

AIR INDUSTRIES GROUP
Form 10-K
March 25, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended: December 31, 2013

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File No. 001-35927

AIR INDUSTRIES GROUP
(Name of small business issuer in its charter)

Nevada
(State or other jurisdiction of incorporation or organization)

80-0948413
(I.R.S. Employer Identification No.)

1479 North Clinton Avenue, Bay Shore, NY 11706
(Address of Principal Executive Offices)

(631 968-5000)
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Exchange on which Registered |
|---------------------------------|--------------------------------------|
| Common Stock, par value \$0.001 | NYSE MKT |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required

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to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Non-Accelerated Filer Accelerated Filer Smaller Reporting Company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter ended June 30, 2013 was \$ 27,872,510.

There were a total of 5,868,068 shares of the registrant's common stock outstanding as of February 28, 2014.

AIR INDUSTRIES GROUP
FORM 10-K
For the Fiscal Year Ended December 31, 2013

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We are an Emerging Growth Company

We qualify as an "emerging growth company" as defined in the Jumpstart our Business Startups Act of 2012, or the JOBS Act. An emerging growth company may take advantage of reduced reporting and other burdens that are otherwise applicable generally to public companies. These provisions include:

- a requirement to have only two years of audited financial statements and only two years of related Management's Discussion and Analysis of Financial Condition and Results of Operations disclosure; and
- an exemption from the auditor attestation requirement in the assessment of our internal control over financial reporting pursuant to the Sarbanes-Oxley Act of 2002.

We may take advantage of these provisions until the end of the fiscal year ending after the fifth anniversary of our initial public offering, December 31, 2018, or such earlier time that we are no longer an emerging growth company and if we do, the information that we provide stockholders may be different than you might get from other public companies in which you hold equity. We would cease to be an emerging growth company if we have more than \$1.0 billion in annual revenue, have more than \$700 million in market value of our shares of common stock held by non-affiliates, or issue more than \$1.0 billion of non-convertible debt over a three-year period.

The JOBS Act permits an "emerging growth company" like us to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies.

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements. Certain of the matters discussed herein concerning, among other items, our operations, cash flows, financial position and economic performance including, in particular, future sales, product demand, competition and the effect of economic conditions, include forward-looking statements.

Forward-looking statements are predictive in nature and can be identified by the fact that they do not relate strictly to historical or current facts and generally include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions. 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, and general economic conditions, these statements and other projections contained herein expressing opinions about future outcomes and non-historical information, are subject to uncertainties and, therefore, there is no assurance that the outcomes expressed in these statements will be achieved.

Investors are cautioned that forward-looking statements are not guarantees of future performance and actual results or developments may differ materially from the expectations expressed in forward-looking statements contained herein. Given these uncertainties, you should not place any reliance on these forward-looking statements which speak only as of the date hereof. See "Risk factors" for a discussion of factors that could cause our actual results to differ from those expressed or implied by forward-looking statements.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. You are advised, however, to consult any additional disclosures we make in our reports filed with the Securities and Exchange Commission ("SEC").

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PART I

ITEM 1. BUSINESS

Introduction

As used in this report, unless otherwise stated or the context requires otherwise, the "Company" and terms such as "we," "us" "our," and "AIRI" refer to Air Industries Group, a Nevada corporation, and our directly and indirectly wholly-owned subsidiaries: Air Industries Machining, Corp., a New York corporation ("AIM"), Welding Metallurgy, Inc., a New York corporation ("Welding Metallurgy," or "WMI"), Nassau Tool Works, Inc., a New York corporation ("NTW"), and Miller Stuart, Inc., a New York corporation and a wholly-owned subsidiary of WMI ("MSI").

We are an aerospace and defense company. We design and manufacture structural parts and assemblies that focus on flight safety, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants and other components. We also provide sheet metal fabrication of aerostructures, tube bending and welding services. Our products are currently deployed on a wide range of high profile military and commercial aircraft including Sikorsky's UH-60 Blackhawk helicopter, Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2D Hawkeye, Boeing's 777, Airbus' 380 commercial airliners, and the US Navy F-18 and USAF F-16 fighter aircraft.

We became a public company in 2005 when our predecessor merged into a publicly traded company with nominal assets. In June 2007, we changed our name to Air Industries Group, Inc. On August 30, 2013, we reincorporated as a Nevada corporation and changed our name to Air industries Group. We acquired Welding Metallurgy in August 2007, and acquired the business now operated by NTW in an asset acquisition in June 2012 (the "NTW Acquisition"). During 2013, our subsidiary WMI made two acquisitions. In July 2013, we acquired the assets and business of Decimal Industries, Inc. ("Decimal") (the "Decimal Acquisition") and in November 2013, we acquired 100% of the shares of MSI (the "MSI Acquisition"). Consequently, we currently operate through four subsidiaries: AIM, WMI and NTW and MSI.

AIM has manufactured components and subassemblies for the defense and commercial aerospace industry for over 40 years and has established long term relationships with leading defense and aerospace manufacturers such as Boeing, Goodrich Landing Gear, Lockheed Martin, and Northrop Grumman. AIM manufactures machined aircraft parts and subassemblies for many of the major aircraft platforms in the industry. AIM's customers include original equipment manufacturers, or OEMs, and members of the defense and commercial aerospace industry supply chains, including Sikorsky, Goodrich Landing Gear, Lockheed Martin, Boeing, and Northrop Grumman. AIM is based in Bay Shore, Long Island, New York.

WMI has provided specialty welding services and metal fabrications to the defense and commercial aerospace industry since 1979. Its customers include GKN Corporation, Sikorsky, Lockheed Martin, Boeing and Northrop Grumman. The assets acquired in the Decimal Acquisition have been relocated to WMI's manufacturing facility in Hauppauge, Long Island, New York. Decimal was founded in 1968 and its principal business is the fabrication of precision sheet metal assemblies for the aerospace industry.

The predecessor of NTW was founded in 1959. NTW's principal business is the fabrication and assembly of landing gear components and complete landing gear for fighter aircraft for the US and foreign governments. NTW also performs sub-contract machining for other aerospace manufacturers. NTW is located in West Babylon, Long Island, New York.

MSI was founded in 1966 and is a manufacturer of aerospace components whose customers include major aircraft manufacturers and the US Military. MSI specializes in electromechanical systems, harness and cable assemblies, electronic equipment and printed circuit boards.

Our principal offices are located at the offices of AIM at 1479 North Clinton Avenue, Bay Shore, New York 11706 and our telephone number is (631) 968-5000. All of our subsidiaries are located within 10 miles of our headquarters.

Air Industries Machining Corp.

AIM manufactures aircraft structural parts and assemblies principally for prime defense contractors in the defense/aerospace industry including, Boeing, Goodrich Landing Gear, Sikorsky, Lockheed Martin, and Northrop Grumman. For the year ended December 31, 2013, we estimate that approximately 85 % of AIM's revenues were derived from sales of parts and assemblies for military applications, although direct sales to the military (U.S. and NATO) constitute only a small fraction of those sales. The balance of AIM's revenues for 2013 represented sales in the airframe manufacturing sector to major commercial aviation manufacturers. AIM is a provider of technically complex structures. AIM's parts are installed on Sikorsky's U/MH - 60M/S Helicopters, generally known as The BlackHawk, Lockheed's F35 Joint Strike Fighter (JSF), Northrop Grumman's E2-C/D Hawkeye, the Airbus A-380 Super Jumbo airliner, and the C-17 Globemaster.

AIM has evolved from being a manufacturer of individual parts to a manufacturer of mechanical and electro-mechanical subassemblies and an engineering integrator. This evolution continues as AIM seeks to become a provider of larger and more complex subassemblies. AIM currently produces over 2,400 individual products (SKU's) that are assembled by a skilled labor force into 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. AIM is the single or sole source for many of the parts it supplies to Sikorsky. Sales of parts and services to Sikorsky are subject to General Ordering Agreements which were recently renegotiated and extended through 2017.

AIM's achievements in manufacturing quality control have enabled it to receive various international certifications that distinguish it from less qualified manufacturers, as well as several highly technical, customer-based proprietary quality approvals. AIM has also been recognized with the supplier of the year awards from notable customers such as United Technologies (Sikorsky) and Northrop Grumman.

