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Research Report – Update

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

Air Industries Group

Speculative Buy

John Nobile
December 15, 2015

AIRI $7.65 — (NYSE MKT)

	2013A*	2014A	2015E	2016E
Revenues (millions)	$62.8	$64.3	$80.9	$90.6
Earnings (loss) per share	$0.63	$0.10	$0.02	$0.24

52-Week range	$10.97 – $6.57	Fiscal year ends:	December
Common shares out as/of 11/10/15	7.6 million	Revenue per share (TTM)	$10.42
Approximate float	6.9 million	Price/Sales (TTM)	0.7X
Market capitalization	$58 million	Price/Sales (FY2016)E	0.6X
Tangible book value/share	$2.05	Price/Earnings (TTM)	NMF
Price/tangible book value	3.7X	Price/Earnings (FY2016)E	31.9X
Annual Dividend	$0.60	Dividend Yield	7.8%

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

Air Industries Group, headquartered in Hauppauge, New York, operates primarily in the aerospace and defense industry. The company designs and manufactures structural parts and assemblies, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants, jet engines and other components. Air Industries also provides sheet metal fabrication of aerostructures, tube bending and welding services. (www.airindustriesgroup.com)

Key investment considerations:

Reiterate Speculative Buy rating but lowering twelve-month price target to $11.00 per share from $12.50 per share due to a reduction in our 2016 sales estimates.

Strategic acquisitions and a growing commercial business underlie sales growth potential in 2015 and 2016. However, that potential has been reduced by delays in the passage of a Federal budget. Congress has until December 16, 2015 to pass the total spending (appropriations) bill to avoid a government shutdown or further budget extensions.

Low sales levels have significantly reduced gross margins in AIRI's Turbine Engine Components segment. Company expectations are for orders in December 2015/January 2016 to raise margins in AIRI's Turbine Engine Components segment to the upper 20% range by 2Q16.

2016 sales should benefit from a full year's contribution from Sterling and Compac, and a potential 7% increase in Department of Defense (DoD) operation and maintenance (O&M) spending.

We have lowered our 2015 revenue projection to $80.9 million from $85.3 million and our EPS projection to $0.02 from $0.19 to reflect 3Q15 results and the adverse effects stemming from the delay in approval of the US military budget.

We project 2016 revenue of $90.6 million and EPS of $0.24, down from $96 million revenue and EPS of $0.52 to primarily reflect lower sales and margin expectations for the Turbine Engine Components segment stemming from continued delays in awards of defense contracts.

3Q15 revenue (10-Q released 11/16/15) increased 39% to $21.1 million. EPS was $0.04 versus $0.05 in 3Q14. We projected 3Q15 revenue of $23.4 million and EPS of $0.09. 3Q15 sales were supported by acquisitions that were completed in 2014 and 2015.

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

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Recommendation and Valuation

We are reiterating our Speculative Buy rating on Air Industries Group (AIRI) but lowering our twelve-month price target to $11.00 per share from $12.50 per share due to as reduction in our 2016 sales estimates.

Due to the extreme swings in the company's tax rate (from an expense of 665% to a benefit of 187% over the last two years), our valuation will be based on a price/sales multiple going forward.

Shares of AIRI are currently trading at a multiple of 0.7X trailing-twelve-month (TTM) sales, a level consistent with the aerospace & defense industry multiple (excludes market caps over $100 million). We believe the market will accord the stock a multiple of 1X sales, a premium over the industry, based largely on the strong sales growth we project for AIRI (2016 sales growth of approximately 12% vs. 7% for the industry). We applied a multiple of 1X our 2016 sales of $11.77, discounted to account for potential delays in awards of defense contracts, to obtain a year ahead value of approximately $11.00 per share.

Air Industries' valuation is likely to remain higher than the aerospace and defense industry due to higher sales growth stemming from recent acquisitions and recovering organic sales as revenue from commercial contracts ramp. However, continuing delays in passage of the Federal budget could result in revenue delays for AIRI.

Business Overview

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

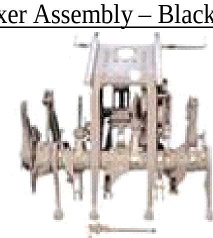
Many of the company's products influence critical aspects of aircraft performance. Air Industries is required to have advanced certifications for these products as a condition to being a supplier. Many of these products are subject to wear and tear or fatigue and are routinely replaced on aircraft at a time of service or flight cycle basis. Replacement demand should continue so long as an aircraft remains in service. This should help to lessen the effect of reductions in defense spending which have adversely affected AIRI's revenue.

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

Complex Machining accounted for 69% of 2014 revenue. Products include electromechanical devices, mixer (primary flight control) assemblies, rotor-hub components for Blackhawk helicopters, arresting gear for the E2C/D Hawkeye, C2A Greyhound and US Navy Fighters, vibration absorbing assemblies for Sikorsky helicopters, landing gear components for the F-35 Joint Strike Fighter (JSF), and many other subassembly packages.

AIRI's Complex Machining segment also manufactures complete landing gear assemblies and landing gear components for the US Air Force F-16 Fighting Falcon and the US Navy's F-18 Hornet aircraft. The company specializes in deep hole gun-drilling (a process that produces deep, straight holes in a variety of materials) and trepanning (the removal of a disk or cylindrical core from metal) and performs sub-contract machining services for prime contractors in the defense and aerospace industries.

