

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

AIR INDUSTRIES GROUP, INC.
Form 10QSB
August 14, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-QSB

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 000-29245

AIR INDUSTRIES GROUP, INC.

(Formerly Gales Industries Incorporated).
(Exact name of small business as specified in its charter)

Delaware 20-4458244
(State or other jurisdiction of (IRS Employer Identification Number)
incorporation or organization)

1479 Clinton Avenue, Bay Shore, New York 11706
(Address of principal executive offices)

(631) 968-5000
(Issuer's telephone number, including area code)

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 67,008,469 shares of Common Stock, \$.001 per share, as of August 10, 2007.

Transitional Small Business Disclosure Format (check one): Yes No

AIR INDUSTRIES GROUP INC.
(formerly Gales Industries Incorporated)

INDEX

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

PART I. FINANCIAL INFORMATION

Item 1.	Condensed Consolidated Financial Statements.....	3
	Condensed Consolidated Balance Sheet as of June 30, 2007 (unaudited) and December 31, 2006.....	3
	Condensed Consolidated Statement of Operations for the three month and six month periods ended June 30, 2007 (unaudited) and 2006 (unaudited).....	4
	Condensed Consolidated Statement of Cash Flows for the six month periods ended June 30, 2007 (unaudited) and 2006 (unaudited)	5
	Notes to Condensed Consolidated Financial Statements.....	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	10
Item 3.	Controls and Procedures.....	19

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings.....	20
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds.....	20
Item 4.	Submission of Matters to a Vote of Security Holders.....	20
Item 6.	Exhibits and Reports on Form 8-K.....	21
	SIGNATURES.....	22

PART I. FINANCIAL INFORMATION AIR INDUSTRIES GROUP INC. (formerly Gales Industries Incorporated) Condensed Consolidated Balance Sheet

	June 30, 2007 (unaudited)
ASSETS	
Current Assets	
Cash and Cash Equivalents	\$ 1,010,522
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$244,597 and \$176,458	6,331,004
Inventory	20,360,593
Prepaid Expenses and Other Current Assets	261,082
Deposits	692,578

Total Current Assets	28,655,779
Property and Equipment, net	3,394,883
Deferred Financing Costs	346,820
Other Assets	486,885

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

Goodwill	6,434,282
Income Taxes Receivable	60,260
Deposits	424,490

TOTAL ASSETS	\$ 39,803,399
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities	
Accounts Payable and Accrued Expenses	\$ 7,501,566
Notes Payable - Revolver	9,899,414
Notes Payable - Current Portion	127,776
Notes Payable - Sellers - Current Portion	555,004
Capital Lease Obligations - Current Portion	166,397
Due to Sellers	--
Dividends Payable	120,003
Deferred Gain on Sale - Current Portion	38,033
Income Taxes Payable	--

Total current liabilities	18,408,193
Long term liabilities	
Notes Payable - Net of Current Portion	709,070
Notes Payable - Sellers - Net of Current Portion	1,603,673
Capital Lease Obligations - Net of Current Portion	776,988
Deferred Tax Liability	695,379
Deferred Gain on Sale - Net of Current Portion	694,101
Deferred Rent	134,487

Total liabilities	23,021,891

Commitments and contingencies	
Stockholders Equity	
Preferred Stock - \$0.001 Par Value, 8,003,716 Shares Authorized	--
Series B Convertible Preferred - \$0.001 Par Value, 2,000,000 Shares	
Authorized 802,300 and 0 Shares Issued and Outstanding as of June 30, 2007	
and December 31, 2006 respectively	8,023
Common Stock - \$0.001 Par, 120,055,746 Shares Authorized	
67,008,469 and 57,269,301 Shares Issued and Outstanding	
as of June 30, 2007 and December 31, 2006 respectively	67,009
Additional Paid-In Capital	18,179,678
Accumulated Deficit	(1,473,202)

Total Stockholders' Equity	16,781,508

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 39,803,399
	=====

See notes to condensed consolidated financial statements

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

	June 30		June
	2007	2006	2007
Net sales	\$ 10,989,536	\$ 9,220,165	\$ 18,477,666
Cost of Sales	8,616,698	7,467,326	14,856,182
Gross profit	2,372,838	1,752,839	3,621,484
Operating costs and expenses:			
Selling and marketing	525,536	142,543	620,878
General and administrative	1,804,962	1,024,550	2,836,412
Income from operations	42,340	585,746	164,194
Interest and financing costs	280,869	362,126	411,823
Gain on sale of life insurance policy	--	--	--
Gain on Sale of Real Estate	(9,509)	--	(19,018)
Other Income	(8,441)	(803)	(9,887)
Other Expenses	16,726	--	25,304
(Loss) income before income taxes	(237,305)	224,423	(244,028)
Provision for income taxes	78,138	84,855	142,903
Net (loss) income	(315,443)	139,568	(386,931)
Less: Dividend attributable to preferred stockholders	110,964	180,000	110,964
Net loss attributable to common stockholders	\$ (426,407)	\$ (40,432)	\$ (497,895)
Loss per share (basic and diluted)	\$ (0.01)	\$ (0.00)	\$ (0.01)
Weighted average shares outstanding (basic and diluted)	65,667,564	14,723,421	62,241,376

See notes to condensed consolidated financial statements

4

AIR INDUSTRIES GROUP INC.
(formerly Gales Industries Incorporated)

Condensed Consolidated Statement of Cash Flows
(Unaudited)

Six Months Ended June

2007

20

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (Loss) Income	(386,931)	\$ 27
Adjustments to Reconcile Net (Loss) Income to Net		
Cash Used in Operating Activities, net of effects of acquisition:		
Depreciation and amortization of property and equipment	341,482	27
Bad Debt Expense	68,139	
Non-Cash Compensation Expense	266,503	6
Warrants issued for services	31,304	1
Accrued Interest on Notes Payable-Sellers	16,604	
Amortization of deferred financing costs	64,728	6
Gain on Sale of Real Estate	(19,018)	
Deferred Taxes	182,442	(1
Changes in Assets and Liabilities		
(Increase) Decrease in Assets:		
Accounts receivable	(211,392)	(48
Income Taxes Receivable	(60,260)	
Inventory	(2,281,450)	(1,00
Prepaid expenses and Other Current Assets	16,770	4
Deposits	(464,042)	(2
Cash surrender value - officer's life insurance	--	2
Other assets	(400,600)	
Increase (Decrease) in Liabilities:		
Accounts payable and accrued expenses	(1,993,173)	(1
Income Taxes Payable	(653,426)	
Deferred Rent	95,116	
NET CASH USED IN OPERATING ACTIVITIES	(5,387,204)	(77
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisition, including transaction costs of \$280,500	(4,341,296)	
Cash Paid for Deposit on Leasehold Improvements	(24,040)	
Purchase of property and equipment	(47,434)	(14
Cash paid for Deferred Financing Costs	(42,500)	
NET CASH USED IN INVESTING ACTIVITIES	(4,455,270)	(14
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from Private Placement	8,023,000	
Payment of Issuance Costs of Private Placement	(698,840)	
Principal payments of capital lease obligations	(16,432)	(17
Repayment of notes payable to Officers and Sellers	(210,128)	(4
Proceeds (repayments) from notes payable, net	(1,116,555)	1,30
Proceeds from Notes Payable-Revolver	4,871,951	
NET CASH PROVIDED BY FINANCING ACTIVITIES	10,852,996	1,08
Net increase in cash and cash equivalents	1,010,522	16
Cash and cash equivalents at the beginning of period	--	1,05
Cash and cash equivalents at the end of period	\$ 1,010,522	\$ 1,22
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 126,616	\$ 41
Cash paid during the period for taxes	\$ 678,729	\$