Nearly all of the parts and subassemblies produced by AIM are built to customer specifications and are not protected by patents, trademarks or other rights owned or licensed by AIM. AIM's investments have been for manufacturing engineering, process engineering and tooling, to achieve manufacturing efficiency certifications and customer approvals that provide entry barriers to competitors for follow-on procurements.

Welding Metallurgy, Inc.

Welding Metallurgy was originally founded as a provider of specialty welding services. Since its acquisition in August 2007, its product and service offerings have increased and now include tube bending and metal fabrications of aircraft structures. WMI's services and products are principally provided to prime contractors, aerospace engine manufacturers and to other subcontractors to aerospace manufacturers throughout the United States.

Welding Metallurgy is an important supplier on the Northrop Grumman E-2 C/D Hawkeye Program producing approximately 300 different parts annually. For the year ended December 31, 2013 nearly 100% of WMI's revenues were derived from sales of parts and assemblies for military applications, although direct sales to the military (US and NATO) were a small fraction. WMI produces the inlet housing and the auxiliary long and short beams for the Sikorsky BlackHawk helicopter and various welded door and panel assemblies for the Boeing CH-47 Chinook Helicopter. WMI also provides environmental tubing to Lockheed for the F-35 Joint Strike Fighter.

Decimal Industries was acquired by and merged into WMI in July of 2013. Decimal is a supplier of brazed and welded sheet metal fabrications to the aerospace industry. Its customers include Raytheon, Telephonics, and BAE Industries.

Nassau Tool Works

NTW is a manufacturer of complete landing gear and landing gear components for the F-16 Fighting Falcon and F-18 Hornet aircraft of the US Air Force and Navy. In addition NTW specializes in deep hole gun-drilling and trepanning and performs sub-contract machining services for prime contractors in the defense and aerospace industries. Our acquisition of NTW in June 2012 (the “NTW Acquisition”) enhanced our position in aircraft landing gear. Not only did we expand our customer base and increase the number of aircraft platforms we support, we also decreased our dependence on any single customer.

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Miller Stuart

MSI is a manufacturer and fabricator of wiring harnesses and other electro-mechanical and electronic assemblies for the aerospace industry. MSI's customers include Raytheon, Boeing and CPI Aerostructures. The MSI acquisition enhanced our penetration with our existing customers including Boeing and Raytheon and expanded the range of products that we manufacture. Nearly all of MSI's products are for the defense industry.

Our Market

We operate in both the military and to a lesser degree commercial aviation industries. Defense revenues represent approximately 90% of our sales. The Department of Defense has announced plans to significantly reduce spending beginning in Fiscal 2013. On March 1, 2013, as a result of the continuing budget impasse, automatic government spending cuts termed the Sequester were implemented. In December 2013 the US Government reached an accommodation in the budget impasse replacing the Sequester reductions with targeted reductions and spending limits to be determined by appropriate committees of the Congress. This has not yet been accomplished. In March 2014, the President announced a proposed budget for Fiscal 2015, beginning October 1, 2014, that included additional reductions in military spending.

Our products are incorporated into many aircraft platforms, the majority of which remain in production, and of which there are a substantial number of operating aircraft. We are a supplier of flight critical parts to Sikorsky's Black Hawk helicopter. We also make products for the Northrop Grumman E-2C, and the new E-2D Advanced Hawkeye aircraft including complete landing gear, the F-16 Falcon and F-18 Hornet fighter aircraft, the Airbus 380 Super Jumbo, and Boeing's (formerly McDonnell Douglas) C17 Globemaster, and the Lockheed F-35 Joint Strike Fighter.

Many of our products are "flight critical" essential to aircraft performance on takeoff, during flight and when landing. These products require advanced certifications as a condition to being a supplier. For many of our products we are the sole or one of a limited number of sources of supply. Many of these parts are subject to wear and tear or fatigue and are routinely replaced on aircraft on a time of service or flight cycle basis. Replacement demand for these products will continue, albeit at perhaps a lower rate, so long as an aircraft remains in service, which can be many years after production has stopped. We believe that this may lessen the effect on our revenues of reductions in defense spending. Nevertheless, it appears that our revenues, particularly those at AIM, have been impacted by a slowing of orders in anticipation of a reduction or shift in the mix of defense spending and there can be no assurance that our financial condition and results of operations will not be materially adversely impacted by reductions in defense spending or a change in the mix of products purchased by defense departments in the United States or other countries or the perception on the part of our customers that such changes are about to occur.

Sales and Marketing

Air Industries Machining

Our approach to sales and marketing can be best understood through the concept of customer alignment. The aerospace industry is dominated by a small number of large prime contractors and equipment manufacturers. These customers are increasingly seeking subcontractors who can supply and are qualified to integrate the fabrication of larger, more complex and more complete subassemblies. We seek to position ourselves within the supply chain of these contractors and manufacturers to be selected for subcontracted projects.

Successful positioning requires that we qualify to be a preferred supplier by achieving and maintaining independent third party quality approval certifications, specific customer quality system approvals and top supplier ratings through strong performance on existing contracts.

Initial contracts are usually obtained through competitive bidding against other qualified subcontractors, while follow-on contracts are usually retained by successfully performing initial contracts. The long term business of each of our current subsidiaries, AIM, WMI, NTW and MSI, generally benefits from barriers to entry resulting from investments, certifications, familiarization with the needs and systems of customers, and manufacturing techniques developed during the initial manufacturing phase.

As our business base grows with targeted customers, we endeavor to develop each of our relationships to one of a “partnership” where we participate in the resolution of pre-production design and build issues, and initial contracts are obtained as single source awards and follow-on pricing is determined through negotiations. Despite these efforts we estimate that a minority of our sales are based on negotiated prices.

Welding Metallurgy

WMI has historically enjoyed ongoing relationships with some of the world's leading aerospace companies, including Northrop Grumman, Boeing and Middle River Aircraft Systems. These relationships were based on the company's ability to provide precision welding services, which are sought after in the aerospace industry. Since we acquired Welding Metallurgy, we have implemented a marketing effort that is aimed at growth, with a focus on the following strategic objectives:

Favorable differentiation of Welding Metallurgy from the competition, and the securing of long-term customer commitments.

Diversification of customer base.

Evolution from being a supplier of welding services to being a supplier of welded assemblies.

Development into a Product Integrator, focused on providing Structural Assemblies to the Industry.

Favorable differentiation

Since we acquired WMI in 2007, our focus has been on providing world class customer service and we have restructured WMI's pricing to improve its competitive position. Welding Metallurgy also has embarked on a face-to-face marketing campaign with established customers, using members of its top management team accompanied by the management of AIRI. We believe that this personal approach, combined with improved pricing and performance, has resulted in new opportunities for Welding Metallurgy with existing customers and customers of AIM that were not utilizing the services of WMI.

Diversification

Prior to our acquisition of WMI, Northrop Grumman represented 70-75% of its annual revenues. Through direct marketing efforts by executive management of WMI and AIRI, Welding Metallurgy has secured the approval of and is now a supplier to Sikorsky Aircraft, Lockheed, Piper Aircraft, GKN Aerospace, M7 Aerospace, Vought Aerospace and Ametek/Hughes-Treitler. Consequently, though it remains a significant customer, the amount received from Northrop Grumman represented a significantly lower portion of WMI's revenues for the trailing twelve months ended December 31, 2013.

Evolution from Welder to Turnkey Solution Provider:

Once considered only a supplier of welding services, our long term goal for Welding Metallurgy is to develop the company into a product integrator providing structural assemblies to the aerospace industry. We believe this strategy is very much in line with current prime contractor supply chain strategy. Consequently WMI has recruited the personnel to fabricate complete, fully-assembled products, and, more recently, design products. In our marketing efforts we let customers know that we now have employees with the talent and experience to manage the manufacture

of sections of aircraft structures to be delivered to the final assembly phase of the aircraft manufacturing cycle, and customers have now engaged WMI for these services.

Nassau Tool Works

In recent years, the marketing effort at the predecessor of NTW was minimal and consisted largely of re-competing for contracts from the US Government and foreign governments for the F-16 and F-18 aircraft. Historically, the predecessor of NTW was a supplier to Goodrich Landing Gear, Gulfstream Aviation and others.