Mixer Assembly – Blackhawk



E-2D Landing Gear

Source: Air Industries Group, Inc.

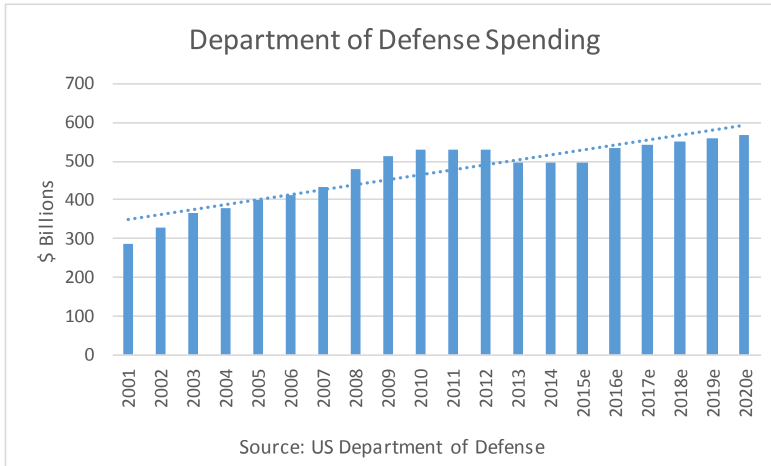
Aerostructures and Electronics accounted for 28% of total revenue in 2014. This segment provides specialty welding services and metal fabrications, electromechanical systems and assemblies, and wire harness and cable assemblies to the defense and commercial aerospace industry.

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

Defense Spending Overview

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

Changes in defense spending are likely to directly impact AIRI's revenues. US defense spending increased through much of the post-9/11 decade and peaked in 2012 at over $530 billion. However, budget cuts reduced defense spending by 7% to $495.5 billion in 2013 and spending for 2014 and 2015 remained flat. Defense spending is projected to increase through 2020 (see chart at right), but at this writing, Congress has not yet agreed to a FY2016 Federal budget.



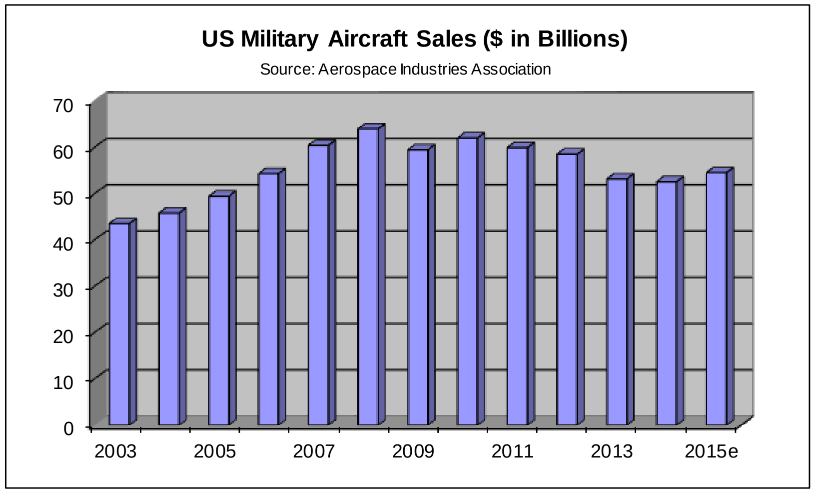
The Federal budget process begins with the President submitting a comprehensive budget request in early February outlining the Administration's policy and funding priorities for the coming fiscal year (October 1 to September 30). Congress then holds hearings on the President's budget and drafts a budget resolution (independent of the President's budget) that sets how they believe monies should be allocated for the next fiscal year. The budget resolution is sent to an appropriations committee which considers how monies for twelve annual spending bills (includes defense budget) will be allocated. Once Congress has passed all of the spending bills, they are sent to the President to be signed into law, however, as history has proved, this process is susceptible to delays.

The latest defense spending budget marks the seventh year in a row that Congress has failed to pass a defense appropriations bill in time for the fiscal year (which starts on October 1st). Also, should the programs or funding levels approved by Congress vary too greatly from those set by the President in his budget proposal, the President could veto one or all of the spending bills which could delay the process further.

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

Military Aircraft Market and Forecast

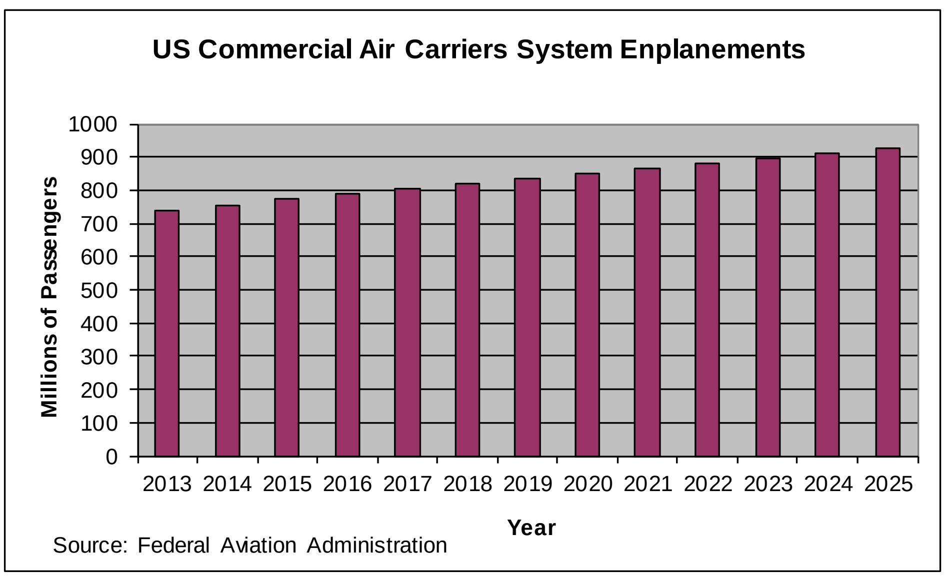
Over 90% of Air Industries' revenue is derived from sales to the US military aircraft market. The latest report from the Aerospace Industries Association (AIA) is for US military aircraft sales to total $54.5 billion in 2015, up 4% from 2014 but down 15% from the peak in 2008 (see chart at top right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



