousands $)

	9M18A	9M17A
Complex Machining	30,022	30,562
Aerostructures & Electronics	1,585	4,204
Turbine Engine Components	3,593	5,469
Total sales	35,200	40,235
Cost of sales	30,249	34,704
Gross profit	4,951	5,531
Operating expenses	7,238	8,419
Operating income	(2,287)	(2,888)
Interest and financing costs	(2,471)	(3,633)
Other (expense) income	175	65
Income before taxes	(4,583)	(6,456)
Income tax (benefit)	2	(170)
Net income / (loss)	(4,585)	(6,286)
Preferred stock dividends	-	(913)
Net income/(loss) to common	(4,585)	(7,199)
EPS*	(0.17)	(0.47)
Shares Outstanding	26,296	13,463
Margin Analysis		
Gross margin	14.1%	13.7%
Operating margin	(6.5)%	(7.2)%
Tax rate	(0.0)%	2.6%
Year / Year Growth		
Total Revenues	(12.5)%	
Net Income	NMF	
EPS	NMF	

*Continuing operations. Excludes results of WMI.
Source: Company filings

Liquidity - As of September 30, 2018, the company had $917,000 cash and a current ratio of 1.3X, in line with the aerospace and defense industry. Total debt was approximately $30 million (of which $24 million is classified as current) for a debt/equity ratio of 1.7X, in line with the aerospace and defense industry.

In 9M18, cash used in operations was $2.9 million consisting of cash earnings of $542,000 and a $3.4 million increase in working capital. Working capital increased primarily due to a decrease in payables and accruals and an increase in deposits. Cash used in investing was $1 million consisting of $400,000 of capitalized engineering costs and $629,000 of capital expenditures. Cash provided by financing of $4.2 million consisted primarily of proceeds from the issuance of debt and equity offset in part by debt repayments. Cash increased by $287,000 to $917,000 at September 30, 2018.

The company's loan facility provides for a $20 million revolving loan and a term loan with a balance of $2.4 million at September 30, 2018. Under the terms of the loan facility, the revolving and term loans bear interest at an alternate base rate plus 3% with respect to domestic rate loans, and the Eurodollar rate plus 4.5% with respect to Eurodollar rate loans. The amount outstanding under the revolving loan was $22.4 million as of September 30, 2018. The amount outstanding under the term loan was $2.4 million as of September 30, 2018. Both the revolving loan and the term loan mature on December 31, 2018 and are classified with the current portion of notes and capital lease obligations. If the company is unsuccessful at renegotiating and extending these loans, it would be considered to be in default which would likely have an adverse effect on the company's operations. As of September 30, 2018, the company was in compliance with its loan covenants.

As of September 30, 2018, capitalized lease obligations totaled $2.1 million, 8% convertible notes payable totaled $2.6 million, and related party notes payable totaled $2.9 million (payable at the rate of 1% per month).

Projections

AIRI's backlog from continuing operations remains strong at approximately $113 million at October 31, 2018. The company continues to focus on implementing operational efficiencies and has reduced annual operating expenses by over $5 million since 2016. Consolidation of AIM and Nassau Tool Works (completed at the end of October 2018) and cost reductions should enable the company to generate cash earnings in 2018 and 2019.

The following table provides a segmented breakdown of Air Industries' 2016 and 2017 actual sales and our projections for 2018 and 2019. Air Industries Machining (AIM) and Nassau Tool Works (NTW) are classified under AIRI's Complex Machining segment, EUR-PAC, and Compac are classified under AIRI's Aerostructures and Electronics segment while Sterling is classified under AIRI's Turbine Engine Components segment.

	Sales ($ in thousands)											
	2016A*	2017A*	1Q18A	2Q18A	3Q18A	4Q18E	2018E	1Q19E	2Q19E	3Q19E	4Q19E	2019E
Complex Machining	37,124	38,489	10,627	9,705	9,690	9,810	39,832	10,661	11,941	13,220	14,500	50,322
Aerostructures & Electronics	3,224	4,574	333	942	310	520	2,105	563	630	698	765	2,656
Turbine Engine Components	10,973	6,806	1,282	1,268	1,043	1,170	4,763	1,276	1,429	1,582	1,735	6,022
Total	51,321	49,869	12,242	11,915	11,043	11,500	46,700	12,500	14,000	15,500	17,000	59,000

*Restated for sale of WMI
Source: Company filings and Taglich Brothers' estimates

<u>2018</u> – We project revenue of $46.7 million and a net loss from continuing operations of $5.8 million or ($0.22) per share. Gross margins should improve to 13.8% from 9.8% in 2017 reflecting improved manufacturing efficiencies.