NTW has retained the qualifications which its predecessor had with its customers and the required tooling for parts for many other aircraft platforms. NTW's machining capabilities are somewhat different from and complementary to those of AIM. We intend to leverage our relationship with Goodrich and other customers to broaden the range of customers and products produced at NTW initially emphasizing those that its predecessor produced but de-emphasized as it focused on the F-16 and F-18. We have already identified several opportunities for AIM and WMI to bid on subcontracts utilizing the capabilities of NTW.

Miller Stuart

MSI has established relationships with Raytheon, Boeing and others. When acquired on November 6, 2013, Air Industries anticipated in the near term these relationships would remain in place. Recent orders from Boeing and an anticipated order from Raytheon have confirmed this assumption. In July 2013, we acquired Decimal which is a supplier of sheet metal enclosures to electronics manufacturers. We will attempt to expand MSI's business with the customers of Decimal. In addition, we have recently hired a new manufacturing manager at MSI. This will allow the General Manager of MSI, who has extensive experience and knowledge of the industry, to spend more time on marketing and sales.

Our Backlog

Our backlog is best understood by looking at our four operating subsidiaries independently.

AIM has a number of long-term multi-year General Purchase Agreements or GPA's with several customers. These agreements specify part numbers, specifications and prices of the covered products for a specified period, but do not authorize immediate production and shipment. Nevertheless, before a customer will award a GPA, we or any other potential supplier must demonstrate the ability to produce products meeting the customer's specifications and during the life of the contract maintain a strong quality performance rating and a consistent on-time delivery record, all at an acceptable price.

AIM's "firm backlog" includes only fully authorized orders received for products to be delivered within the forward 18-month period. The "projected backlog" includes the firm backlog and forecasted demand from our base of leading prime aerospace/defense contractors for product releases against GPAs. Although the forecasted releases against GPAs within the forward 18-month period are included in the "projected backlog", we may actually receive additional "follow-on" awards through the balance of a GPA period. As of February 28, 2013, AIM's 18-month "firm backlog" was approximately \$51.7 million and our "projected backlog" as of that date for the same 18-month period was approximately \$76.4 million.

Like AIM, WMI and NTW also have long term agreements with customers' agreements which specify part numbers, specifications and prices of the covered products for a specified period, but do not authorize immediate production and shipment. Their "firm backlog" as reported by us includes only fully authorized orders received for products to be delivered within the forward 18-month period. As of February 28, 2013, WMI's 18 month firm backlog was approximately \$10.1 million, and NTW's 18 month firm backlog was approximately \$14.4 million.

Competition

Winning a new contract is highly competitive. For the most part we manufacture to customer designs and specifications, and compete against companies that have similar manufacturing capabilities in a global marketplace. Consequently, the ability to obtain contracts requires providing quality products at competitive prices. To accomplish this requires that we make continuous improvements in our capabilities to assure our competitiveness and provide value to our customers. Our marketing strategy involves developing long-term ongoing working relationships with

customers. These relationships enable us to develop entry barriers to would-be competitors by establishing and maintaining advanced quality approvals, certifications and tooling investments that are difficult and expensive to duplicate.

Despite these barriers to entry, many of our competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers. Among our competitors are 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.

Many of our competitors are larger enterprises or divisions of significantly larger companies having greater financial and physical and technical resources, and the capabilities to timelier respond under much larger contracts.

Raw Materials and Replacement Parts

As product integrators, the manufacturing processes of both AIM and NTW require significant purchases of raw materials, hardware and subcontracted details. As a result, much of their success in profitably meeting customer demand requires efficient and effective subcontract management. Price and availability of many raw materials utilized in the aerospace industry are subject to volatile global markets. Most suppliers of raw materials are unwilling to commit to long-term contracts at fixed prices. This is a substantial risk as our strategy often involves long term fixed price commitments to our customers.

Welding Metallurgy and MSI do not require significant amounts of materials to produce finished products. Supplies required for their operations are readily available and do not require significant inventories to be held on hand.

Future Expansion Strategy

Since the 1990s, the aerospace and defense industries have undergone radical consolidation. The largest prime contractors have merged or been acquired resulting in fewer, and much larger, entities. Some examples are Boeing which acquired McDonnell Douglas; Lockheed Martin, formed by Lockheed's acquisition of Martin Marietta, together with the aerospace divisions of General Dynamics; Northrop Grumman, which fused together Northrop, Grumman, Westinghouse and Litton Industries into one entity. Where once there were nine companies there are now just three.

The consolidation of the prime contractors has caused a similar consolidation of suppliers. Major contractors seek to streamline supply chains by buying both larger quantities and more complete sub-assemblies from fewer suppliers. This has led to increased competitive pressure on many smaller firms. To survive in this environment, suppliers must invest in systems and infrastructures capable of interfacing with and meeting the needs of prime contractors. Suppliers with \$15-\$100 million in annual sales, referred to as the "Tier III and IV Manufacturing Sector," must become fully capable of working interactively in a computer aided three dimensional automated engineering environment and must have independent third party quality system certifications. We believe this industry trend will increase pressure on smaller aerospace/defense critical component manufacturers, the Tier III and IV suppliers, as the cost of upgrading their systems to achieve the level of interactivity necessary to work with prime contractors, to the extent they have not already done so, will adversely impact their profit margins. Our acquisitions of WMI and MSI, and the NTW Acquisition are part of our strategy to react to this market environment.

We intend to increase our business through internal growth and accretive acquisitions. Our ability to make acquisitions is dependent, in part, on our available cash and upon our ability to raise debt or equity as necessary to complete any acquisition. Currently we are in the later stages of negotiations with three acquisition candidates and have reached an understanding with the first candidate which we are reducing to a contract. Pursuant to the anticipated agreement we will acquire 100% of the stock and the entire business of this Long Island based company (the "LI Target") which produces products very similar to those manufactured by Decimal Industries which we acquired in the second half of 2013 and merged into WMI. The second acquisition candidate is a fabricator of sheet metal components using drop hammer and hydro-forming machinery located in the Southwestern United States (the "SW Target"). The SW Target is currently a supplier of components to WMI. Its other customers include major aerospace companies, some of which already do business with us. The third target (the "NE Target"), located in New England, is a logistics company which aggregates products and assembles kits of equipment for the US Military and Government.

For the year ended December 31, 2013 the three targets had combined revenues of approximately \$13 million and combined EBITDA, after adjustment for owners' compensation, of approximately \$2.5 million. The aggregate

purchase price including liabilities to be assumed is approximately \$6.5 million, subject to adjustments for changes in working capital. The anticipated purchase price is to be paid \$5 million in cash and \$1.5 million in shares of our common stock. We currently anticipate that we will seek to raise equity or increase our indebtedness to complete one or all of the acquisitions.

As of the date hereof there is no binding contract with the shareholders of any of the Targets and there can no assurance that any or all of the three transactions will be consummated on the terms described above, or at all. Our ability to complete any or all of the acquisitions is subject to the consent of our lender and our ability to increase our debt or raise equity. Any issuance of equity would result in an increase in the number of our shares outstanding, diluting the interests of our current shareholders. Nevertheless, given that the three acquisitions are anticipated to be accretive to our earnings per share, we believe it is in the best interests of our shareholders to complete the acquisitions if appropriate financing can be obtained.

Employees

As of March 1, 2014, we employed approximately 250 people.

AIM is a party to a collective bargaining agreement (the "Agreement") with the United Service Workers, IUJAT, Local 355 (the "Union") with which we believe we maintain good relations. The Agreement, dated January 1, 2012, expires December 31, 2015, and covers all of AIM's production personnel. AIM is required to make a monthly contribution to each of the Union's United Welfare Fund and the United Services Worker's Security Fund. This is the only pension benefit required by the Agreement and the Company is not obligated for any future defined benefit to retirees. The Agreement contains a "no-strike" clause, whereby, during the term of the Agreement, the Union will not strike and AIM will not lockout its employees.

All employees of the Company are covered under a co-employment agreement with Insperty, Inc.

Regulations

Environmental Regulation; Employee Safety

We are subject to regulations administered by the United States Environmental Protection Agency, the Occupational Safety and Health Administration, various state agencies and county and local authorities acting in cooperation with federal and state authorities. Among other things, these regulatory bodies impose restrictions that require us to control air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous chemicals and substances. The extensive regulatory framework imposes compliance burdens and financial and operating risks on us. Governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose civil and criminal fines in the case of violations.

The Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") imposes strict, joint and several liability on the present and former owners and operators of facilities that release hazardous substances into the environment. The Resource Conservation and Recovery Act of 1976 ("RCRA") regulates the generation, transportation, treatment, storage and disposal of hazardous waste. In New York, the handling, storage and disposal of hazardous substances are governed by the Environmental Conservation Law, which contains the New York counterparts of CERCLA and RCRA. In addition, the Occupational Safety and Health Act, which requires employers to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, obligates employers to provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances.

Federal Aviation Administration

We are subject to regulation by the Federal Aviation Administration ("FAA") under the provisions of the Federal Aviation Act of 1958, as amended. The FAA prescribes standards and licensing requirements for aircraft and aircraft components. We are subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. Our failure to comply with applicable regulations could result in the termination of or our disqualification from some of our contracts, which could have a material adverse effect on our operations. We have never been subject to such fines or disqualifications.

Government Contract Compliance

Our government contracts and those of many of our customers are subject to the procurement rules and regulations of the United States government, including the Federal Acquisition Regulations ("FAR"). Many of the contract terms are dictated by these rules and regulations. During and after the fulfillment of a government contract, we may be audited in respect of the direct and allocated indirect costs attributed to the project. These audits may result in adjustments to our contract costs. Additionally, we may be subject to U.S. government inquiries and investigations because of our participation in government procurement. Any inquiry or investigation can result in fines or limitations on our ability to continue to bid for government contracts and fulfill existing contracts.

We believe that we are in compliance with all federal, state and local laws and regulations governing our operations and have obtained all material licenses and permits required for the operation of our business.

ITEM 1A. RISK FACTORS

The purchase of our common stock involves a very high degree of risk.

In evaluating us and our business, you should carefully consider the risks and uncertainties described below and the other information and our consolidated financial statements and related notes included herein. If any of the events described in the risks below actually occurs, our financial condition or operating results may be materially and adversely affected, the price of our common stock may decline, perhaps significantly, and you could lose all or a part of your investment.

The risks below can be characterized into three groups:

- 1) Risks related to our business, including risks specific to the defense and aerospace Industry:
- 2) Risks arising from our indebtedness; and
- 3) Risks related to our common stock and our status as a public company.

Risks Related to Our Business

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

Approximately 90% of our revenue is derived from products for US military aviation. There are risks associated with programs that are subject to appropriation by Congress, which could be potential targets for reductions in funding. The Department of Defense has announced plans to significantly reduce spending beginning in Fiscal 2014 and beyond. Reductions in United States Government spending on defense or future changes in the mix of defense products required by United States Government agencies could limit demand for our products, and may have a materially adverse effect on our operating results and financial condition.

On March 1, 2013, the US Government imposed across the board spending reductions commonly referred to as “the Sequester”. These spending reductions included spending by the Department of Defense. During 2013, we have experienced a reduction in sales at our AIM subsidiary that we believe is the result of a slowing of orders in anticipation of the Sequester and the resulting reduction or shift in the components of defense spending. This reduction in orders at our AIM subsidiary is continuing in the first calendar quarter of 2014. We have also experienced slowdowns, albeit to a lesser degree at our WMI and NTW subsidiaries.

We depend on revenues from a few significant relationships, in particular with United Technology Corporation. Any loss, cancellation, reduction, or interruption in these relationships could harm our business.

We expect that our customer concentration will not change significantly in the near future. We derive most of our revenues from a small number of customers. In both 2013 and 2012, three of our customers accounted for 56% and 65% of our net sales, respectively. The markets in which we sell our products are dominated by a relatively small number of customers which have contracts with United States governmental agencies, thereby limiting the number of potential customers. Our success depends on our ability to develop and manage relationships with significant 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.

We depend on revenues from components for a few aircraft platforms and the cancellation or reduction of either production or use of these aircraft platforms could harm our business.

AIM 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 and the McDonnell Douglas (Boeing) C-17 Globemaster. Boeing has announced that it will close its C-17 production line in 2015. NTW derives most of its revenues from the F-16 Falcon and the F-18 Hornet. These aircraft platforms constituted nearly 75% of the revenues of the operations of NTW and its predecessor during 2012 and 2013. A reduction in demand for our products as a result of either 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 our operating results and financial condition.

Intense 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 increase and perhaps intensify as the overall market remains static or declines. Many competitors have significantly greater technical, manufacturing, financial and 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 operating results and financial condition.

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 a sole or 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.

There are risks associated with the bidding processes in which we compete.

We obtain many contracts through a competitive bidding process. We must devote substantial time and resources to prepare bids and proposals and may not have contracts awarded to us. Even if we win contracts, there can be no assurance that the prices that we have bid will be sufficient to allow us to generate a profit from any particular contract. There are significant costs involved with producing a small number of initial units of any new product and it may not be possible to recoup such costs on later production runs.

Due to fixed contract pricing, increasing contract costs expose us to reduced profitability and the potential loss of future business.

The cost estimation process requires significant judgment and expertise. Reasons for cost growth may include unavailability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in performance, availability and timing of funding from the customer, natural disasters, and the inability to recover any claims included in the estimates to complete. A significant change in cost estimates on one or more programs could have a material effect on our consolidated financial position or results of operations.

The prices of raw materials we use are volatile.

The prices of raw materials used in our manufacturing processes are volatile. If the prices of raw materials rise we may not be able to pass along such increases to our customers and this could have an adverse impact on our consolidated financial position and results of operations. Significant increases in the prices of raw materials could adversely impact our customers' demand for certain products which could lead to a reduction in our revenues and have a material adverse impact on our revenues and on our consolidated financial position and results of operations.

We do not own the intellectual property rights to products we produce.

Nearly all the parts and subassemblies we produce are built to customer specifications and the customer owns the intellectual property, if any, related to the product. Consequently, if a customer desires to use another manufacturer to fabricate its part or subassembly, it would be free to do so.

There are risks associated with new programs.

New programs typically carry risks associated with design changes, acquisition of new production tools, funding commitments, imprecise or changing specifications, timing delays and the accuracy of cost estimates associated with such programs. In addition, any new program may experience delays for a variety of reasons after significant expenditures are made. If we were unable to perform under new programs to the customers' satisfaction or if a new program in which we had made a significant investment was terminated or experienced weak demand, delays or other problems, then our business, financial condition and results of operations could be materially adversely affected. This could result in low margin or forward loss contracts, and the risk of having to write-off costs and estimated earnings in excess of billings on uncompleted contracts if it were deemed to be unrecoverable over the life of the program.

To perform on new programs we may be required to incur up-front costs which may not have been separately negotiated. Additionally, we may have made assumptions related to the costs of any program which may be material and which may be incorrect, resulting in costs that are not recoverable. Such charges and the loss of up-front costs could have a material impact on our liquidity.

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 through acquisitions. This will result in increased responsibilities for management and could strain our financial and other resources. There can be no assurance that we will successfully integrate any future business acquired through acquisition.

Our ability to manage and support our growth effectively is 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 personnel.

There can be no assurance that we have the management expertise to successfully integrate the operations of any company that we might acquire in the future.

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.

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. Experienced management and technical, marketing and support personnel in the defense and aerospace industries are in demand and competition for their talents 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.

We are subject to strict governmental regulations relating to the environment, which could result in fines and remediation expense in the event of non-compliance.

We are required to comply with extensive and frequently changing environmental regulations at the federal, state and local levels. Among other things, these regulatory bodies impose restrictions to control air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous substances into the environment. This extensive regulatory framework imposes significant compliance burdens and risks on us. In addition, these regulations may impose liability for the cost of removal or remediation of certain hazardous substances released on or in our facilities without regard to whether we knew of, or caused, the release of such substances. Furthermore, we are required to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances. Our operations require the use of chemicals and other materials for painting and cleaning that are classified under applicable laws as hazardous chemicals and substances. If we are found not to be in compliance with any of these rules, regulations or permits, we may be subject to fines, remediation expenses and the obligation to change our business practice, any of which could result in substantial costs that would adversely impact our business operations and financial condition.

We may be subject to fines and disqualification for non-compliance with Federal Aviation Administration regulations.

We are subject to regulation by the Federal Aviation Administration under the provisions of the Federal Aviation Act of 1958, as amended. The FAA prescribes standards and licensing requirements for aircraft and aircraft components. We are subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. Our failure to comply with applicable regulations could result in the termination of or our disqualification from some of our contracts, which could have a material adverse effect on our operations. We have never been subject to such fines or disqualification.