The four largest components of the DoD's spending budget are in operation and maintenance (largest component), military personnel, procurement, and research, development, test & evaluation (RDT&E). As over 90% of AIRI's military sales are for the repair and maintenance of existing aircraft, the category with the greatest impact on AIRI's sales is operation and maintenance spending. The latest (February 2015) DoD budget for operation and maintenance (O&M) spending is for a 1% increase in 2015 followed by a 7% increase in 2016. However, recent contracts should boost AIRI's military sales by 12% in 2015 (excluding acquisitions) and increased O&M spending should boost sales by 7% in 2016. We project AIRI's organic military sales increasing to approximately $62.5 million in 2015 (we expect commercial sales from a 2013 order to be minimal at approximately $750,000), increasing to $67.9 million in 2016.

Commercial Aircraft Market and Forecast

In 2000, commercial aircraft parts accounted for approximately 60% of AIRI's total revenue. AIRI'S customers began shifting to defense after September 11, 2001 resulting in approximately 90% of AIRI'S total revenue coming from defense and less than 10% from the commercial aircraft market in 2014. Although the company's product lines primarily serve the defense market, they also serve the commercial markets. With defense budgets being under pressure over the last three years, prime contractors began to shift their focus to the commercial sector. AIRI's customers (such as Boeing and United Technologies' Sikorsky and Goodrich divisions) typically build to both military and commercial specifications.



According to the Federal Aviation Administration's (FAA) Aerospace Forecast 2015-2025, the number of passengers flying US commercial air carriers is projected to increase steadily throughout its forecast horizon. The FAA is forecasting US carrier passenger growth over the next ten years to average two percent per year (see chart at 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 2.6% annually from 2016 to 2019, slowing to 2.4% from 2020 to 2025.

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

Competition

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

A new contract is usually obtained through competitive bidding against other qualified subcontractors. Follow-on contracts are usually obtained by successfully performing initial contracts. The company's long term business generally benefits from barriers to entry such as advanced quality approvals and certifications, and tooling investments that are difficult and expensive to duplicate. But, many of the company's competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers.

Air Industries' competitors include Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group (TTM revenues of $4B), Heroux-Devtek (TTM revenues of $289M), and Ellanef Manufacturing, a division of Magellan Corporation.

Strategy

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

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

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

	Sales (in thousands $)		
	2014A	2015E	2016E
Woodbine	1,047	852	912
Eur-Pac	2,756	4,359	4,664
ECC	281	672	719
Compac	-	344	1,104
AMK	1,838	4,057	4,341
Sterling	-	7,360	9,450
Organic	58,409	63,243	69,420
Total sales	$64,331	$80,887	$90,610

Source: Company reports and Taglich Brothers' estimates

The aerospace and defense industries have consolidated since the 1990s. The consolidation of the prime contractors has caused a similar consolidation of their suppliers. Major contractors seek to streamline supply chains by buying both larger quantities and more complete sub-assemblies from fewer suppliers. Air Industries' acquisitions are part of the company's strategy to grow in this market. AIRI is now producing more complete sub-assemblies sought after by major contractors and sales have grown at a compound annual growth rate of 9% over the past six years due to strategic acquisitions.

Economic Outlook

In October 2015, the International Monetary Fund (IMF) raised its economic growth estimate for the US to 2.6% in 2015 from 2.5% previously (July 2015), but lowered it to 2.8% in 2016 from 3%. The IMF said that US economic growth in the first half of 2015 was weaker than expected, despite a strong second quarter. This reflected setbacks to activity in the first quarter, notably harsh winter weather and port closures, as well as much lower capital spending in the oil sector. The IMF expects the recovery to continue in the US, supported in part by lower energy prices and an improving housing market.

The second estimate of US GDP growth (released on November 24, 2015) showed the US economy grew at an annual rate of 2.1% in 3Q15, up from the October 2015 estimate of 1.5%. The 3Q15 US GDP growth estimate primarily reflects a rise in consumer spending. Spending on nondurable and durable goods also rose. Partly offsetting these contributions to GDP growth was falling private inventory investment, mainly in manufacturing.

The latest fiscal 2016 Pentagon budget is higher than the cap set in the Budget Control Act of 2011 (roughly $500 billion). In November 2015, the President signed a bill that boosts the defense spending base budget to $548 billion in fiscal 2016 and $551 billion in fiscal 2017. However, Congress has until December 11, 2015 to pass the broader (omnibus appropriations) bill that includes the already passed increased defense spending bill along with other bills yet to be passed in order to avoid a government shutdown. If the appropriations bill is not passed by December 11, 2015, it would necessitate a short-term funding bill in order to keep the government funded.