We forecast a $2.2 million decrease in SG&A expenses to $9.2 million due primarily to a full year of cost reductions that were instituted during 2017 and savings from the plant consolidation of AIM and Nassau Tool Works. We project an operating loss of $2.8 million from an operating loss of $12.8 million in 2017 with margins narrowing to (6)% from (25.6)%. Interest expense is projected to decrease to $3.2 million from $3.4 million due to lower average debt levels. We project the company paying minimal taxes.

We project $3.3 million cash used in operations from cash earnings of $510,000 and a $3.8 million increase in working capital. The increase in working capital should be primarily due to an increase in receivables and deposits and other assets. Proceeds from the sale of WMI (expected in December 2018) and the issuance of stock should more than offset cash used in operations and debt repayments, increasing cash by $2.3 million to $2.9 million by the end of 2018.

<u>2019</u> – We project revenue of $59 million and a net loss from continuing operations of $2.5 million or ($0.09) per share. Gross margins should improve to 16.4% from 13.8% in 2018 reflecting increased manufacturing overhead coverage and a full year of cost savings from the consolidation of AIM and NTW.

We forecast a $262,000 increase in SG&A expenses to $9.5 million as increased compensation costs are offset in part by continued cost controls. We project operating income of $200,000 compared to an operating loss of $2.8 million in 2018 with margin improvement to 0.3% from (6)%. Interest expense is projected to decrease to $2.7 million from $3.2 million due to lower average debt levels. We project the company paying no taxes.

We project $578,000 million in cash from operations on cash earnings of $2.3 million offset in part by a $1.7 million increase in working capital. The increase in working capital should be primarily due to increases in inventory and receivables, offset in part by and an increase in payables. Cash from operations should not cover capital expenditures and repayments of debt necessitating raising $1 million from the issuance of stock. We project a $2 million decrease in cash to $866,000 by the end of 2019.

Risks

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

Going concern issues – Air Industries suffered net losses from continuing operations of $4.6 million and $15.9 million, respectively, for the nine months ended September 30, 2018, and the year ended December 31, 2017. The company also had negative cash flows from operations for the nine months ended September 30, 2018 and year ended December 31, 2017. Air Industries' auditors for the year ended December 31, 2017 said that the company's loss from operations and negative cash flows from operations, among other reasons, raised substantial doubt about the company's ability to continue as a going concern.

Reliance on government spending - AIRI's sales are primarily derived from products for US military aviation. Reductions in US Government spending on defense or future changes in the mix of defense products required by US Government agencies could limit demand for the company's products, and could 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 2017, three customers accounted for 62% 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. Boeing closed its C-17 production line in 2015. 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 Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group, Heroux Aerospace, and Ellanef Manufacturing, a division of Magellan Corporation.

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

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

Material weakness in disclosure controls and procedures – As of September 30, 2018, AIRI's disclosure controls and procedures were not effective due to certain portions of AIRI's inventory control system not being integrated into the system used by others in the company which could result in a failure to properly account for the costs associated with work in process. Slow moving inventory, the value of inventory on hand, and the system used to track employee costs to be included in work in process, is not sufficiently automated to ensure compliance.

Legal proceedings – Contract Pharmacal Corp. commenced an action in October 2018 relating to a sublease entered into between AIRI and Contract Pharmacal in May 2018 with respect to property occupied by WMI in

Hauppauge, New York. In the action Contract Pharmacal seeks damages and an order directing that AIRI make all of the space referenced in the sublease available to Contract Pharmacal. Air Industries disputes the validity of the claims asserted by Contract Pharmacal and intends to contest the action.

In October 2018, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging that the proxy statement for AIRI's 2017 annual meeting contained false and misleading misstatements relating to whether brokers had discretionary authority to vote the shares of their customers in connection with a proposal to increase the number of shares authorized to issue. The plaintiff seeks to void the amendment and rescind any shares issued using the shares authorized by the amendment. AIRI believes it has a meritorious defense to the claim and intends to contest it vigorously. Given the uncertainty of litigation, the preliminary stage of the case, and the legal standards that must be met, the company cannot estimate the reasonably possible loss or range of loss, if any, that may result from this action.