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

See notes to condensed consolidated financial statements

5

AIR INDUSTRIES GROUP INC. (formerly Gales Industries Incorporated)

Condensed Consolidated Statement of Cash Flows (Continued) (Unaudited)

Supplemental disclosure of non-cash investing financing activities:

Note Payable-Seller and accrued interest converted to common stock	\$ 719,773	=====
Purchase of all capital stock of Sigma Metals, Inc and assumption of liabilities in the acquisition as follows:		
Fair Value of Tangible Assets acquired	\$ 5,691,777	
Goodwill	5,168,319	
Cash paid (includes transaction costs of \$280,500)	(4,341,296)	
Notes payable issued to Sellers	(1,497,411)	
Common stock issued	(1,957,000)	

Liabilities assumed	\$ 3,064,389	=====

See notes to condensed consolidated financial statements

6

Note 1. FORMATION AND BASIS OF PRESENTATION

On June 26, 2007, we changed our name from Gales Industries Incorporated to Air Industries Group, Inc.

On April 16, 2007, we acquired all of the issued and outstanding capital stock of Sigma Metals, Inc. ("Sigma"), pursuant to a certain Stock Purchase Agreement, dated as of January 2, 2007, from the three shareholders of Sigma (the "Sellers"), in exchange for, \$4,060,796 in cash, three promissory notes, one in favor of each Seller, in the total principal amount of \$1,497,411, and 7,337,891 shares of our Common Stock (at \$0.25893 per share equaling \$1,900,000 and \$57,000 of the purchase price resulted from a 10% discount on the share price used to calculate the number of shares going to the sellers as part of the purchase price. Soft costs incurred as a result of this acquisition amount to \$280,000. The purchase price is subject to adjustment upon agreement with the Sellers as to Sigma's earnings from January 1, 2007 to April 16, 2007).

Sigma Metals is a specialty distributor of strategic metals, primarily aluminum, stainless steels of various grades, titanium and other exotic end user specified metals. Sigma's products are sold to both aerospace/defense contractors as well as commercial accounts throughout

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

the U.S. and numerous international markets. Customers include the world's largest aircraft manufacturers, subcontractors, original equipment manufacturers and various government agencies.

Our operating results for the quarter ended June 30, 2007, include the results of the operations of Sigma beginning on April 17, 2007. In accordance with Statement of Financial Accounting Standards ("SFAS") 141, Business Combinations, the acquisition of Sigma was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to assets acquired and liabilities assumed based on SFAS No. 141 and are reflect in the balance sheet of the Company as of June 30, 2007 included herein. The Company is in the process of finalizing the allocation of the purchase price to the assets and liabilities based on their relative fair values.

Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Company believes that the disclosures are adequate to make the financial information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2006, filed with the Securities and Exchange Commission on April 2, 2007. All adjustments were of a normal recurring nature unless otherwise disclosed. In the opinion of management, all adjustments necessary for a fair statement of the results of operations for the interim period have been included. The results of operations for such interim periods are not necessarily indicative of the results for the full year.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. The more significant management estimates are the useful lives of property and equipment, provisions for inventory obsolescence, accrued expenses and various contingencies. Actual results could differ from those estimates. Changes in facts and circumstances may result in revised estimates, which are recorded in the period in which they become known.

7

Note 1. FORMATION AND BASIS OF PRESENTATION (Continued)

Share-Based Compensation

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 123(R) "Share Based Payments" which is a revision of SFAS No. 123 "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values at the date of grant. The Company recorded in the accompanying statement of operations an expense of of

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

\$58,905 and \$39,500 for the three month period ended June 30, 2007 and 2006, respectively and an expense of \$266,503 and \$65,405 for the six month period ended June 30, 2007 and 2006, respectively, in accordance with the measurement requirements under SFAS No. 123(R) (See Note 4). The Company adopted SFAS No. 123(R), effective in 2005.

Taxes

Effective January 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). There were no unrecognized tax benefits as of January 1, 2007 and as of June 30, 2007. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. Management is currently unaware of any issues under review that could result in significant payments, accruals or material deviations from its position. The adoption of the provisions of FIN 48 did not have a material impact on the Company's financial position, results of operations and cash flows.

Note 2. CASH SURRENDER VALUE - LIFE INSURANCE

During the quarter ended March 31, 2006, the Company sold one of its key-man life insurance policies. Proceeds from the sale of the insurance policy were \$86,000 which was offset by the cash surrender value of \$32,953. The resulting gain of \$53,047 was recognized as Other Non-Operating Income in the accompanying Statement of Operations for the six month period ended June 30, 2006.

Note 3. CONVERSION OF NOTES PAYABLE

On January 26, 2007, two executive officers exercised their right to convert \$665,262 principal amount of our notes plus accrued interest of \$54,511 into an aggregate of 1,799,432 shares of common stock at a conversion price of \$0.40 per share.

Note 4. SHARE-BASED COMPENSATION ARRANGEMENTS

During 2005, the Company's Board of Directors approved a stock option plan and reserved 10,000,000 shares of its Common Stock for issuance under the plan. The stock option plan permits the Company to grant non-qualified and incentive stock options to employees, directors, and consultants. Awards granted under the Company's plans vest over three, four, five and seven years.

The Company accounts for its stock option plans under the measurement provisions of Statement of Financial Accounting Standards No. 123(R) (revised 2004), Share-Based Payment ("SFAS 123R"). The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. During the six months ended June 30, 2007 and 2006, 2,280,000 and 0 stock options were granted, respectively.

Certain of the Company's stock options contain features which include variability in grant prices. A portion of the currently issued stock options will be exercisable based on average trading prices of the Company's Common Stock at the end of a given future period. Due to this variable feature, these stock options are not deemed to be granted for purposes of applying SFAS 123(R) and accordingly, their fair value will be calculated and expensed in future periods.

Note 4. SHARE-BASED COMPENSATION ARRANGEMENTS (Continued)

At June 30, 2007 and 2006, 2,463,333 and 790,000 options are vested and exercisable, respectively. The weighted average exercise price of exercisable options at June 30, 2007 was \$0.43 per share.

During the quarter ended March 31, 2007, the Company issued warrants to purchase an aggregate of 20,833 shares to a consultant for services rendered. These warrants have a term of five years and an exercise price equal to 120% of the average closing price of the Company's Common Stock during the month immediately preceding the date of issuance. These warrants have a cashless exercise feature. The warrants were valued using the Black-Scholes model and the Company recorded an expense of \$5,514 in its consolidated statement of operations for the six months ended June 30, 2007. The Company's agreement with this consultant was terminated during the first week of September 2006.

In addition, warrants to acquire 125,000 shares with a grant date of March 16, 2007 were issued to another consulting firm. These warrants are exercisable at a per share price of \$0.28 the average closing price of the Company's common stock for the 20 days preceding the date of grant, and have a cashless exercise feature and vested on the grant date. The warrants were valued using the Black-Scholes model and the Company recorded an expense of \$25,789 in its consolidated statement of operations for the quarter ended March 31, 2007.