3Q and Nine-Months 2015 Financial Results

3Q15 - Total revenue increased 39% to $21.1 million. The increase in total sales was primarily due to acquisitions completed in 2014. Net income was $337,000 or $0.04 per share versus net income of $380,000 or $0.05 per share in 3Q14. We projected 3Q15 revenue of $23.4 million and net income of $690,000 or $0.09 per share.

Complex machining sales increased 3% to $10.7 million, aerostructures and electronics sales increased 56% to $7.4 million, and turbine engine components sales were $3 million (no sales reported for 2014 as this segment was acquired in 4Q14).

Gross margins decreased to 19.8% from 23.5 % primarily due to lower margin turbine engine component sales which were absent in 3Q14. Operating (SG&A) expenses increased to $4.2 million, down from $3 million primarily due to the additional expense from acquisitions. AIRI reported 3Q15 operating income of $26,000, down from $560,000 due to increased revenue being more than offset by lower gross margins and higher operating expenses.

Nine-Months 2015 - Total revenue increased 30% to $56.9 million. The net loss was $160,000 or ($0.02) per share versus net income of $1.3 million or $0.20 per share.

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

Complex machining sales decreased 8% to $29.3 million due to DoD budgetary constraints, aerostructures and electronics sales increased 61% to $19.5 million, and turbine engine components sales were $8.2 million (no sales reported for 2014 as this segment was acquired in 4Q14).

Gross margins decreased to 21.9% from 24.9% primarily due to low margin sales of the acquired turbine engine components segment. Operating (SG&A) expenses increased to $11.9 million from $8.9 million primarily due to the additional expense from acquisitions. Operating income dropped to $564,000 from $2 million due to increased revenue being more than offset by lower gross margins and higher operating expenses.

Liquidity

As of September 30, 2015, the company had $791,000 cash and a current ratio of 1X versus 1.2X for the aerospace and defense industry. Total debt increased by approximately $15.5 million in the first nine months of 2015 to $43.2 million for a debt/equity ratio of 1.5X versus 0.8X for the aerospace and defense industry. We project the company should need to increase total debt by approximately $500,000 to meets its operational needs through 2016.

Cash used in operations in the first nine months of 2015 was $1.4 million consisting $3.3 million cash earnings and a $4.7 million increase in working capital. The change in working capital was primarily due to an increase in inventory partly offset by an increase in accounts payable. Cash used in investing was $7.8 million consisting primarily of cash paid for acquisitions. Cash provided by financing was $8.6 million and consisted primarily of net proceeds from additional borrowings partly offset by dividend payments. Cash decreased by $627,000 to $791,000 at September 30, 2015.

Income Statement
(in thousands $)

	9mos15	9mos14
Complex Machining	29,281	31,870
Aerostructures & Electronics	19,468	12,097
Turbine Engine Components	8,195	-
Total sales	56,944	43,967
Cost of sales	44,500	33,012
Gross profit	12,444	10,955
Operating expenses	11,880	8,909
Operating income	564	2,046
Interest and financing costs	(1,341)	(867)
Other (expense) income	98	(64)
Income before taxes	(679)	1,115
Income tax (benefit)	(519)	(222)
Net income / (loss)	(160)	1,337
EPS	(0.02)	0.20
Shares Outstanding	7,451	6,712
Margin Analysis		
Gross margin	21.9%	24.9%
Operating margin	1.0%	4.7%
Tax rate	76.4%	(19.9)%
Year / Year Growth		
Total Revenues	29.5%	
Net Income	(112.0)%	
EPS	(110.8)%	

Source: Company filings

Air Industries has a revolving credit line and term loan with PNC bank. The credit line provides for maximum borrowings of $43 million (September 30, 2015 outstanding balance was $28 million) and term loans of $10.2 million. Air Industries pays an annual interest rate of 4% on the credit facility. As of September 30, 2015, Air Industries was not in compliance with the fixed charge coverage ratio covenant of its loan facility resulting in the revolving credit line and term loan being classified as current. In November 2015, the company received a waiver of this covenant from PNC.

Projections

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

Sales (in thousands $)

	2014A	2015E	2016E
Woodbine	1,047	852	912
Eur-Pac	2,756	4,359	4,664
ECC	281	672	719
Compac	-	344	1,104
AMK	1,838	4,057	4,341
Sterling	-	7,360	9,450
Organic	58,409	63,243	69,420
Total sales	$64,331	$80,887	$90,610