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.

Risks Related to Our Indebtedness

Our indebtedness may materially adversely affect our operations.

As is more fully described under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources", we have significant indebtedness. While our indebtedness remains substantial it has declined in recent years both in absolute terms and in relation to our stockholders' equity and net income. 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. Future payments of principal and interest or a change in policy by our lender may limit our ability to pay cash dividends to our stockholders.

Our leverage may 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.

Risks Related to our Common Stock and our Status as a Public Company

There is only a limited public market for our common stock.

The market for our common stock – as measured by the volume of trading - is limited. The lack of a robust market may impair a stockholder's ability to sell shares of our common stock. 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. In the absence of a more active trading market, any attempt to sell a substantial number of our shares could result in a decrease in the price of our stock. Specifically, you may not be able to resell your shares of common stock at or above the price you paid for such shares or at all.

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.

The number of shares of our common stock eligible for resale is enormous relative to the trading volume of our common stock. Any attempt to sell a substantial number of our shares will severely depress the market 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. Furthermore, we may sell up to \$15,339,627 of additional shares of common stock pursuant to an S-3 "shelf"-registration statement declared effective on December 11, 2013.

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 2013 Equity Incentive Plan allows for the issuance of up to 600,000 shares of common stock, either as stock grants or options, to employees, officers, directors, advisors and consultants of the company. As of December 31, 2013, we had outstanding under the Plan options to purchase 422,040 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.

We are an "emerging growth company" and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.

The JOBS Act permits "emerging growth companies" like us to rely on some of the reduced disclosure requirements that are already available to companies having a public float of less than \$75 million, for as long as we qualify as an emerging growth company. During that period, we are permitted to omit the auditor's attestation on internal control over financial reporting that would otherwise be required by the Sarbanes-Oxley Act. Companies with a public float of \$75 million or more must otherwise procure such an attestation beginning with their second annual report after their initial public offering. For as long as we qualify as an emerging growth company, we are also excluded from the requirement to submit "say-on-pay", "say-on-pay frequency" and "say-on-parachute" votes to our stockholders and may avail ourselves of reduced executive compensation disclosure compared to larger companies. In addition, as described in the following risk factor, as an emerging growth company we can take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies.

Until such time as we cease to qualify as an emerging growth company, investors may find our common stock less attractive because we may rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

As an "emerging growth company" we may take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies.

Section 107 of the JOBS Act also provides that, as an emerging growth company, we can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. We can therefore delay the adoption of certain accounting standards until those standards would

otherwise apply to private companies. We have elected to take advantage of the benefits of this extended transition period. Our financial statements may therefore not be comparable to those of companies that comply with such new or revised accounting standards. Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates" for further discussion of the extended transition period for complying with new or revised accounting standards.

At such time as we cease to qualify as an "emerging growth company" under the JOBS Act, the costs and demands placed upon management will increase.

We will continue to be deemed an emerging growth company until the earliest of (i) the last day of the fiscal year during which we had total annual gross revenues of \$1,000,000,000 (as indexed for inflation), (ii) the last day of the fiscal year following the fifth anniversary of the date of the first sale of common stock under a registration statement under the Securities Act, December 31, 2018, (iii) the date on which we have, during the previous 3-year period, issued more than \$1,000,000,000 in non-convertible debt; or (iv) the date on which we are deemed to be a 'large accelerated filer' as defined by the SEC, which would generally occur upon our attaining a public float of at least \$700 million. Once we lose emerging growth company status, we expect the costs and demands placed upon management to increase, as we would have to comply with additional disclosure and accounting requirements, particularly if our public float should exceed \$75 million.

We incur significant costs as a result of operating as a public company, and our management is required to devote substantial time to compliance requirements, including establishing and maintaining internal controls over financial reporting, and we may be exposed to potential risks if we are unable to comply with these requirements.

As a public company, we will incur significant legal, accounting and other expenses under the Sarbanes-Oxley Act of 2002, together with rules implemented by the Securities and Exchange Commission and applicable market regulators. These rules impose various requirements on public companies, including requiring certain corporate governance practices. Our management and other personnel will need to devote a substantial amount of time to these requirements. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal controls for financial reporting and disclosure controls and procedures. In particular, we must perform system and process evaluations and testing of our internal controls over financial reporting to allow management to report on the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Compliance with Section 404 may require that we incur substantial accounting expenses and expend significant management efforts. Our testing may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses. In the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner, the market price of our stock could decline if investors and others lose confidence in the reliability of our financial statements and we could be subject to sanctions or investigations by the SEC or other applicable regulatory authorities.

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.

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.

ITEM 2. PROPERTIES

Our headquarters and the majority of the operations of AIM are situated on a 5.4-acre corporate campus in Bay Shore, New York. We occupy three buildings on the campus, consisting of 76,000 square feet.

On October 24, 2006, we entered into a “sale/leaseback” transaction whereby we sold the buildings and real property located at the corporate campus and entered into a 20-year triple-net lease for the property. Base annual rent for 2013 was approximately \$644,000 and increases by 3% each subsequent year. The lease grants AIM an option to renew the lease for an additional five years. Under the terms of the lease, we are required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance.

The operations of WMI are conducted in an 81,035 square foot facility located in Hauppauge, New York. This space is occupied under a sublease which had an annual base rent of approximately \$596,000 for 2013 and increases 3% per year through December 31, 2015.

The operations of NTW are conducted in a 60,000 square foot facility in West Babylon, New York. The space is occupied under a lease which provides for an annual base rent of \$30,000 per month through October 2017.

The operations of MSI are conducted in a 6,750 square foot facility in Hauppauge, New York. This space is occupied under a lease which provides for annual base rent of \$4,200 per month through May 31, 2015.

All of our facilities are within 10 miles of each other in Suffolk County, Long Island, New York.

ITEM 3. LEGAL PROCEEDINGS

From time to time we may be engaged in various lawsuits and legal proceedings in the ordinary course of our business. We are currently not aware of any legal proceedings the ultimate outcome of which, in our judgment based on information currently available, would have a material adverse effect on our business, financial condition or operating results. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial stockholder of our common stock, is an adverse party or has a material interest adverse to our interest.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Market for Our Common Stock

Our common stock has been listed on the NYSE MKT since June 12, 2013 under the symbol "AIRI." Prior to June 12, 2013, our common stock was quoted on OTC Bulletin Board under the symbol "AIRI." Prior to February 11, 2013, our common stock was quoted on OTC Pink under the symbol "AIRI.PK." The prices set forth below reflect the quarterly high and low closing prices of a share of our common shares on the OTC Pink for the periods indicated as reported by Yahoo Finance.

| | High | Low |
|----------------------------------|----------|---------|
| Quarter Ended March 31, 2012 | \$ 9.64 | \$ 2.95 |
| Quarter Ended June 30, 2012 | \$ 6.27 | \$ 3.17 |
| Quarter Ended September 30, 2012 | \$ 6.27 | \$ 5.50 |
| Quarter Ended December 31, 2012 | \$ 12.00 | \$ 5.70 |
| Quarter Ended March 31, 2013 | \$ 6.00 | \$ 7.27 |
| Quarter Ended June 30, 2013 | \$ 6.24 | \$ 5.97 |
| Quarter Ended September 30, 2013 | \$ 5.97 | \$ 7.91 |
| Quarter Ended December 31, 2013 | \$ 7.61 | \$ 9.50 |

Holders

On February 28, 2014, there were approximately 324 stockholders of record of our common stock. The number of record holders does not include persons who held our common stock in nominee or "street name" accounts through brokers.

Dividends

On both April 1, and July 5, 2013, we paid dividends of \$0.0625 per share on our common stock. On both October 15, 2013 and January 9, 2014, we paid dividends of \$0.125 per share on our common stock. We intend to continue to pay dividends each fiscal quarter of 2014. However all determinations relating to our dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions and future prospects and other factors the Board of Directors may deem relevant. Further, the payment of any cash dividends requires compliance with financial covenants of the loan agreement with our principal lender.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes shares of our Common Stock to be issued upon exercise of options and warrants, the weighted-average exercise price of outstanding options and warrants and options available for future issuance pursuant to our equity compensation plans as of December 31, 2013:

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans |
|--|---|---|--|
| Eq Equity compensation plans approved by security holders | 422,040 | \$ 9.34 | 177,960 |
| Equ Equity compensation plans not approved by security holders | 118,335 | \$ 6.30 | None |
| Tot Total | 540,375 | \$ 8.67 | 177,960 |

Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities

Except as previously reported in our periodic reports filed under the Exchange Act, we did not issue any unregistered securities during the fourth quarter of the fiscal year ended December 31, 2013.