The Company issued to Taglich Brothers, Inc., placement agent for the private offering of the Company's Series B Convertible Preferred Stock described in Note 5, warrants to purchase 2,900,578 shares of Common Stock at a per share exercise price of \$0.305 in addition to other consideration. These warrants have a term of five-years and a cashless exercise feature. These warrants were valued at \$32,000 using the Black-Scholes model and the value of such warrants was deducted from the additional paid in capital resulting from the offering.

Note 5. ISSUANCE OF SERIES B PREFERRED STOCK

To finance the acquisition of Sigma and provide us with additional working capital, we completed a private placement of our Series B Convertible Preferred Stock, par value \$0.001 per share ("Series B Preferred Stock") in which we raised gross proceeds of \$8,023,000.

The Company issued to Taglich Brothers, Inc. placement agent for the private offering of the Company's Series B Convertible Preferred Stock: (i) a sales commission of \$641,840 or 8% of the gross proceeds of the offering, (ii) \$25,000 as reimbursement of its actual and reasonable out-of-pocket expenses incurred in connection with offering, including fees and expenses of its counsel, and (iii) warrants to purchase 2,900,578 shares of Common Stock at a per share exercise price of \$0.305. These warrants have a term of five-years and a "cashless exercise" feature. The preferred stock contains a 7% cumulative non-declared dividend which amounted to \$110,964 for the six months ended June 30, 2007.

Note 6. AMENDMENT OF CREDIT FACILITY

On April 19, 2007, in connection with the acquisition of Sigma Metals, the Company entered into a Third Amendment to the Revolving Credit, Term Loan,

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

Equipment Line of Credit and Security Agreement with PNC Bank. The amendment cost \$42,500 and modified the terms of the Loan Facility with PNC to allow for Sigma to become a borrower under the Loan Facility. This cost is being amortized over the remaining term of the credit facility. As a result of Sigma becoming a borrower under the Loan Facility, Sigma pledged all of its assets and properties to PNC to secure its obligations under the Loan Facility. In addition, the termination date of the Loan Facility was extended to April 30, 2010 and the maximum revolving advance amount was increased by \$2,000,000, from \$9,000,000 to \$11,000,000. The Company remains in compliance with its Debt covenants.

Note 7. CASHLESS EXERCISE OF OPTIONS TO FORMER CHARIMAN

On May 17, 2007, the former Executive Chairman converted 250,000 of his options into 90,580 shares of Company Common Stock pursuant to the cashless exercise feature contained in his option agreement.

9

Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion of our results of operations constitutes management's review of the factors that affected our financial and operating performance for the three and six months ended June 30, 2007 and 2006. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report and in our Form 10-KSB, for the year ended December 31, 2006.

General

We manufacture aircraft structural parts and assemblies principally for prime defense contractors in the aerospace industry. During 2006, approximately 85% of our revenues were derived from sales of parts and assemblies directed toward military applications, although direct sales to the military (U.S. and NATO) constituted less than 8.5% of our revenues. We have evolved from being an individual parts manufacturer to being a manufacturer of subassemblies (i.e. being an assembly constructor) and being an engineering integrator. We currently produce over 2,400 individual products (SKU's) that are assembled by a skilled labor force into electromechanical devices, mixer assemblies, rotor-hub components, rocket launching systems, arresting gear, vibration absorbing assemblies, landing gear components and many other subassembly packages.

As a result of our acquisition on April 16, 2007, of Sigma Metals, Inc. we are now also a specialty distributor of strategic metals, primarily aluminum, stainless steels of various grades, titanium and other exotic end user specified materials sourced from suppliers throughout the world. Our metals products are sold to both commercial and defense aerospace manufacturers, throughout the U.S. and in numerous international markets. Our metals customers include prime contractors in the defense and commercial aerospace industries, aerospace engine manufacturers and various subcontractors to aerospace manufacturers

Sales of parts and services to one customer accounted for approximately 49.6% of our consolidated revenue in the second quarter of 2007, and are subject to General Ordering Agreements which extend through 2013.

Results of Operations

We completed the acquisition of our metals distribution operations on April 16, 2007, and the results of such operations from April 17, 2007, are included in our financial statements for the quarter ended June 30, 2007, and

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

reflected in the discussion below.

Results of Operations

Three months ended June 30, 2007 compared with three months ended June 30, 2006

Net Sales. Net sales were \$10,989,536 for the three months ended June 30, 2007 ("Second Quarter 2007"), an increase of \$1,769,371 or 19.20% from net sales of \$9,220,165 for the three months ended June 30, 2006 ("Second Quarter 2006"). The increase in net sales was primarily attributable to the acquisition of our metals distribution business which generated net sales during the period of \$2,784,424 partially offset by a reduction of \$1,015,053 in the net sales from our pre-existing operations as compared to the Second Quarter 2006. The reduction in sales for the Second Quarter 2007 as compared to the Second Quarter 2006 is primarily attributable to the continued delays of our largest customer in accepting delivery of products manufactured at its direction.

Gross Profit. In the Second Quarter 2007, gross profit was \$2,372,838 or 21.60% of net sales, compared to gross profit of \$1,752,839 or 19.01% of net sales in Second Quarter 2006. The increase in gross profit primarily reflects the contribution of \$622,913 from our newly acquired metals distribution operation, partially offset by a reduction in the gross profit of our pre-existing operations. The increase in gross profit margin reflects an increase in the gross profit margin of our pre-existing operations to 21.3% and the fact that the gross profit margin at our metals distribution operation was 22.4% during the Second Quarter 2007.

Selling and Marketing Expenses. Selling and marketing expenses were \$525,536 in Second Quarter 2007, a increase of \$382,993 or 268.8% from selling and marketing expenses of \$142,543 in Second Quarter 2006. The increase in selling and marketing expenses is attributable to expenses associated with our recently acquired metals distribution operation slightly offset by a reduction of \$25,984 in selling and marketing expenses of our pre-existing operations.

General and Administrative Expenses. General and administrative expenses were \$1,804,962 in Second Quarter 2007, an increase of \$780,412 or 76.17 % from general and administrative expenses of \$1,024,550 in Second Quarter 2006. The increase reflects the general and administrative expenses of our metals distribution operations, costs related to the integration of the operating and financial systems of our metals distribution operations into our general systems, cost of upgrading our financial reporting systems to accommodate future acquisitions, and the increased expense of preparing to comply with Section 404 of Sarbanes-Oxley by yearend.

10

Interest and Financing Costs. Interest and financing costs were \$280,869 in Second Quarter 2007, a decrease of \$81,257 or 22.44% from interest and financing costs of \$362,126 in Second Quarter 2006. The decrease in interest and financing costs resulted from the decrease in our debt outstanding as a result of the sale and leaseback of our headquarters in October 2006 partially offset by the debt incurred to acquire our metals distribution operations.

Gain on sale of real estate. We are required to defer recognition of a portion of the gain on the sale of our headquarters in the fourth quarter of 2006. This gain is being recognized ratably over the twenty year term of our lease for this real estate. Accordingly, we recognized \$9,509 during the Second Quarter of 2007.