Source: Company reports and Taglich Brothers' estimates

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

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

	2014A	1Q15A	2Q15A	3Q15A	4Q15E	2015E	1Q16E	2Q16E	3Q16E	4Q16E	2016E
Sales ($ in thousands)											
Complex Machining	44,220	9,064	9,530	10,687	12,211	41,492	11,250	11,350	11,450	11,560	45,610
Aerostructures & Electronics	18,273	5,782	6,277	7,408	8,380	27,847	7,650	7,750	7,850	7,950	31,200
Turbine Engine Components	1,838	1,965	3,250	2,981	3,352	11,548	3,300	3,400	3,500	3,600	13,800
Total	64,331	16,811	19,057	21,076	23,943	80,887	22,200	22,500	22,800	23,110	90,610
Gross Profit ($ in thousands)											
Complex Machining	8,691	2,091	2,229	2,568	2,931	9,819	2,700	2,724	2,748	2,774	10,946
Aerostructures & Electronics	4,812	2,162	1,396	1,449	2,011	7,018	1,836	1,860	1,884	1,908	7,488
Turbine Engine Components	595	116	272	161	235	784	561	935	963	990	3,449
Total	14,098	4,369	3,897	4,178	5,176	17,620	5,097	5,519	5,595	5,672	21,883
Gross Margin											
Complex Machining	19.7%	23.1%	23.4%	24.0%	24.0%	23.7%	24.0%	24.0%	24.0%	24.0%	24.0%
Aerostructures & Electronics	26.3%	37.4%	22.2%	19.6%	24.0%	25.2%	24.0%	24.0%	24.0%	24.0%	24.0%
Turbine Engine Components	32.4%	5.9%	8.4%	5.4%	7.0%	6.8%	17.0%	27.5%	27.5%	27.5%	25.0%
Total	21.9%	26.0%	20.4%	19.8%	21.6%	21.8%	23.0%	24.5%	24.5%	24.5%	24.2%

Source: Company filings and Taglich Brothers' estimates

Our gross margin projections for 2015 and 2016 have been lowered to 21.8% and 24.2%, respectively, from 23.9% and 26%, respectively, to primarily reflect reduced sales in the Turbine Engine Components segment stemming from a delay in passing the US military spending budget. Company expectations are for orders in December 2015/January 2016 to ramp margins in AIRI's Turbine Engine Components segment to the upper 20% range by 2Q16.

2015 – We have lowered our revenue projection to $80.9 million from $85.3 million and our net income projection to $186,000 or $0.02 per share from $1.4 million or $0.19 per share to reflect 3Q15 results and the adverse effects from the delayed passing of the Federal budget. In November 2015, the President signed a bill that boosts the defense spending base budget by 10% to $548 billion in fiscal 2016. However, Congress has until December 16, 2015 to pass the total spending (appropriations) bill that includes the already passed increased defense spending bill in order to avoid a government shutdown or further budget extension.

Gross profit is projected to increase to $17.6 million for gross margins of 21.8%. Operating margins are projected to decrease to 2% from 2.7% as higher SG&A expenses, primarily from the acquisition of Sterling, more than offsets the increase in gross profit. We project interest expense will increase to $1.8 million from $1.3 million in 2013 due primarily to the additional debt related to acquisitions and increases in inventory. We project a tax rate of 281%.

We project $1.4 million cash from operations consisting of cash earnings of $5.4 million and increases in working capital of $4.1 million. The increase in working capital is primarily due to increases in inventory offset in part by an increase in accounts payable and accrued expenses and a decrease in accounts receivable. Cash from operations and $7.5 million cash from financing activities (primarily from increased debt offset in part by dividend payments) should cover $8 million cash used in investing (primarily for Sterling, Compac, and landing gear asset acquisitions), resulting in a $826,000 increase in cash to $2.3 million at year-end 2015.

_2016_ – We project revenue of $90.6 million and net income of $1.8 million or $0.24 per share, down from $96 million revenue and $4.1 million or $0.52 per share net income previously to primarily reflect lower sales and margin expectations for the Turbine Engine Components segment stemming from continued delays in defense contracts.

Increased sales and gross profit expectations should more than offset the increase in SG&A expenses boosting operating margins to 5.8% from 2% in 2015. We project interest expense will increase to $2.2 million from $1.8 million in 2015 due primarily to a full year of debt payments related to 2015 acquisitions and increases in inventory. We project a tax rate of 40%.

We project $3.2 million cash from operations consisting of cash earnings of $6.9 million and increases in working capital of $3.7 million. The increase in working capital is primarily due to increases in inventory and accounts receivable offset in part by an increase in accounts payable and accrued expenses. Cash from operations and increased debt will fall short of covering capital expenditures and dividend payments resulting in a $2 million decrease in cash to $366,000 at year-end 2016.

Risks

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

Reliance on government spending - Approximately 90% of AIRI's sales are to US military and commercial aviation. In 2014, AIRI's Complex Machining segment experienced a reduction in sales as a result of a slowing of orders from reduced military spending. Further reductions in defense spending, or delays in passage of a FY2016 budget, 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 2014, three customers accounted for 56% of net sales. The loss of one or more of the company's largest customers will likely have a materially adverse impact on AIRI's financial results.

Reliance on a few aircraft platforms – The company derives most of its revenues from components for a few aircraft platforms, specifically the Sikorsky BlackHawk helicopter, the Northrop Grumman E-2 Hawkeye naval aircraft, the McDonnell Douglas (Boeing) C-17 Globemaster, the F-16 Falcon and the F-18 Hornet. A reduction in the production of new aircraft or a reduction in the use of existing aircraft in the fleet (reducing after-market demand) would have a material adverse effect on AIRI's financial results.

Competition - The defense and aerospace component manufacturing market is highly competitive. Many of the company's competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers. Air Industries' prime competitors include Sterling Machine, Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group, Heroux Aerospace, and Ellanef Manufacturing, a division of Magellan Corporation.

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

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

Liquidity risk - Shares of Air Industries Group have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. There are 6.9 million shares in the float and the average daily volume is approximately 5,100 shares.