Purchases of Our Equity Securities

No repurchases of our common stock were made during the fourth quarter of our fiscal year ended December 31, 2013.

ITEM 6. SELECTED FINANCIAL DATA

Not required.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion of our financial condition and results of operations should be read in conjunction with the audited financial statements and the notes to those statements included elsewhere in this Report. This discussion contains forward-looking statements that involve risks and uncertainties. You should specifically consider the various risk factors identified in this Report that could cause actual results to differ materially from those anticipated in these forward-looking statements.

Business Overview

We are an aerospace and defense company. We design and manufacture structural parts and assemblies that focus on flight safety, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants and other components. We also provide sheet metal fabrication of aerostructures, tube bending and welding services. Our products are currently deployed on a wide range of high profile military and commercial aircraft including Sikorsky's

UH-60 Blackhawk helicopter, Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2D Hawkeye, Boeing's 777, Airbus' 380 commercial airliners, and the US Navy F-18 and USAF F-16 fighter aircraft.

We became a publicly traded company in December 2005 through the “reverse-merger” of our wholly-owned subsidiary, AIM into a publicly traded shell company with nominal assets. In June 2007, we changed our name to Air Industries Group, Inc. On August 30, 2013, we reincorporated as a Nevada corporation and changed our name to Air Industries Group. We acquired Welding Metallurgy in August 2007 and completed the NTW Acquisition in June 2012. On July 1, 2013 we acquired certain assets and the business of Decimal Industries. Decimal was acquired by our Welding Metallurgy subsidiary and the operations of Decimal have been relocated to our Hauppauge facility. On November 6, 2013, Welding Metallurgy also acquired 100% of the stock of MSI. Consequently, we currently have four operating subsidiaries - AIM, WMI, NTW, and MSI.

AIM has manufactured components and subassemblies for the defense and commercial aerospace industry for over 40 years. WMI has provided specialty welding services and metal fabrications to the defense and commercial aerospace industry since 1979. The predecessor of NTW was founded in 1959 and its principal business is the fabrication and assembly of landing gear components and complete landing gear for fighter aircraft for the US and foreign governments. MSI is a manufacturer and fabricator of wiring harnesses and other electro-mechanical and electronic assemblies for the aerospace industry

The aerospace and defense market is highly competitive and we face intense competition in all areas of our business. Nearly all of our revenues are derived by producing products to customer specifications after being awarded a contract through a competitive bidding process. As the aerospace and defense industries continue to consolidate and major contractors seek to streamline their supply chains by buying more complete sub-assemblies from fewer suppliers, we have sought to remain competitive not only by providing cost-effective world class service but also by increasing our ability to deliver more complex and complete assemblies.

Our ability to operate profitably is determined by our ability to win new contracts and renewals of existing contracts, and then fulfill these contracts on a timely satisfactory basis at costs that enable us to generate a profit based upon the agreed upon contract price. Winning a contract generally requires that we submit a bid containing a fixed price for the product or products covered by the contract for an agreed upon period of time. Thus, when submitting bids we are required to estimate our future costs of productions and, since we often rely upon subcontractors, the prices we can obtain from our subcontractors.

While our revenues are largely determined by the number of contracts we are awarded, the volume of product delivered and price of product under each contract, our costs are determined by a number of factors. The principal factors impacting our costs are the cost of materials and supplies, labor, financing and the efficiency at which we can produce our products. The cost of materials used in the aerospace industry is highly volatile. In addition, the market for the skilled labor we require to operate our plants is highly competitive.

Segment Data

We follow FASB ASC 280, "Segment Reporting", which establishes standards for reporting information about operating segments in annual and interim financial statements, and requires that companies report financial and descriptive information about their reportable segments based on a management approach. ASC 280 also establishes standards for related disclosures about products and services, geographic areas and major customers.

AIM is primarily engaged in processing, cutting, milling, machining and hardening metals into flight critical and other assemblies widely used in the aerospace industry and sold primarily to prime defense contractors. WMI specializes in complex welding applications in tubular structures and fabrication of complex sheet metal structures. Due to its small size and recent acquisition, MSI is included in the same segment as WMI. NTW is primarily engaged in the production of complete landing gear and landing gear sub-assemblies for military fighter aircraft, sold primarily directly to the US Government.

Along with our operating subsidiaries, we report the results of our corporate division as an independent segment. Given the similarity of their operations, the combination of AIM and NTW will enable us to increase the variety and complexity we of products we produce for customers. Nevertheless, we have continued to operate AIM and NTW as independent business units and, in the discussion below, they are considered independent business segments.

The accounting policies of each of the segments are the same as those described in the Summary of Significant Accounting Policies. We evaluate performance based on revenue, gross profit contribution and assets employed. Operating costs that are not directly attributable to a particular segment are included in Corporate. These costs include corporate costs such as legal, audit, tax and other professional fees including those related to being a public company.

Results of Operations

The results of the operations of NTW have been reflected within our financial reports since its acquisition in June 2012. The results of operations of Decimal and MSI have been reflected within our financial reports since the dates of their acquisition, July 1, 2013 and November 6, 2013, respectively.

Years ended December 31, 2013 and 2012:

Selected Financial Information:

Statement of Operations Data

| | 2013 | 2012 |
|------------------------------|---------------|---------------|
| Net sales | \$ 62,833,000 | \$ 64,215,000 |
| Cost of sales | 47,598,000 | 49,357,000 |
| Gross profit | 15,235,000 | 14,858,000 |
| Operating and interest costs | 11,962,000 | 10,717,000 |
| Other income (expense) net | 296,000 | (146,000) |
| Income taxes (benefit) | (170,000) | 1,447,000 |
| Net Income | \$ 3,739,000 | \$ 2,548,000 |

Balance Sheet Data

| | December 31, 2013 | December 31, 2012 |
|----------------------------|-------------------|-------------------|
| Cash and cash equivalents | \$ 561,000 | \$ 490,000 |
| Working capital | 12,531,000 | 11,680,000 |
| Total assets | 50,172,000 | 53,156,000 |
| Total stockholders' equity | 21,613,000 | 18,988,000 |

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The following sets forth the results of operations for each of our segments individually and on a consolidated basis for the periods indicated.

Year Ended December 31,

| | 2013 | 2012 |
|-----------------------|---------------|---------------|
| AIM | | |
| Net Sales | \$ 34,997,000 | \$ 42,075,000 |
| Gross Profit | 6,305,000 | 8,218,000 |
| Pre Tax Income | 2,368,000 | 3,260,000 |
| Assets | 21,889,000 | 24,673,000 |
| WMI | | |
| Net Sales | 13,630,000 | 14,907,000 |
| Gross Profit | 3,482,000 | 4,030,000 |
| Pre Tax Loss | (203,000) | 1,138,000 |
| Assets | 11,619,000 | 10,818,000 |
| NTW | | |
| Net Sales | 14,206,000 | 7,233,000 |
| Gross Profit | 5,448,000 | 2,610,000 |
| Pre Tax Income | 1,905,000 | 796,000 |
| Assets | 11,318,000 | 14,410,000 |
| Corporate | | |
| Net Sales | - | - |
| Gross Profit | - | - |
| Pre Tax Loss | (501,000) | (1,199,000) |
| Assets | 9,647,000 | 13,200,000 |
| Consolidated | | |
| Net Sales | 62,833,000 | 64,215,000 |
| Gross Profit | 15,235,000 | 14,858,000 |
| Pre Tax Income | 3,569,000 | 3,995,000 |
| Provision for Taxes | (170,000) | 1,447,000 |
| Net Income | 3,739,000 | 2,548,000 |
| Elimination of Assets | (4,301,000) | (9,945,000) |
| Assets | 50,172,000 | 53,156,000 |

The following discussion of our results of operations constitutes management's review of the factors that affected our financial and operating performance for the years ended December 31, 2013 and 2012. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report.