Income (Loss) before Income Taxes. The Loss before the impact of income

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

taxes was \$237,305 in Second Quarter 2007 compared to income before the provision for income taxes of \$224,423 in Second Quarter 2006, a decrease of \$461,728 year over year. This was a function of lower sales for our pre-existing operations, which was down \$1,015,053 (or 11%) in the Second Quarter of 2007 as compared to the year earlier period, as a major customer continued to defer shipments as it recovers from prior years' operating difficulties. In addition, we recognized higher general and administrative expenses as we moved toward becoming compliant with Sarbanes-Oxley by yearend and realized the cost of integrating our metals distribution business into the pre-existing company's operating and financial control systems.

Net Loss. Net income decreased from \$139,568 in Second Quarter 2006 to a net loss of \$315,443 in the Second Quarter of 2007. The decrease was primarily attributable to lower revenue from our pre-existing operations and other factors discussed above. The effect of FAS 109, income tax expense was minimal period over period, as it remained relatively constant.

Net Income (Loss) Attributable to Common Stockholders. The dividend payable on the our Series A preferred stock in the Second Quarter 2006 exceeded our net income during such period, resulting in a net loss attributable to common stock of \$40,432. Our Series A preferred stock was automatically converted into common stock in August 2006. In April and May of 2007, we issued Series B Preferred Stock. The dividend on our Series B Preferred Stock for the six months ended June 30, 2007 increased our net loss attributable to common stockholders to \$426,407

Six months ended June 30, 2007 compared with Six months ended June 30, 2006

Net Sales. Net sales were \$18,477,666 for the six months ended June 30, 2007, an increase of \$359,229 (or 2.00%) from net sales of \$18,118,437 for the six months ended June 30, 2006. The increase in net sales was primarily attributable to the consolidation of \$2,784,424 of net sales from the metals distribution operations acquired on April 16, 2007. Net sales of our pre-existing operations decreased by \$2,425,195 or 13% from the net sales recorded in the six months ended June 30, 2006. The reduction in sales at our pre-existing operations for the six months end June 30, 2007 as compared to the six months ended June 30, 2006 is primarily attributable to the continued delay of our largest customer accepting delivery of products manufactured at its direction.

Gross Profit. In the six months ended June 30, 2007, gross profit was \$3,621,484 or 19.60% of net sales, compared to gross profit of \$3,265,545 or 18.02% of net sales in six months ended June 30, 2006, an improvement of 10.9% in gross profit and 1.58% in gross profit margin. The increase in gross profit primarily reflects the contribution of our metals distribution operation offset by a reduction in the gross profit at our pre-existing operations. The increase in gross profit margin reflects the combined effect an increase in the gross profit margin of our pre-existing operations for the first six months of 2007 to 19.11% and the gross margin of our metals distribution operations that was acquired during the period of 22.4%.

Selling and Marketing Expenses. Selling and marketing expenses were \$620,878 in the six months ended June 30, 2007, an increase of \$322,633 or 108.2% from selling and marketing expenses of \$298,245 in the six months ended 2006. The increase in selling and marketing expenses is attributable to expenses of our metals distribution operations. Our pre-existing operations selling and marketing expenses decreased year over year for the period by \$101,238, or 34%, due to lower sales.

General and Administrative Expenses. General and administrative expenses were \$2,836,412 in the first six months of 2007, an increase of \$962,479 or 51.36 % from general and administrative expenses of \$1,873,933 in the six months

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

ended June 30, 2006. The increase primarily reflects a combination of the expense for our metals distribution operations of \$223,871 for the two and a half months during the second quarter that this operation was consolidated with our pre-existing operations. In addition, we incurred costs related to the integration of the metals operations and financial systems into our pre-existing systems, and the cost of upgrading our financial reporting systems to accommodate future acquisitions and preparing to comply with Section 404 of Sarbanes-Oxley by yearend.

11

Interest and Financing Costs. Interest and financing costs were \$411,283 in six months ended June 30, 2007, a decrease of \$275,893 or 40.15% from interest and financing costs of \$687,176 in six months ended 2006. The decrease in interest and financing costs resulted from the decrease in the levels of our outstanding debt as a result of the sale leaseback of our headquarters in October 2006, partially offset by the increase in debt associated with the acquisition of our metals distribution operations.

Gain on sale of real estate. We were required to defer recognition of a portion of the gain on the sale of our headquarters in the fourth quarter of 2006. This gain is being recognized ratably over the twenty year term of the lease for this real estate. Accordingly, we recognized \$19,018 during the six months ended June 30, 2007.

Income (Loss) before Income Taxes. The Loss before the impact of income taxes was (\$244,028) in the six months ended June 30, 2007 as compared to pre-tax income in the same period for the prior year of \$460,041, a decrease of \$704,069. This was a function of lower sales during the first half 2007 at our pre-existing operations, which decreased by \$2,425,196 (or 13.4%) from the prior year's \$18,118,437, as a major customer continued to delay shipments as it recovers from prior year's operating difficulties, and the increased general and administrative expenses caused by the items discussed above.

Net Income (Loss). Net income decreased from \$275,933 in the six months ended June 30, 2006 to a net loss of \$386,931 in the first six months of 2007. The decrease in net income was attributable to the factors discussed above. The effect of FAS 109, income tax expense was minimal period over period, as it remained relatively constant.

Net Income (Loss) Attributable to Common Stockholders. The dividend payable our Series A preferred stock in the six months ended 2006 exceeded our net income during such period, resulting in a net loss attributable to common stock of \$84,067. Our Series A preferred stock was automatically converted into common stock in August 2006. The dividend related to our Series B preferred stock during the six months ended June 30, 2007 increased our net loss attributable to common stockholders during such period, resulting in a net loss attributable to common stockholders of \$497,895. Our Series B preferred stock accrues interest at a rate of 7% per annum.

12

Impact of Inflation

Inflation has not had a material effect on our results of operations.

Liquidity and Capital Resources

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

At June 30, 2007 and December 31 2006, we had cash or cash equivalents of \$1,010,522 and \$0, respectively. The loan agreement between PNC and our operating subsidiaries requires that all cash be swept on a daily basis to our loan accounts. The \$1,010,522 currently on hand represents the portion of the proceeds of our private placement completed in April, 2007, that has yet to be applied to operations. At June 30, 2007, we had working capital of \$ 10,247,587 as compared to working capital of \$4,911,354 as of December 31, 2006. This increase in working capital reflects the proceeds of the placement of our Series B Preferred Stock, offset by the cost of acquiring our metals distribution operations and our negative cash flow from operations during the first half of 2007. Subject to our need for cash to complete the acquisition of Welding Metallurgy, we believe that our cash requirements for operations in the next twelve months will be met by revenues from operations, cash reserves, and amounts available under the Loan Facility. We only recently completed the acquisition of our metals distributions operations and although we believe that these operations will generate cash during the balance of 2007, it is possible that they will be a net user of cash in the immediate future as we integrate them into our existing business.

We used \$5,387,204 in operations during the six months ended June 30, 2007. The use of cash in operations reflects an increase in our inventory of \$2,281,450, an increase in our deposits with vendors of \$464,042, a decrease in prepaid expenses of \$16,770, a decrease in our accounts payable and accrued expenses of \$1,993,175, and an increase in the accounts receivable associated with our pre-existing operations of \$211,392. The increase in inventory resulted primarily from the acquisition of our metals operations and, in part, from work flow disruptions at our principal customer which prevented us from shipping all of the inventory originally anticipated. The increase in deposits with vendors and decrease in accounts payable are due to advanced payment requirements imposed by certain suppliers. As a result of efforts to reduce amounts due these suppliers, we anticipate that they may not require prepayments in the immediate future.