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

Consolidated Balance Sheets
(in thousands $)

	2012A	2013A	2014A	9/15A	2015E	2016E
Cash and cash equivalents	490	561	1,418	791	2,331	366
Accounts receivable	11,631	8,584	11,916	13,966	11,050	12,379
Inventory	26,739	26,222	28,391	38,932	35,757	38,844
Deferred tax asset	-	1,051	1,421	1,545	1,710	975
Prepaid expenses and other current assets	546	510	875	823	823	823
Deposits - vendors	133	-	-	-	-	-
Total current assets	39,539	36,928	44,021	56,057	51,672	53,387
Property and equipment, net	5,883	6,523	9,557	15,967	15,835	13,846
Capitalized engineering costs	802	752	712	939	939	939
Deferred financing costs	590	605	825	1,205	1,205	1,205
Intangible assets	5,889	4,726	4,513	4,192	3,285	2,057
Deferred tax asset	-	185	858	1,484	1,649	1,903
Goodwill	453	453	5,434	9,324	9,324	9,324
Total assets	**53,156**	**50,172**	**65,920**	**89,168**	**83,909**	**82,661**
Notes payable and capitalized lease obligations	19,211	14,969	19,508	39,401	39,401	35,912
Accounts payable and accrued expenses	7,077	6,855	6,948	13,327	8,751	9,506
Lease impairment	85	71	56	12	12	12
Deferred gain on sale	38	38	38	38	38	38
Deferred revenue	-	251	158	893	893	893
Dividends payable	-	717	1,066	1,134	1,134	1,134
Income taxes payable	1,448	1,496	71	-	-	-
Total current liabilities	27,859	24,397	27,845	54,805	50,229	47,495
Long-term debt	4,640	2,527	8,213	3,785	3,785	7,785
Lease impairment	127	56	4	4	4	4
Deferred gain on sale	485	447	409	381	381	381
Deferred rent	1,057	1,132	1,177	1,202	1,202	1,202
Total liabilities	**34,168**	**28,559**	**37,648**	**60,177**	**55,601**	**56,867**
Total stockholders' equity*	**18,988**	**21,613**	**28,272**	**28,991**	**28,308**	**25,794**
Total liabilities & stockholders' equity	**53,156**	**50,172**	**65,920**	**89,168**	**83,909**	**82,661**

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

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

	2012A	2013A	2014A	2015E	2016E
Net sales	64,215	62,833	64,331	80,887	90,610
Cost of sales	49,357	47,598	50,233	63,267	68,727
Gross profit	14,858	15,235	14,098	17,620	21,883
Operating expenses	8,874	10,622	12,363	16,030	16,600
Operating income	5,984	4,613	1,735	1,590	5,283
Interest and financing costs	(1,843)	(1,340)	(1,295)	(1,791)	(2,223)
Other (expense) income	(146)	296	(141)	98	-
Income before taxes	3,995	3,569	299	(103)	3,060
Income tax (benefit)	1,447	(170)	(368)	(288)	1,224
Net Income / (Loss)	2,548	3,739	667	186	1,836
EPS	0.54	0.63	0.10	0.02	0.24
Shares Outstanding	4,759	5,933	6,916	7,616	7,700
Margin Analysis					
Gross margin	23.1%	24.2%	21.9%	21.8%	24.2%
Operating margin	9.3%	7.3%	2.7%	2.0%	5.8%
Net margin	4.0%	6.0%	1.0%	0.2%	2.0%
Tax rate	36.2%	(4.8)%	(123.1)%	281.3%	40.0%
Year / Year Growth					
Total Revenues	19.5%	(2.2)%	2.4%	25.7%	12.0%
Net Income	13.4%	46.7%	(82.2)%	(72.1)%	NMF
EPS	(14.7)%	17.7%	(84.7)%	(74.7)%	NMF

Source: Company filings and Taglich Brothers' estimates

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

	3/14A	6/14A	9/14A	12/14A	2014A	3/15A	6/15A	9/15A	12/15E	2015E	3/16E	6/16E	9/16E	12/16E	2016E
Net sales	15,453	13,360	15,154	20,364	64,331	16,811	19,057	21,076	23,943	80,887	22,200	22,500	22,800	23,110	90,610
Cost of sales	11,408	10,007	11,597	17,221	50,233	12,442	15,160	16,898	18,767	63,267	17,103	16,981	17,206	17,438	68,727
Gross profit	4,045	3,353	3,557	3,143	14,098	4,369	3,897	4,178	5,176	17,620	5,097	5,519	5,595	5,672	21,883
Operating expenses	2,816	3,096	2,997	3,454	12,363	3,903	3,825	4,152	4,150	16,030	4,150	4,150	4,150	4,150	16,600
Operating income	1,229	257	560	(311)	1,735	466	72	26	1,026	1,590	947	1,369	1,445	1,522	5,283
Interest and financing costs	(303)	(304)	(260)	(428)	(1,295)	(346)	(544)	(451)	(450)	(1,791)	(547)	(561)	(563)	(552)	(2,223)
Other (expense) income	(1)	(62)	(1)	(77)	(141)	8	54	36	-	98	-	-	-	-	-
Income before taxes	925	(109)	299	(816)	299	128	(418)	(389)	576	(103)	400	808	882	970	3,060
Income tax (benefit)	584	(725)	(81)	(146)	(368)	24	183	(726)	231	(288)	160	323	353	388	1,224
Net Income / (Loss)	341	616	380	(670)	667	104	(601)	337	346	186	240	485	529	582	1,836
EPS	0.06	0.09	0.05	(0.10)	0.10	0.01	(0.08)	0.04	0.04	0.02	0.03	0.06	0.07	0.08	0.24
Shares Outstanding	6,125	6,598	7,389	6,916	6,916	7,521	7,557	7,686	7,700	7,616	7,700	7,700	7,700	7,700	7,700
Margin Analysis															
Gross margin	26.2%	25.1%	23.5%	15.4%	21.9%	26.0%	20.4%	19.8%	21.6%	21.8%	23.0%	24.5%	24.5%	24.5%	24.2%
Operating margin	8.0%	1.9%	3.7%	(1.5)%	2.7%	2.8%	0.4%	0.1%	4.3%	2.0%	4.3%	6.1%	6.3%	6.6%	5.8%
Net margin	2.2%	4.6%	2.5%	(3.3)%	1.0%	0.6%	-3.2%	1.6%	1.4%	0.2%	1.1%	2.2%	2.3%	2.5%	2.0%
Tax rate	63.1%	665.1%	(27.1)%	17.9%	(123.1)%	18.8%	(43.8)%	186.6%	40.0%	281.3%	40.0%	40.0%	40.0%	40.0%	40.0%
Year / Year Growth															
Total Revenues	7.9%	(8.7)%	(5.6)%	14.3%	2.4%	8.8%	42.6%	39.1%	17.6%	25.7%	32.1%	18.1%	8.2%	(3.5)%	12.0%
Net Income	22.2%	172.6%	(85.0)%	(195.7)%	(82.2)%	(69.5)%	(197.6)%	(11.3)%	(151.6)%	(72.1)%	130.8%	(180.7)%	56.9%	68.3%	NMF
EPS	15.9%	139.1%	(88.1)%	(182.1)%	(84.7)%	(75.2)%	(185.2)%	(14.7)%	(146.4)%	(74.7)%	125.4%	(179.2)%	56.7%	68.3%	NMF