For 2013 and 2012, we had three segments operating segments, AIM, Welding Metallurgy and NTW, and separately report our corporate overhead. For segment reporting purposes, MSI is included with Welding Metallurgy.

Net Sales:

Consolidated net sales from operations for year ended December 31, 2013 were approximately \$62,833,000, a decrease of (\$1,382,000) or (2.2%) compared with \$64,215,000 for the year ended December 31, 2012. Net sales at AIM for the year ended December 31, 2013 were \$34,997,000, a decrease of approximately (\$7,078,000) or (16.8%) compared with \$42,075,000 for the year ended December 31, 2012. The decrease in net sales at AIM is primarily attributable to a reduction in sales to Sikorsky, AIM's largest customer beginning during the second half of 2012. Net sales at Welding for the year ended December 31, 2013 were \$13,630,000, a decrease of approximately (\$1,277,000) or (8.6%) compared with \$14,907,000 for the year ended December 31, 2012. Net sales at NTW for the year ended December 31, 2013 were \$14,206,000. Net sales for the period June 20, 2012, the date of acquisition to December 31, 2012 were \$7,233,000.

As indicated in the table below, three customers represented 56.0% and 65.3% of total sales for the years ended December 31, 2013 and 2012, respectively.

| Customer | Percentage of Sales | |
|-------------------------------------|---------------------|------|
| | 2013 | 2012 |
| Sikorsky Aircraft | 27.7 | 27.6 |
| Goodrich Landing Gear Systems | 18.3 | 26.3 |
| United States Department of Defense | 10.0 | ** |
| Northrup Grumman Corporation | * | 11.4 |

* Customer was less than 10% of sales for the year ended December 31, 2013

** Customer was less than 10% of sales for the year ended December 31, 2012

As indicated in the table below, two customers represented 42.9% and three customers represented 54.6% of gross accounts receivable at December 31, 2013 and 2012, respectively.

| Customer | Percentage of Receivables | |
|-------------------------------|---------------------------|---------------|
| | December 2013 | December 2012 |
| GKN Aerospace | 22.8 | 18.6 |
| Goodrich Landing Gear Systems | 20.1 | 10.7 |
| Northrup Grumman Corporation | * | 25.3 |

* Customer was less than 10% of Gross Accounts Receivables at December 31, 2013

Gross Profit:

Consolidated: Gross profit from operations for the year ended December 31, 2013 was \$15,235,000 an increase of approximately \$377,000 or 2.5% as compared to gross profit of \$14,858,000 for the year ended December 31, 2012. AIM: Gross profit from operations for the year ended December 31, 2013 was \$6,305,000 a decrease of approximately (\$1,913,000) or (23.3%) as compared to gross profit of \$8,218,000 for the year ended December 31, 2012. The decline in gross profit is due almost entirely to lower sales. Gross margin stayed relatively constant during 2013 as compared to 2012.

WMI: Gross profit from operations for the year ended December 31, 2013 was \$3,482,000 a decrease of approximately (\$548,000) or (13.6%) as compared to

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gross profit of \$4,030,000 for the year ended December 31, 2012. The decrease in gross profit at WMI is due to reduced sales, and by a lower gross margin.

WMI's gross margin declined from 27% of sales in 2012 to 25.5% in 2013.

NTW: Gross profit from operations for the year ended December 31, 2013 was \$ 5,448,000. Gross profit for the period June 20, 2012 to December 31, 2012 was \$2,610,000.

Selling, General & Administrative (“SG&A”):

Consolidated SG&A costs for the year ended December 31, 2013 totaled \$10,622,000 and increased by \$1,748,000 or 19.7% compared to \$8,874,000 for the year ended December 31, 2012. Beginning January 1, 2013, the Company began to allocate all of the corporate SG&A costs of Air Industries Group to AIM, WMI and NTW. For 2013 these are allocated 50% to AIM and 25% to each of WMI and NTW. For the year ended December 31, 2012 SG&A costs have been reclassified to reflect an allocation of AIRI corporate costs of 75% to AIM and 25% to WMI during the first six months of 2012 and 50% to AIM and 25% each to each of WMI and NTW beginning with the third quarter of 2012. For 2012, SG&A at NTW included only the period from June 20, to December 31. The amount reclassified for the year ended December 31, 2012 is approximately \$921,000 to AIM; \$363,000 to WMI and \$167,000 to NTW. Included in SG&A costs for 2013 are approximately \$1,754,000 in costs incurred at NTW for the period January 1 to June 30, 2013, which accounts for nearly 100% of the increase in SG&A.

The principal components of the SG&A costs were:

- o AIM: SG&A costs for the year ended December 31, 2013 totaled approximately \$3,150,000 and decreased by (\$1,131,000) or (26.4 %) compared \$4,281,000 for the year ended December 31, 2012.
- o WMI: SG&A costs for the year ended December 31, 2013 totaled approximately \$3,928,000 and increased by \$1,148,000 or approximately 41.3% compared to \$2,780,000 for the year ended December 31, 2012. The increase in SG&A costs at Welding resulted in part from a reclassification in 2012 of certain management personnel costs from factory overhead to SG&A and by additional personnel resulting from the Decimal Industries acquisition in July 2013.
- o NTW: SG&A costs for the year ended December 31, 2013 totaled approximately \$3,544,000 an increase of \$1,733,000 compared to \$1,811,000 for the period June 20, 2012 to December 31, 2012.

Interest and Financing Costs; Income Taxes and Net Income.

Interest and financing costs were approximately \$1,340,000 for the year ended December 31, 2013, a decrease of approximately \$(503,000) or (27.3%) as compared to \$1,843,000 for the year ended December 31, 2012. Interest expense decreased in part as a result of lower outstanding balances. Total debt and capital lease obligations at December 31, 2013 were \$5,711,000 less than at December 31, 2012. In addition during for the period January 1 to approximately June 30, 2012, the Company had Junior Subordinated Notes which bore interest at 12% outstanding. These Notes were converted into common stock in June 2012.

The Company recognized an income tax benefit of approximately \$170,000 for year ended December 31, 2013 compared to an income tax expense of \$1,447,000 for the comparable period in 2012. This change was based upon the fact that the Company determined it no longer needed to provide a valuation allowance on certain deferred tax assets. This was based upon the fact that management believes that due to the sustained profitability of the Company

and the probability that such profitability will continue, the realizability of the net deferred tax assets is more likely than not to be realized.

Net income for the year ended December 31, 2013 was \$3,739,000, an increase of \$1,191,000 or 46.7% compared to net income of \$2,548,000 for the year ended December 31, 2012.

Impact of Inflation

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

LIQUIDITY AND CAPITAL RESOURCES

The Company is highly leveraged and relies upon its ability to continue to borrow from PNC. Substantially all of the assets of the Company are pledged as collateral under our existing loan agreements with PNC. The Company is required to maintain a lockbox account with PNC, into which substantially all of the Company's cash receipts are paid. If PNC were to cease lending, the Company would lack funds to continue its operations.

On June 27, 2013, the Company entered into an Amended and Restated Revolving Credit, Term Loan, and Security Agreement ("Loan Facility") with PNC. The Loan Facility, as amended on December 20, 2013, now provides for maximum borrowings under a revolving loan of \$20,000,000 (including an inventory sub-limit of \$12,500,000) limited to the borrowing base as defined and a term loan in the amount of \$1,948,000. The Company paid an amendment fee of \$25,000 in connection with the execution of the December amendment. The interest rate on the term loan is 5.0% per annum, subject to adjustment based upon a reference rate. The interest rate on our revolving credit line, which adjusts based upon changes in a referenced rate, is currently 4% per annum.

On July 1, 2013 the Company acquired certain assets including production equipment, inventory and intangible assets of Decimal. The business acquired has become a division of WMI. The purchase price of the assets was \$975,000, which included inventory of approximately \$665,000 valued at a percentage of completion including anticipated profit on sale. The purchase price was paid as follows: \$315,000 in cash at closing with the balance payable in eight equal monthly installments without interest in the amount of \$76,667, with a final payment in the amount of \$46,766. As part of the transaction, the Company leased for 12 months until June 2014 the facility that had been occupied by Decimal. It is our intention to relocate the operations of Decimal into WMI's facility in Hauppauge.