Sale of WMI – Our projections are predicated on the sale of WMI in December 2018. If the sale does not transact as expected or at all, it is likely that our projections will change.

Bank loans - The company's revolving loan ($22.4 million outstanding) and term loan ($2.4 million outstanding) mature on December 31, 2018. If the company is unsuccessful at renegotiating and extending these loans, it would be considered to be in default which would likely have an adverse effect on the company's operations.

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 21.2 million shares in the float and the average daily volume is approximately 41,000 shares.

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

Consolidated Balance Sheets
(in thousands $)*

	2016A	2017A	9/18A	2018E	2019E
Cash and cash equivalents	1,304	630	917	2,898	866
Accounts receivable	6,073	5,464	6,713	7,135	9,014
Inventory	32,568	31,141	30,949	30,965	32,867
Prepaid expenses and other current assets	299	214	190	190	190
Assets held for sale	21,297	10,082	12,341	-	-
Prepaid taxes	409	49	49	49	49
Total current assets	61,950	47,580	51,159	41,237	42,986
Property and equipment, net	11,197	10,050	8,638	8,001	6,506
Capitalized engineering costs	1,627	2,188	2,095	2,073	1,958
Deferred financing costs	1,088	665	848	848	848
Intangible assets	471	-	-	-	-
Goodwill	6,467	272	272	272	272
Total assets	**82,800**	**60,755**	**63,012**	**52,431**	**52,570**
Notes payable and capitalized lease obligations	33,999	23,393	24,047	17,047	16,047
Accounts payable and accrued expenses	14,150	10,872	10,070	10,064	12,325
Deferred gain on sale	38	38	38	38	38
Deferred revenue	946	931	865	865	865
Liabilities associated with assets held for sale	4,235	2,795	3,327	-	-
Income taxes payable	20	20	20	20	20
Total current liabilities	53,388	38,049	38,367	28,034	29,295
Long-term debt	2,971	3,448	5,967	5,967	5,967
Deferred gain on sale	333	295	266	266	266
Deferred rent	1,218	1,197	1,173	1,173	1,173
Total liabilities	**57,910**	**42,989**	**45,773**	**35,440**	**36,701**
Preferred stock	**1**	**-**	**-**	**-**	**-**
Common equity	**24,889**	**17,766**	**17,239**	**16,991**	**15,869**
Total stockholders' equity**	**24,890**	**17,766**	**17,239**	**16,991**	**15,869**
Total liabilities & stockholders' equity	**82,800**	**60,755**	**63,012**	**52,431**	**52,570**

* Continuing operations. Excludes results of WMI.
**Includes $1.7 million additional paid-in capital related to the fair value allocation of warrants
Source: Company filings and Taglich Brothers estimates

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

	2016A	2017A	2018E	2019E
Net sales	51,321	49,869	46,700	59,000
Cost of sales	47,052	45,002	40,254	49,300
Gross profit	4,269	4,867	6,446	9,700
Impairment of goodwill	-	6,195	-	-
Operating expenses	14,404	11,430	9,238	9,500
Operating income (loss)	(10,135)	(12,758)	(2,792)	200
Interest and financing costs	(2,500)	(3,378)	(3,211)	(2,732)
Loss on extinguishment of debt	-	(112)	-	-
Gain (loss) on sale of subsidiary	-	200	-	-
Other (expense) income	(131)	(22)	235	-
Income (loss) before taxes	(12,766)	(16,070)	(5,768)	(2,532)
Income tax (benefit)	2,101	(197)	2	-
Net income / (loss)	(14,867)	(15,873)	(5,770)	(2,532)
EPS*	(1.96)	(1.20)	(0.22)	(0.09)
Shares Outstanding	7,579	13,231	26,707	29,500
Margin Analysis				
Gross margin	8.3%	9.8%	13.8%	16.4%
Operating margin	(19.7)%	(25.6)%	(6.0)%	0.3%
Net margin	(29.0)%	(31.8)%	(12.4)%	(4.3)%
Tax rate	(16.5)%	1.2%	0.0%	0.0%
Year / Year Growth				
Total Revenues		(2.8)%	(6.4)%	26.3%
Net Income		NMF	NMF	NMF
EPS		NMF	NMF	NMF