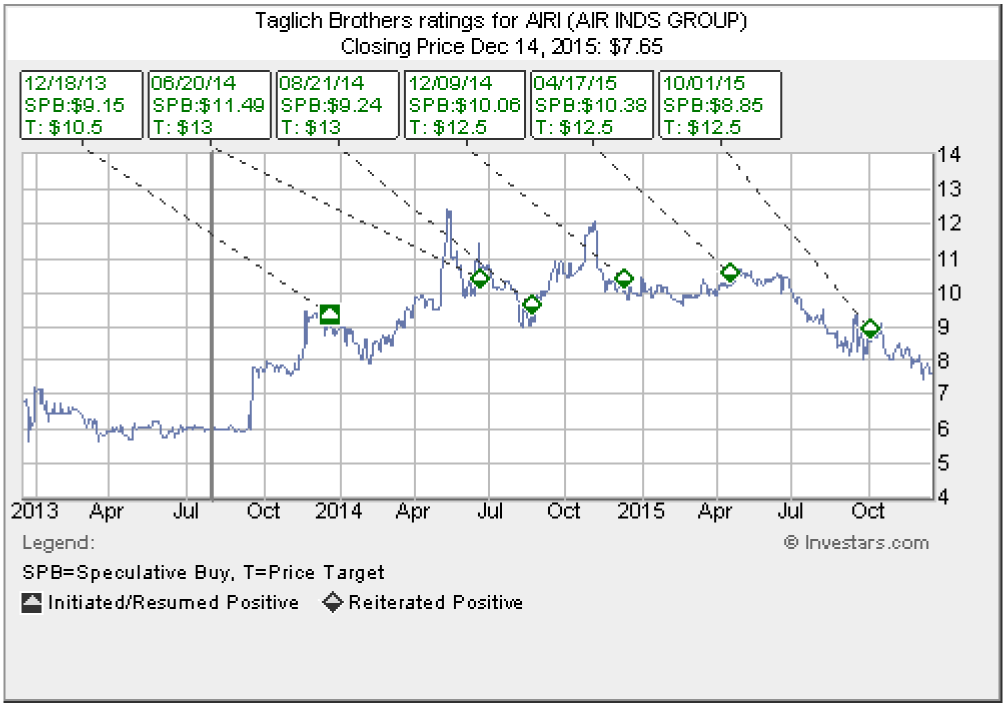
Source: Company filings and Taglich Brothers' estimates