In connection with the acquisition of Air Industries Machining Corp. , we incurred notes payable obligations to the sellers in the aggregate principal amount of \$1,627,262, of which \$665,262 were in the form of convertible promissory notes which were, on January 26, 2007, converted by the holders into 1,799,432 shares of common stock at a conversion price of \$0.40 per share. The principal amount of the remaining note is \$721,500 and is repayable by us in equal quarterly installments of \$48,100 principal plus interest.

In connection with the acquisition of Sigma Metals, we incurred notes payable obligations to the former shareholders of Sigma Metals in the aggregate principal amount of \$1,497,411. The principal balance of the remaining balance is \$1,437,177 and is repayable by us in equal monthly installments of \$30,117 principal, plus interest.

The terms of the PNC Loan Facility are set forth in our Consolidated Financial Statements included in our Annual Report on Form 10-KSB for the year ended December 31, 2006. Under the PNC Loan Facility, as of June 30, 2007, we had revolving loan balances of \$9,899,414, a term loan balance of \$298,146, an equipment loan balance of \$411,200, and an outstanding stand-by letter of credit in the amount of \$127,500. In addition, as of June 30, 2007 we had capital lease obligations to other parties totaling \$943,385.

On April 16, 2007, we acquired Sigma Metals pursuant to a Stock Purchase Agreement dated as of January 2, 2007, with the three shareholders of Sigma Metals, as sellers (the "Sellers"), in exchange for, subject to adjustment upon

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

determination of the earnings of Sigma for the period January 1, 2006 through April 16, 2007, \$4,060,796 in cash, three promissory notes, one in favor of each Seller, in total principal amount of \$1,497,411, and 7,337,891 shares of our Common Stock (at \$0.25893 per share equaling \$1,900,000).

Sigma Metals is a specialty distributor of strategic metals, primarily aluminum, stainless steels of various grades, titanium and other exotic end user specified metals. Sigma's products are sold to both aerospace/defense contractors as well as commercial accounts throughout the U.S. and numerous international markets. Customers include the world's largest aircraft manufacturers, subcontractors, original equipment manufacturers and various government agencies.

To finance the acquisition of Sigma and provide us with additional working capital, portions of which may be used in connection with future acquisitions, we completed a private placement (the "Offering") of our Series B Convertible Preferred Stock, par value \$0.001 per share ("Series B Preferred Stock") in which we raised gross proceeds of \$8,023,000. A first closing, in which we received gross proceeds of \$4,955,000 occurred simultaneously with the acquisition of Sigma and was entirely devoted to the acquisition. A second closing occurred on May 3, 2007, in which we received gross proceeds of \$3,068,000, which will be used as working capital or in connection with future acquisitions. The holders of the Series B Preferred Stock are entitled to a cumulative annual dividend of 7% per annum which under certain circumstances, is payable in shares of the Company's stock. The shares of Series B Preferred Stock issued in the offering are initially convertible into 29,005,785 shares of the Company's common stock.

We paid Taglich Brothers, Inc. placement agent for the private offering of our series B convertible preferred stock: (i) a sales commission of \$641,840 or 8% of the gross proceeds of the offering, (ii) \$25,000 as reimbursement of its actual and reasonable out-of-pocket expenses incurred in connection with offering, including fees and expenses of its counsel, and (iii) warrants to purchase 2,900,578 shares of Common Stock at a per share exercise price of \$0.305. These warrants have a term of five-years and a "cashless exercise" feature and were valued at \$32,000 using the Black-Scholes model and the value of such warrants was deducted from the additional paid in capital.

In connection with the acquisition of Sigma, we also amended and modified the terms of the Loan Facility with PNC to allow for Sigma to become a borrower under the Loan Facility. The cost of this amendment was \$42,500 and is being amortized over the remaining term of the Credit Facility. As a result of Sigma becoming a borrower under the Loan Facility, Sigma pledged all of its assets and properties to PNC to secure its obligations under the Loan Facility. In addition to the foregoing the termination date of the Loan Facility was extended to April 30, 2010 and the maximum revolving advance amount was increased by \$2,000,000, from \$9,000,000 to \$11,000,000.

As of June 30, 2007, one customer accounted for approximately 31% of our accounts receivable. In addition, this customer accounted for approximately 49.6% of net sales for the quarter ended June 30, 2007. In the event such customer is unable or unwilling to pay amounts due or in the event our relationship with such customer is severed or negatively affected, our results of operations will be materially adversely affected and we may not have the resources to meet our capital obligations.

On March 9, 2007, we entered into a Stock Purchase Agreement (the "Welding Agreement") to acquire Welding Metallurgy, Inc. for aggregate consideration of \$6,050,000, subject to adjustment for working capital, payable in a combination of cash, a secured promissory note and shares of the Company's common stock. We currently anticipate closing this acquisition in mid-August, 2007, subject to continued due diligence by the Company and various conditions, including our

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

ability to obtain the consent of our lender and such additional debt or equity financing as may be necessary to close the transaction. There can be no assurance that we will be able to close this acquisition on the anticipated closing date, if at all.

14

Cautionary Note Regarding Forward-Looking Statements

Our disclosure and analysis in this report contains some forward-looking statements. Certain of the matters discussed concerning our operations, cash flows, financial position, economic performance and financial condition, including, in particular, future sales, product demand, competition and the effect of economic conditions include forward-looking statements within the meaning of section 27A of the Securities Act and Section 21E of the Securities Exchange Act.

Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions are forward-looking statements. Although we believe that these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital, capital expenditures, distribution channels, profitability, new products, adequacy of funds from operations, these statements and other projections and statements contained herein expressing general optimism about future operating results and non-historical information, are subject to several risks and uncertainties, and therefore, we can give no assurance that these statements will be achieved.

Investors are cautioned that our forward-looking statements are not guarantees of future performance and actual results or developments may differ materially from the expectations expressed in the forward-looking statements.

As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainty of estimates, forecasts and projections and may be better or worse than projected. Given these uncertainties, you should not place any reliance on these forward-looking statements. These forward-looking statements also represent our estimates and assumptions only as of the date that they were made. We expressly disclaim a duty to provide updates to these forward-looking statements, and the estimates and assumptions associated with them, after the date of this filing to reflect events or changes in circumstances or changes in expectations or the occurrence of anticipated events.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise. You are advised, however, to consult any additional disclosures we make in our Form 10-KSB, Form 10-QSB and Form 8-K reports to the SEC. Also note that we provide a cautionary discussion of risk and uncertainties under the caption "Risk Factors" in this report. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed here could also adversely affect us. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

Risk Factors

The purchase of our common stock involves a high degree of risk. Before you invest you should carefully consider the risks and uncertainties described below, our Management's Discussion and Analysis of Financial Condition and

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

Results of Operations set forth in Item 2 of Part I of this report and our consolidated financial statements and related notes included in Item 1 of Part I of this report, as well as our consolidated financial statements and related notes, our Management's Discussion and Analysis of Financial Condition and Results of Operations and the other information in our Annual Report on Form 10-KSB for the fiscal year ended December 31, 2006. If any of the following events actually occurs, our financial condition or operating results may be materially and adversely affected, our business may be severely impaired, and the price of our common stock may decline, perhaps significantly. This means you could lose all or a part of your investment.