*Continuing operations. Excludes results of WMI.
Source: Company filings and Taglich Brothers estimates

Quarterly Income Statements
(in thousands $)*

	3/18A	6/18A	9/18A	12/18E	2018E	3/19E	6/19E	9/19E	12/19E	2019E
Net sales	12,242	11,915	11,043	11,500	46,700	12,500	14,000	15,500	17,000	59,000
Cost of sales	10,239	10,327	9,683	10,005	40,254	10,750	11,830	12,865	13,855	49,300
Gross profit	2,003	1,588	1,360	1,495	6,446	1,750	2,170	2,635	3,145	9,700
Impairment of goodwill	-	-	-	-	-	-	-	-	-	-
Operating expenses	2,616	2,647	1,975	2,000	9,238	2,150	2,300	2,450	2,600	9,500
Operating income (loss)	(613)	(1,059)	(615)	(505)	(2,792)	(400)	(130)	185	545	200
Interest and financing costs	(777)	(861)	(833)	(740)	(3,211)	(713)	(693)	(673)	(653)	(2,732)
Loss on extinguishment of debt	-	-	-	-	-	-	-	-	-	-
Gain (loss) on sale of subsidiary	-	-	-	-	-	-	-	-	-	-
Other (expense) income	16	71	88	60	235	-	-	-	-	-
Income (loss) before taxes	(1,374)	(1,849)	(1,360)	(1,185)	(5,768)	(1,113)	(823)	(488)	(108)	(2,532)
Income tax (benefit)	2	-	-	-	2	-	-	-	-	-
Net income / (loss)	(1,376)	(1,849)	(1,360)	(1,185)	(5,770)	(1,113)	(823)	(488)	(108)	(2,532)
EPS*	(0.05)	(0.07)	(0.05)	(0.04)	(0.22)	(0.04)	(0.03)	(0.02)	(0.00)	(0.09)
Shares Outstanding	26,116	26,200	26,769	27,744	26,707	29,500	29,500	29,500	29,500	29,500
Margin Analysis										
Gross margin	16.4%	13.3%	12.3%	13.0%	13.8%	14.0%	15.5%	17.0%	18.5%	16.4%
Operating margin	(5.0)%	(8.9)%	(5.6)%	(4.4)%	(6.0)%	(3.2)%	(0.9)%	1.2%	3.2%	0.3%
Net margin	(11.2)%	(15.5)%	(12.3)%	(10.3)%	(12.4)%	(8.9)%	(5.9)%	(3.1)%	(0.6)%	(4.3)%
Tax rate	(0.1)%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Year / Year Growth										
Total Revenues					(6.4)%	2.1%	17.5%	40.4%	47.8%	26.3%
Net Income					NMF					NMF
EPS					NMF					NMF

*Continuing operations. Excludes results of WMI.

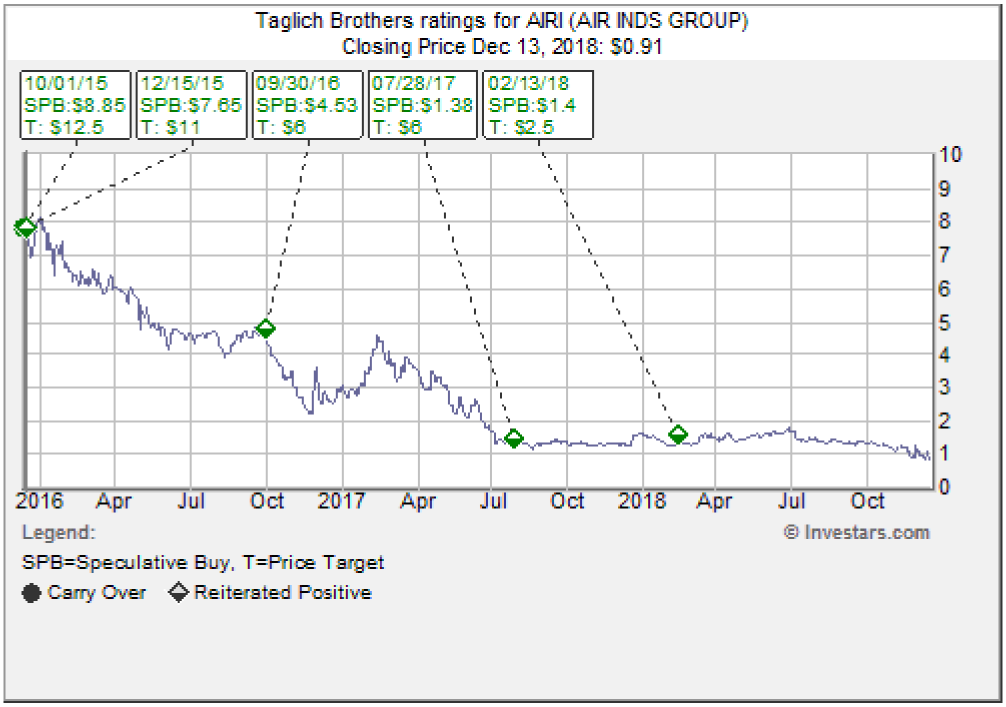
Source: Company filings and Taglich Brothers estimates