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

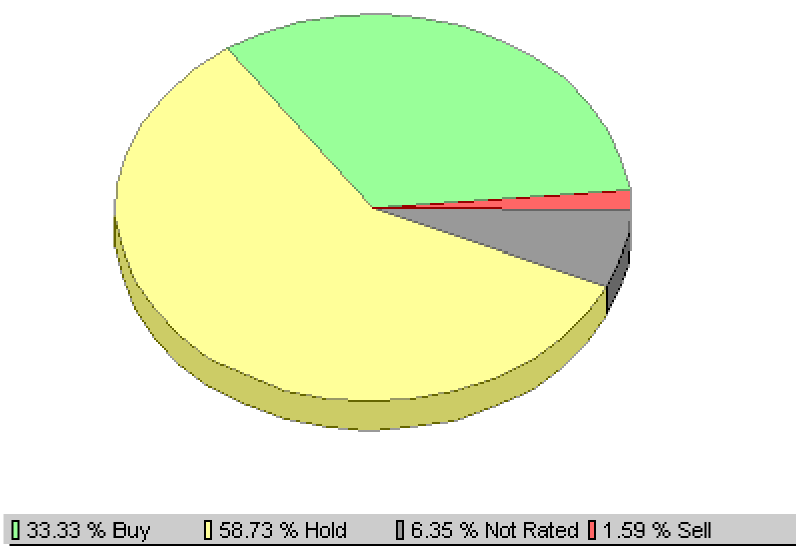
	2012A	2013A	2014A	9mos15A	2015E	2016E
Net income (loss)	2,548	3,739	667	(160)	186	1,836
Depreciation	1,557	1,709	2,364	2,679	3,844	3,189
Amortization of intangible assets	693	1,163	1,163	923	1,230	1,230
Amortization of capitalized engineering costs	459	430	375	238	320	320
Bad debt expense	80	394	299	76	76	76
Stock compensation expense	101	38	42	77	100	100
Amortization of deferred financing costs	52	69	49	142	190	190
Negative goodwill from acquisition	-	(361)	-	-	-	-
Gain on sale of real estate	(38)	(38)	(38)	(28)	(28)	-
Deferred income taxes	-	(1,236)	(1,043)	(650)	(485)	-
Adjustments to lease impairment	53	-	-	-	-	-
Cash earnings (loss)	5,505	5,907	3,878	3,297	5,433	6,941
Changes in assets and liabilities						
Accounts receivable	(4,606)	2,871	(2,417)	(114)	866	(1,328)
Inventory	1,136	440	(1,802)	(10,291)	(7,366)	(3,086)
Prepaid expenses and other current assets	(216)	35	(244)	12	52	-
Deposits and other assets	(81)	154	(164)	(108)	(108)	(108)
Accounts payable and accrued expenses	(1,534)	(892)	(577)	5,065	1,803	755
Deferred rent	82	75	45	26	26	26
Income taxes payable	1,408	48	(1,425)	(71)	(71)	-
Deferred revenue	-	251	(93)	735	735	-
(Increase) decrease in working capital	(3,811)	2,982	(6,677)	(4,746)	(4,064)	(3,741)
Net Cash Provided by Operations	**1,694**	**8,889**	**(2,799)**	**(1,449)**	**1,369**	**3,200**
Cash paid for acquisitions, net	(11,600)	(450)	(8,757)	(6,340)	(6,340)	-
Capitalized engineering costs	(292)	(380)	(335)	(465)	(465)	(465)
Purchase of property and equipment	(1,059)	(288)	(571)	(967)	(1,200)	(1,200)
Deposit for new property and equipment	(87)	-	-	-	-	-
Net Cash Used in Investing	**(13,038)**	**(1,118)**	**(9,663)**	**(7,772)**	**(8,005)**	**(1,665)**
Proceeds from sales of common stock	7,115	997	9,530	-	-	-
Costs to raise capital	(587)	-	(968)	-	-	-
Proceeds from capital lease refinance	-	-	-	500	500	-
Notes payable - sellers	(601)	(644)	(691)	(41)	(41)	-
Capital lease obligations	(608)	(996)	(143)	(487)	(487)	(1,236)
Notes payable - jr. subordinated debt	(115)	-	-	-	-	-
Notes payable - revolver	4,787	(3,637)	3,142	10,328	10,328	-
Proceeds from notes payable - term loan	3,900	-	7,328	3,500	3,500	4,500
Payments of notes payable - term loan	(2,153)	(1,800)	(913)	(1,466)	(1,466)	(2,253)
Cash paid for deferred financing costs	(21)	(102)	(151)	(362)	(362)	-
Payments related to lease impairment	(101)	(85)	(67)	(44)	(60)	(60)
Dividends paid	(359)	(1,433)	(3,748)	(3,334)	(4,450)	(4,450)
Net Cash Provided by (Used in) Financing	**11,257**	**(7,700)**	**13,319**	**8,594**	**7,462**	**(3,499)**
Net Change in Cash	**(87)**	**71**	**857**	**(627)**	**826**	**(1,964)**
Cash - Beginning of Period	**664**	**577**	**648**	**1,418**	**1,505**	**2,331**
Cash - End of Period	**577**	**648**	**1,505**	**791**	**2,331**	**366**

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	**1**	**5**
Hold		
Sell		
Not Rated		

Important Disclosures

As of the date of this report, Taglich Brothers, Inc. and/or its affiliates, own more than 1% of AIRI common stock. Michael Taglich, President of Taglich Brothers, Inc. and Chairman of Air Industries Group, owns or has a controlling interest in 411,223 shares of AIRI common stock, 15,250 stock options (right to purchase), and 41,190 warrants. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 428,724 shares of AIRI common stock, 15,250 stock options (right to purchase), and 41,190 warrants. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 56,042 shares of AIRI common stock and 14,000 warrants. Robert Schroeder, Vice President of Investment Banking at Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 50,554 shares of AIRI common stock, 15,250 stock options (right to purchase), and 27,585 warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 13,054 shares of AIRI common stock. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 356 shares of AIRI common stock and 10,500 AIRI warrants. Taglich Brothers, Inc. owns 17,990 shares of AIRI common stock. Taglich Brothers, Inc. had an investment banking relationship with the company mentioned in this report. In April and May of 2007, Taglich Brothers Inc. served as the placement agent in the sale of convertible preferred stock for the company. In June 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes for the company. In September and October of 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes and convertible preferred stock for the company. In October 2013 and May 2014, Taglich Brothers, Inc. served as the placement agent in the sale of common stock for the company.

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

General Disclosures

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Analyst Certification

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

Public companies mentioned in this report:

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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.