We cannot assure you that any business we acquire will benefit from its acquisition by us.

We cannot assure you that any benefits to the business of AIM, Sigma Metals, or any other entities that we acquire will be achieved from their acquisition by us or by our status as a public company, or that the results of operations of AIM, Sigma Metals or such other acquired entities will not be adversely impacted by their acquisition by us. The process of combining the organizations of private companies into a public company such as ours may cause fundamental changes to their businesses or in their operations.

The past performance and results of operations of AIM, Sigma Metals or any other entity that we acquire are not necessarily indicative of our future performance or results of operations. Future performance may be adversely affected as a result of the integration of the acquired business into our organization and the significant increase in expenses relating to financial statement preparation and compliance with controls and procedures standards established by the Sarbanes-Oxley Act of 2002.

Our inability to successfully manage the growth of our business may have a material adverse effect on our business, results of operations and financial condition.

We expect to experience growth in the number of employees and the scope of our operations as a result of internal growth and acquisitions. These activities could result in increased responsibilities for management.

15

Our future success will be highly dependent upon our ability to manage successfully the expansion of operations. Our ability to manage and support our growth effectively will be substantially dependent on our ability to implement adequate improvements to financial, inventory, management controls, reporting, union relationships, order entry systems and other procedures, and hire sufficient numbers of financial, accounting, administrative, and management personnel. We may not succeed in our efforts to identify, attract and retain experienced accounting and financial personnel.

Our future success also depends on our ability to address potential market opportunities and to manage expenses to match our ability to finance operations. The need to control our expenses will place a significant strain on our management and operational resources. If we are unable to control our expenses effectively, our business, results of operations and financial condition may be adversely affected.

The unsuccessful integration of a business or business segment we acquire could have a material adverse effect on our results.

As part of our business strategy, we expect to acquire assets and

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

businesses relating to or complementary to our operations. These acquisitions will involve risks commonly encountered in acquisitions. These risks include, among other things, exposure to unknown liabilities of the acquired companies, additional acquisition costs and unanticipated expenses. Our quarterly and annual operating results will fluctuate due to the costs and expenses of acquiring and integrating new businesses. We may also experience difficulties in assimilating the operations and personnel of acquired businesses. Our ongoing business may be disrupted and our management's time and attention diverted from existing operations. Our acquisition strategy will likely require additional debt or equity financing, resulting in additional leverage or dilution of ownership. We cannot assure you that any future acquisition will be consummated, or that if consummated, that we will be able to integrate such acquisition successfully.

Any reduction in government spending on defense could materially adversely impact our revenues, results of operations and financial condition.

There are risks associated with programs that are subject to appropriation by Congress, which could be potential targets for reductions in funding to pay for other programs. Future reductions in United States Government spending on defense or future changes in the kind of defense products required by United States Government agencies could limit demand for our products, which would have a materially adverse effect on our operating results and financial condition.

In addition, potential shifts in responsibilities and functions within the defense and intelligence communities could result in a reduction of orders for defense products by segments of the defense industry that have historically been our major customers. As a result, demand for our products could decline, resulting in a decrease in revenues and materially adversely affecting our operating results and financial condition.

We depend on revenues from a few significant relationships, in particular with Sikorsky Aircraft, and any loss, cancellation, reduction, or interruption in these relationships could harm our business.

In general, we have derived a material portion of our revenues from one or a limited number of customers. We expect that in future periods we may enter into contracts with customers which represent a significant concentration of our revenues. If such contracts were terminated, our revenues and net income could significantly decline. Our success will depend on our continued ability to develop and manage relationships with significant customers. Sikorsky accounted for approximately 49.6 % of our consolidated sales during the six months ended June 30, 2007. Any adverse change in our relationship with Sikorsky could have a material adverse effect on our business. Although we are attempting to expand our customer base, we expect that our customer concentration will not change significantly in the near future. The markets in which we sell our products are dominated by a relatively small number of customers who have contracts with United States governmental agencies, thereby limiting the number of potential customers. We cannot be sure that we will be able to retain our largest customers or that we will be able to attract additional customers, or that our customers will continue to buy our products in the same amounts as in prior years. The loss of one or more of our largest customers, any reduction or interruption in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may have to make, could significantly harm our business.

Continued competition in our markets may lead to a reduction in our revenues and market share.

The defense and aerospace component manufacturing market is highly competitive and we expect that competition will continue to increase. Current competitors have significantly greater technical, manufacturing, financial and

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

marketing resources than we do. We expect that more companies will enter the defense and aerospace component manufacturing market. We may not be able to compete successfully against either current or future competitors. Increased competition could result in reduced revenue, lower margins or loss of market share, any of which could significantly harm our business.

Our future revenues are inherently unpredictable, our operating results are likely to fluctuate from period to period and if we fail to meet the expectations of securities analysts or investors, our stock price could decline significantly.

16

Our quarterly and annual operating results are likely to fluctuate significantly due to a variety of factors, some of which are outside our control. Accordingly, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indications of performance. Some of the factors that could cause quarterly or annual operating results to fluctuate include conditions inherent in government contracting and our business such as the timing of cost and expense recognition for contracts, the United States Government contracting and budget cycles, introduction of new government regulations and standards, contract closeouts, variations in manufacturing efficiencies, our ability to obtain components and subassemblies from contract manufacturers and suppliers, general economic conditions and economic conditions specific to the defense market. Because we base our operating expenses on anticipated revenue trends and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing forecasted revenues could significantly harm our business.

Fluctuations in quarterly results, competition or announcements of extraordinary events such as acquisitions or litigation may cause earnings to fall below the expectations of securities analysts and investors. In this event, the trading price of our common stock could significantly decline. In addition, we cannot assure you that an active trading market will develop or be sustained for our common stock. These fluctuations, as well as general economic and market conditions, may adversely affect the future market price of our common stock, as well as our overall operating results.

We may lose sales if our suppliers fail to meet our needs.

Although we procure most of our parts and components from multiple sources or believe that these components are readily available from numerous sources, certain components are available only from sole sources or from a limited number of sources. While we believe that substitute components or assemblies could be obtained, use of substitutes would require development of new suppliers or would require us to re-engineer our products, or both, which could delay shipment of our products and could have a materially adverse effect on our operating results and financial condition.

Attracting and retaining key personnel is an essential element of our future success.

Our future success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel and on our ability to continue to attract, retain and motivate executive and other key employees, including those in managerial, technical, marketing and information technology support positions. Attracting and retaining skilled workers and qualified sales representatives is also critical to us. Experienced management and technical, marketing and support personnel in the defense and aerospace industries are in demand and competition for their talents

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

is intense. The loss of the services of one or more of our key employees or our failure to attract, retain and motivate qualified personnel could have a material adverse effect on our business, financial condition and results of operations.

Terrorist acts and acts of war may seriously harm our business, results of operations and financial condition.

United States and global responses to the Middle East conflict, terrorism, perceived nuclear, biological and chemical threats and other global crises increase uncertainties with respect to U.S. and other business and financial markets. Several factors associated, directly or indirectly, with the Middle East conflict, terrorism, perceived nuclear, biological and chemical threats, and other global crises and responses thereto, may adversely affect the Company.