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

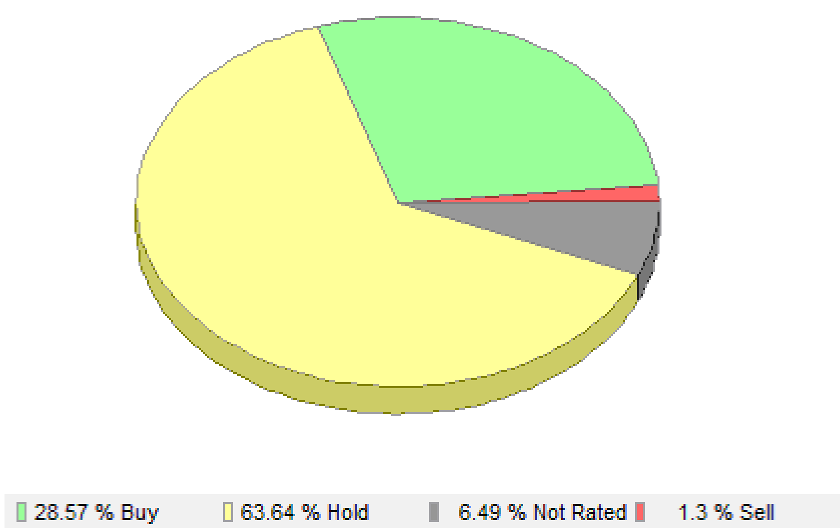
	2016A	2017A	9m18A	2018E	2019E
Net income (loss)	(15,623)	(22,551)	(4,413)	(5,770)	(2,532)
Depreciation	3,347	2,723	2,165	2,849	2,295
Amortization of intangible assets	1,279	673	-	-	-
Amortization of capitalized engineering costs	362	423	493	660	660
Loss on impairment of goodwill	-	9,612	-	-	-
Bad debt expense (recovery)	274	87	190	250	250
Stock compensation expense	167	564	308	410	410
Amortization of deferred financing costs	371	267	158	210	210
Gain on sale of real estate	(38)	(38)	(29)	(29)	-
Loss on sale of assets held for sale	5	-	930	930	-
(Gain) loss on sale of subsidiary	-	(200)	-	-	-
Deferred income taxes	2,063	-	-	-	-
Loss on impairment of intangible assets	-	1,085	-	-	-
Loss on assets held for sale	-	1,563	-	-	-
Loss on extinguishment of debt	172	112	-	-	-
Amortization of convertible notes payable	217	2,301	740	1,000	1,000
Cash earnings (loss)	(7,404)	(3,379)	542	510	2,293
Changes in assets and liabilities					
Assets held for sale	(39)	39	-	-	-
Accounts receivable	4,616	1,004	(1,167)	(1,671)	(1,879)
Inventory	(2,902)	905	(836)	176	(1,902)
Prepaid expenses and other current assets	394	281	89	24	-
Prepaid taxes	126	360	-	-	-
Deposits and other assets	(150)	(113)	(1,275)	(1,275)	-
Accounts payable and accrued expenses	4,495	(3,527)	(1,736)	(809)	2,255
Deferred rent	82	34	4	(24)	-
Income taxes payable	6	-	-	-	-
Deferred revenue	84	410	1,513	(194)	(189)
(Increase) decrease in working capital	6,712	(607)	(3,408)	(3,772)	(1,715)
Net cash provided by (used in) operations	**(692)**	**(3,986)**	**(2,866)**	**(3,262)**	**578**
Capitalized engineering costs	(963)	(985)	(400)	(533)	(533)
Purchase of property and equipment	(1,632)	(1,514)	(629)	(800)	(800)
Proceeds from sale of fixed assets	1,671	-	-	-	-
Proceeds from sale of subsidiary	-	4,260	-	9,000	-
Net cash provided by (used in) investing	**(924)**	**1,761**	**(1,029)**	**7,667**	**(1,333)**
Notes payable - revolver	(5,211)	(7,938)	3,615	3,615	-
Payments of notes payable - term loan	(3,184)	(3,178)	(1,108)	(8,108)	(1,000)
Capital lease obligations	(1,226)	(1,397)	(958)	(1,277)	(1,277)
Proceeds from notes payable - related party	4,500	2,660	803	803	-
Proceeds from notes payable	3,695	4,184	70	70	-
Payments of notes payable	-	(463)	-	-	-
Deferred financing costs	(223)	(50)	(125)	(125)	-
Expense for issuance of stock	(663)	-	-	-	-
Expense for issuance of debt	(547)	-	-	-	-
Proceeds from issuance of stock	5,250	7,733	1,885	2,885	1,000
Net cash provided by (used in) financing	**2,391**	**1,551**	**4,182**	**(2,137)**	**(1,277)**
Net change in cash	**775**	**(674)**	**287**	**2,268**	**(2,032)**
Cash - beginning of period	**529**	**1,304**	**630**	**630**	**2,898**
Cash - end of period	**1,304**	**630**	**917**	**2,898**	**866**