While some of our products may experience greater demand as a result of increased U.S. Government defense spending, various responses could realign U.S. Government programs and affect the composition, funding or timing of our government programs and those of our customers. U.S. Government spending could shift to defense programs in which we and our customers do not participate. Given the current Middle East and global situation, U.S. defense spending is generally expected to remain high over the next several years. Increased defense spending does not necessarily correlate to increased business, because not all the programs in which we participate or have current capabilities may be earmarked for increased funding.

Terrorist acts of war (wherever located around the world) may cause damage or disruption to us, our employees, facilities, partners, suppliers, distributors and resellers, and customers, which could significantly impact our revenues, expenses and financial condition. The potential for future terrorist attacks, the national and international responses to terrorist attacks, and other acts of war or hostility have created many economic and political uncertainties, which could adversely affect our business and results of operations in ways that cannot presently be predicted. In addition, as a company with headquarters and significant operations located in the United States, we may be impacted by actions against the United States.

Our indebtedness may affect operations.

As described under the caption "Management's Discussion and Analysis or Plan of Operation - Liquidity and Capital Resources", we have significant indebtedness. We are significantly leveraged and our indebtedness is substantial in relation to our stockholders' equity. Our ability to make principal and interest payments will depend on future performance, which is subject to many factors, some of which are outside our control. In addition, our Loan Facility is secured by substantially all of our assets. In the case of a continuing default under our Loan Facility, the lender will have the right to foreclose on our assets, which would have a material adverse effect on our business. Payment of principal and interest on the Loan Facility may limit our ability to pay cash dividends to our stockholders and the documents governing the Loan Facility prohibit the payment of cash dividends in certain situations. Our leverage may also adversely affect our ability to finance future operations and capital needs, may limit our ability to pursue business opportunities and may make our results of operations more susceptible to adverse economic conditions.

We may issue shares of our capital stock or debt securities to complete an acquisition, which would reduce the equity interest of our stockholders.

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

We may issue our securities to acquire companies or businesses. Most likely, we will issue additional shares of our common stock or preferred stock, or both, to complete acquisitions. If we issue additional shares of our common stock or shares of our preferred stock, the equity interest of our existing stockholders may be reduced significantly, and the market price of our common stock may decrease. The shares of preferred stock we issue are likely to provide holders with dividend, liquidation and voting rights, and may include participation rights, senior to, and more favorable than, the rights and powers of holders of our common stock.

If we issue debt securities as part of an acquisition, and we are unable to generate sufficient operating revenues to pay the principal amount and accrued interest on that debt, we may be forced to sell all or a significant portion of our assets to satisfy our debt service obligations, unless we are able to refinance or negotiate an extension of our payment obligation. Even if we are able to meet our debt service obligations as they become due, the holders of that debt may accelerate payment if we fail to comply with, and/or are unable to obtain waivers of, covenants that require us to maintain certain financial ratios or reserves or satisfy certain other financial restrictions. In addition, the covenants in the loan agreements may restrict our ability to obtain additional financing and our flexibility in operating our business.

We have a limited number of shares available for future issuance and will need approval by our current shareholders to authorize more shares for issuance.

We are authorized to issue 120,055,746 shares of common stock. As of August 10, 2007, we had outstanding or commitments to issue 109,972,865 shares of common stock after giving effect to the conversion of our series B convertible preferred stock and the exercise of all outstanding options and warrants. Restrictions in our credit facility require that we pay dividends on our series B convertible preferred stock by issuing shares of our common stock. In addition, we will issue approximately 1,700,000 shares of our common stock in connection with our pending acquisition of Welding Metallurgy, Inc., if successfully completed, as to which we are unable to give you assurance. We are authorized to issue 8,003,716 shares of blank check preferred stock of which 2,000,000 shares have been designated series B convertible preferred stock. To facilitate the raising of additional capital or the completion of acquisitions, it is likely that we will seek shareholder approval to increase the number of shares of common stock we are authorized to issue.

Because of our limited resources and the significant competition for acquisitions, we may not be able to consummate an acquisition with growth potential, if at all.

We expect to encounter intense competition from other entities having a business objective similar to ours, including venture capital funds, leveraged buyout funds and operating businesses competing for acquisitions. Many of these entities are well established and have extensive experience in identifying and effecting business combinations. Many of these competitors possess greater technical, human and other resources than we do and our financial resources will be relatively limited when contrasted with those of many of these competitors. While we believe that there are numerous potential target businesses that we could acquire, our ability to compete in acquiring certain target businesses will be limited by our available financial resources. This inherent competitive limitation gives others an advantage in pursuing the acquisition of certain target businesses.

We may be unable to obtain financing, if required, to complete an acquisition or to fund the operations and growth of any business acquired, which could compel us to abandon a particular prospective acquisition.

If we require financing to complete an acquisition, that financing may not

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

be available in amounts and on terms acceptable to us, if at all. To the extent that financing proves to be unavailable when needed to consummate a particular acquisition, we would be compelled to restructure the transaction or abandon that particular acquisition. In addition, if we consummate an acquisition, we may require financing to fund the operations or growth of the business acquired. Our inability to secure additional financing could have a material adverse effect on the continued development or growth of our business.

There is only a limited public market for our securities.

The trading market for our common stock is limited and conducted on the OTC Bulletin Board. Our common stock is very thinly traded. We cannot assure you that a more active trading market in our common stock will ever develop, or if one does develop, that it will be sustained. We also cannot assure you that our common stock will ever become eligible for listing on Nasdaq or a stock exchange.

If our common stock becomes subject to the SEC's penny stock rules, broker-dealers may experience difficulty in completing customer transactions and trading activity in our securities may be adversely affected.

If at any time our net tangible assets are \$5,000,000 or less and our common stock has a market price per share of less than \$5.00, transactions in our common stock may be subject to the SEC's "penny stock" rules under the Securities Exchange Act. If our common stock falls within the definition of penny stock it will become subject to rules that impose additional sales practice requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally those with assets in excess of \$1,000,000, or annual incomes exceeding \$200,000 or \$300,000, together with their spouse).

18

For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of such securities and have received the purchaser's prior written consent to the transaction. Additionally, for any transaction, other than exempt transactions, involving a penny stock, the rules require the delivery, prior to the transaction, of a risk disclosure document mandated by the SEC relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell our common stock and may affect the ability of investors to sell our common stock in the secondary market. These rules also may cause fewer broker-dealers to be willing to make a market in our common stock, and it may affect the level of news coverage we receive.

Future sales of our common stock, or the perception that such sales could occur, could have an adverse effect on the market price of our common stock.

Future sales of our common stock, pursuant to a registration statement or Rule 144 under the Securities Act, or the perception that such sales could occur, could have an adverse effect on the market price of our common stock. The number of our shares available for sale pursuant to registration statements or Rule 144 is enormous relative to the trading volume of our shares. Any attempt to sell a substantial number of our shares will severely depress the market

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

price of our common stock. In addition, we may use our capital stock in the future to finance acquisitions and to compensate employees and management, which will further dilute the interests of our existing shareholders and could eventually significantly depress the trading price of our common stock.