* Continuing operations. Excludes results of WMI.
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	**3**	**11**
Hold		
Sell		
Not Rated	**1**	**50**

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 3,713,969 shares of AIRI common stock, 1,121,334 shares that may be acquired upon the conversion of convertible notes, 573,948 shares that may be acquired upon the conversion of warrants, and 24,250 shares that may be acquired upon the conversion of stock options. In September 2015, April, May, and August 2016, and in March and May 2017, Michael Taglich loaned the company monies. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 2,265,321 shares of AIRI common stock, 688,000 shares that may be acquired upon the conversion of convertible notes, 454,931 shares that may be acquired upon the conversion of warrants, and 24,250 shares that may be acquired upon the conversion of stock options. In April and May 2016, and in February, March, and May 2017, Robert Taglich loaned the company monies. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 56,042 shares of AIRI common stock, and 23,908 shares that may be acquired upon the conversion of 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 62,012 shares of AIRI common stock, 24,250 shares that may be acquired upon the conversion of stock options, and 55,278 shares that may be acquired upon the conversion of warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 15,513 shares of AIRI common stock that may be acquired upon the conversion of warrants. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 356 shares of AIRI common stock, and 44,951 shares upon the conversion of warrants. Taglich Brothers, Inc. owns 1,030 shares of AIRI common stock. Taglich Brothers, Inc. had an investment banking relationship with the company mentioned in this report. In April and May of 2007, Taglich Brothers Inc. served as the placement agent in the sale of convertible preferred stock for the company. In June 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes for the company. In September and October of 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes and convertible preferred stock for the company. In October 2013 and May 2014, Taglich Brothers, Inc. served as the placement agent in the sale of common stock for the company. In May and June 2016, Taglich Brothers, Inc. served as the placement agent in the sale of convertible preferred stock for the company. In August, November and December 2016, and in February and March 2017, Taglich Brothers, Inc. served as the placement agent in the sale of convertible notes for the company. In May 2017, Taglich Brothers, Inc. served as a placement agent in the sale of convertible notes and warrants for the company. In January 2018, Taglich Brothers, Inc. served as a placement agent in the sale of common stock and warrants for the company.

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

General Disclosures

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

Analyst Certification

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

Public companies mentioned in this report:

Boeing (NYSE: BA)
CPI Aerostructures Inc. (NYSE MKT: CVU)
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.