The issuance of shares of our common stock, or the possible issuance of shares, under our stock option plan may limit the price that investors are willing to pay in the future for shares of our common stock and have the effect of delaying or preventing a change in control of our company, and the issuance of shares under the plan will decrease the amount of earnings and assets available for distribution to existing holders of our common stock and dilute their voting power.

Our 2005 Stock Incentive Plan allows for the issuance of up to 10,000,000 shares of common stock, either as stock grants or options, to employees, officers, directors, advisors and consultants of the company. As of June 30, 2007, we had outstanding options under the Plan to purchase 6,125,000 shares. The committee administering the Plan, which has sole authority and discretion to grant options under the Plan, may grant options which become immediately exercisable in the event of a change in control of our company and in the event of certain mergers and reorganizations. The issuance of shares of our common stock, or the possible issuance of shares, under our stock option plan may limit the price that investors are willing to pay in the future for shares of our common stock and have the effect of delaying or preventing a change in control of our company, and the issuance of shares under the plan will decrease the amount of earnings and assets available for distribution to existing holders of our common stock and dilute their voting power.

Item 3. Controls and Procedures

SEC Release 33-8760 provides that non-accelerated filers such as us are not required to include management's evaluation of controls and procedures under this Item until our Annual Report for the fiscal year ended December 31, 2007.

19

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

The Company was involved in litigation with J.C. Herbert Bryant, III, a former officer, director and shareholder of the Company, and KMS-Thin Tab 100, Inc., which was settled in September 2002. As part of the settlement, the Company entered into a distribution agreement with KMS permitting it to purchase certain products from the Company and to exclusively distribute those products in Florida from Orlando south. In October 2003, the Company terminated the distribution agreement with KMS. On December 1, 2003, the Company filed suit against KMS in the Palm Beach County Circuit Court for breach of contract, trademark infringement and for a declaration of rights that the distribution agreement is terminated. KMS answered the complaint and filed its own counterclaim for fraud in the inducement, trademark infringement, dilution and fraudulent misrepresentation; the fraud-based counterclaims were dismissed with prejudice by the Court on summary judgment. KMS subsequently amended its counterclaim to allege a breach of contract under the distribution agreement. In January 2005, the State Court in Florida ruled that neither party should prevail and rejected a request for attorney's fees by KMS of approximately \$60,000. KMS subsequently filed a notice of appeal. Subsequent to the Company's emergence from Bankruptcy, KMS requested that the Bankruptcy Court reopen our bankruptcy

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

case and award it the attorney's fees previously rejected by the Florida State Court. The Bankruptcy Court granted the motion in so far as it allowed KMS to prosecute in the Fourth District Court of Appeal in Florida its appeal of the State Court decision. Subsequently, KMS filed its appeal and brief with the Fourth District seeking attorney's fees. On April 25, 2007, the Fourth District Court of Appeals issued a per curiam opinion affirming the lower court's determination that neither party should be awarded attorney's fees.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Information concerning the issuance of unregistered securities during the fiscal quarter ended June 30, 2007 has previously been disclosed in the Company's Current Reports on Form 8-K.

Item 4. Submission of Matters to a Vote of Security Holders

At the Company's Annual Meeting of Stockholders on September 28, 2007, our shareholders:

1. Elected the following individuals to serve as directors: James A. Brown, Louis A. Giusto, Peter D. Rettaliata, Dario Peragallo, Seymour G. Siegel, Gen Ira A. Hunt, Jr. (Ret. USA), David J. Buonanno. Stephen Naglar was not nominated for re-election and no longer serves on the Board. Each nominee received 44,987,887 votes, representing all votes cast for the election of directors.
2. Ratified the appointment of Goldstein Golub Kessler LLP as the Company's registered certified public accountant for the fiscal year ending December 31, 2007.

Votes For -----	Votes Against -----	Abstentions -----	Broker Non-Votes -----
44,513,554	0	0	474,333

3. Approved an amendment to the Company's Certificate of Incorporation changing our name to Air Industries Group, Inc.

Votes For -----	Votes Against -----	Abstentions -----	Broker Non-Votes -----
44,513,554	0	2	474,331

20

Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit No.	Description
3.1	Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K report, filed February 15, 2006).
3.2	Certificate of Amendment to Certificate of Incorporation (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K report, filed July 2, 2007).
3.3	By-Laws of the Registrant (incorporated by reference to Exhibit 3.2 of the Registrant's Form 8-K report, filed February 15, 2006).
4.1	Certificate of Designation (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

- 4.2 Convertible Promissory Note, dated November 30, 2005, in the amount of \$332,631, from Gales Industries Incorporated (and assumed by the Registrant) to Dario Peragallo (incorporated by reference to Exhibit 4.2 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.3 Form of Warrant issued by the Registrant to GunnAllen Financial, Inc. (incorporated by reference to Exhibit 4.3 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.4 Form of Warrant issued by Original Gales to Atlas Private Equity, LLC (and assumed by the Registrant) (Incorporated by reference to Exhibit 4.4 of the Registrants Form 10-KSB, filed April 17, 2006).
- 4.5 Form of Warrant issued by Gales Industries Incorporated (and assumed by the Registrant) to investors in the \$45,000 Bridge Financing in or about August 2005 (incorporated by reference to Exhibit 4.5 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.6 Form of Warrant issued by Gales Industries Incorporated (and assumed by the Registrant) to investors in the \$105,000 Bridge Financing in or about September, 2005 (incorporated by reference to Exhibit 4.6 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.7 Form of Warrant issued to Porter, LeVay & Rose, Inc. (incorporated herein by reference to Exhibit 4.7 to Registrant's Amendment No. 1 on Form SB-2/A, filed June 16, 2006).
- 10.1 Form of Subscription Agreement for series B convertible preferred stock (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.2 Stock Purchase Agreement, dated January 2, 2007, between the Registrant, Sigma Metals, Inc. and the shareholders of Sigma Metals, Inc. (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 3, 2007).
- 10.3 Form of Promissory Note issued to the former shareholders of Sigma Metals, Inc. (incorporated by reference from Exhibit 10.2 to the Registrant's Current report on Form 8-K filed on April 18, 2007).
- 10.4 Employment Agreement by and between the Registrant and George Elkins, dated as of April 12, 2007 (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.5 Employment Agreement by and between the Registrant and Carole Tate, dated as of April 12, 2007 (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.6 Employment Agreement by and between the Registrant and Joseph Coonan, dated as of April 12, 2007 (incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.7 Letter of Clarification between the Registrant and Michael A. Gales dated May 11, 2007 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-QSB for the fiscal quarter ended March 31, 2007).
- 10.8 Stock Purchase Agreement, dated March 9, 2007, between the Registrant and the shareholders of Welding Metallurgy, Inc. (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 15, 2007).
- 10.9 Amendment No 1. to Stock Purchase Agreement, dated August 2, 2007, between the Registrant and the shareholders of Welding Metallurgy, Inc. (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8- K/A filed on August 3, 2007).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

21

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 14, 2007

AIR INDUSTRIES GROUP INC.
(formerly Gales Industries Incorporated)

By: /s/ Peter D. Rettaliata

Peter D. Rettaliata
President and Chief Executive Officer

/s/ Louis A. Giusto

Louis A. Giusto
Vice Chairman, Chief Financial Officer
and Treasurer (Principal Financial and
Accounting Officer)

22