On November 6, 2013, the Company acquired all of the common stock of MSI for \$142,000, of which \$25,000 was paid at the date of closing, with the remainder due on December 6, 2013. Miller Stuart is a manufacturer of aerospace components whose customers include major aircraft manufacturers and the US Military. Miller Stuart specializes in electromechanical systems, harness and cable assemblies, electronic equipment and printed circuit boards.

As of December 31, 2013, our debt for borrowed monies in the amount of \$17,496,000 consisted of the revolving credit note due to PNC in the amount of \$12,029,000, the term loan due to PNC in the amount of \$1,948,000, a note due the sellers of WMI in the aggregate amount of \$732,000, Junior Subordinated Notes of \$1,000,000 and capitalized lease obligations of \$1,787,000. This represents a decrease in our debt for borrowed monies at December 31, 2012 of \$23,851,000, when the revolving note due to PNC was \$15,667,000, the term loan due to PNC was \$3,748,000, the note due the sellers of WMI was \$1,376,000, the principal of the outstanding Junior Subordinated Notes was \$1,000,000 and capitalized lease obligations were \$2,060,000.

On July 1, 2013, coincident with the Decimal Acquisition, we retired capital leases in the amount of \$454,000 that had maturities of less than one year remaining and took title to the equipment that had been leased. We pledged this equipment to PNC as collateral supporting the term loan. The equipment acquired in the Decimal Transaction was also pledged as collateral to PNC and we are in the process of amending the Loan Facility to pledge the assets of MSI to PNC in support of the revolving note.

As of December 31, 2013, we had approximately \$561,000 in cash.

Anticipated uses of Cash

As a requirement of our Loan Facility substantially all of our cash receipts from operations are deposited into our lockbox account at PNC. These cash receipts are used to reduce our indebtedness under our Revolving Credit Note. Repayment under the term loan shall consist of 19 consecutive monthly principal installments, the first 18 of which

will be in the amount of \$150,000 and which commenced on the first business day of July 2013, with the 19th and final payment of any unpaid balance of principal and interest payable on the first business day of January 2015. Additionally, commencing with the fiscal quarter ended June 30, 2013 (formerly September 30, 2012), upon a request from PNC no later than the last day of any fiscal quarter, we would be required to make a payment equal to 50% of the Excess Cash Flow (as defined) for that fiscal quarter at such time as we deliver our financial statements for such fiscal quarter to PNC, but no later than 45 days after the end of the fiscal quarter. PNC did not make such a request for the quarter ended December 31, 2013.

As of December 31, 2013, there is approximately \$411,000 due to NTW Dissolution, formerly Nassau Tool Works. This amount relates to a working capital adjustment based on the net working capital of Nassau Tool Works as of June 20, 2012, the date of the acquisition as compared to the net working capital at December 31, 2011. Additionally, there is approximately \$276,000 due to the former owners of Decimal, which is to be paid in monthly installments of approximately \$76,667

In August of 2013, we entered into a capital lease to finance the acquisition of new machinery. The monthly lease payment is approximately \$15,000.

Currently we are in the later stages of negotiations with three acquisition candidates and have reached an understanding with the first candidate which we are reducing to a contract. Pursuant to the anticipated agreement we will acquire 100% of the stock and the entire business of this Long Island based company (the “LI Target”) which produces products very similar to those manufactured by Decimal Industries which we acquired in the second half of 2013. The second acquisition candidate is a fabricator of sheet metal components using drop hammer and hydro-forming machinery located in the Southwestern United States (the “SW Target”). The SW Target is currently a supplier of components to WMI. Its other customers include major aerospace companies, some of which already do business with us. The third target (the “NE Target”), located in New England, is a logistics company which aggregates products and assembles kits of equipment for the US Military and Government.

If all three acquisitions were completed, the operations of the LI Target would quickly be consolidated into WMI’s facility. It is anticipated that for the foreseeable future, the operations of the SW Target and NE Target would remain in their current locations and be operated as separate subsidiaries of Air Industries.

For the year ended December 31, 2013 the three targets had combined revenues of approximately \$13 million and combined EBITDA, after adjustment for owners’ compensation, of approximately \$2.5 million. The aggregate purchase price including liabilities to be assumed is approximately \$6.5 million, subject to adjustments for changes in working capital. The anticipated purchase price is to be paid \$5 million in cash and \$1.5 million in shares of our common stock.

As of the date hereof there is no binding contract with the shareholders of any of the Targets and there can no assurance that any or all of the three transactions will be consummated on the terms described above, or at all.

Subject to the discretion of our Board of Directors, and compliance with PNC’s loan covenants, we intend to continue to make quarterly dividend payments on our common stock. Dividend payments of \$0.0625 per share or approximately \$360,000 were made in the last quarter of 2012 and the first two quarters of 2013. In the third quarter of 2013 the dividend was increased to \$0.125 per share or approximately \$716,000, and paid on October 15, 2013. On January 9, 2014 we paid a dividend equal to \$0.125 per share or approximately \$717,000.

Cash Flow

The following table summarizes our net cash flow from operating, investing and financing activities for the years ended December 31 (in thousands):

| | 2013 | 2012 |
|---|----------|-----------|
| Cash Provided by (used in): | | |
| Operating activities | \$ 8,889 | \$ 1,694 |
| Investing activities | (1,118) | (13,038) |
| Financing Activities | (7,700) | 11,257 |
| Net increase in cash and cash equivalents | \$ 71 | \$ (87) |

Cash Provided By Operating Activities

Cash provided by operating activities primarily consists of our net income adjusted for certain non-cash items and changes to working capital.

For the year ended December 31, 2013, our net cash provided by operating activities of \$8.9 million was comprised of net income of \$3.7 million increased by \$3.0 million of cash provided by changes in working capital and adjustments for non-cash items of \$2.2 million. Adjustments for non-cash items consisted primarily of depreciation of property

and equipment of \$1.7 million, amortization of capitalized engineering costs, intangibles and other items of \$1.7 million, bad debt expense of \$394,000 representing all amounts more than 120 days past due, offset by a change in deferred income taxes of \$1.2 million and the negative goodwill resulting from the bargain purchase on the acquisition of MSI in the amount of \$361,000. The increase in working capital activities primarily consisted of net decreases in Operating Assets of \$3.5 million and a net decrease in Operating Liabilities of \$518,000. The decreases in Operating Assets were comprised of decreases in accounts receivable of \$2.9 million due to the timing of a cash receipt from a customer, inventory of \$440,000 and prepaid expenses and other current assets of \$189,000. The decreases in Operating Liabilities were comprised of decreases in accounts payable and accrued expenses of \$892,000 due to the timing of the receipt and payment of invoices offset by an increase in customer prepayments of \$251,000, income taxes payable of \$48,000 and deferred rent of \$75,000.

For the year ended December 31, 2012, our net cash provided by operating activities of \$1.7 million was comprised of net income of \$2.5 million offset by \$3.8 million of cash used by changes in working capital and adjustments for non-cash items of \$3.0 million. Adjustments for non-cash items consisted primarily of depreciation of property and equipment of \$1.6 million, amortization of capitalized engineering costs, intangibles and other items of \$1.2 million, bad debt expense of \$80,000 representing all amounts more than 120 days past due, and non-cash compensation of \$101,000. The decrease in working capital activities primarily consisted of net increases in Operating Assets of \$3.8 million and a net decrease in Operating Liabilities of \$44,000. The increases in Operating Assets were comprised of an increase in accounts receivable of \$4.6 million due to the timing of shipments to customers offset by decreases in inventory of \$1.1 million and prepaid expenses and other current assets of \$297,000. The decreases in Operating Liabilities were comprised of a decrease in accounts payable and accrued expenses of \$1.5 million due to the timing of the receipt and payment of invoices offset by an increase in income taxes payable of \$1.4 million due to the complete utilization of our NOL.

Cash Used in Investing Activities

Cash used in investing activities consists of capital expenditures for property and equipment, capitalized engineering costs and the cash portion of the cost of any business we might acquire. A description of capitalized engineering costs can be found in footnote 3 Summary of Significant Accounting Policies in our Consolidated Financial Statements for the year ended December 31, 2013.

For the year ended December 31, 2013, cash used in investing activities was \$1.1 million. This was comprised of \$450,000 of cash paid for acquisitions net of cash acquired, \$288,000 for the purchase of property and equipment and \$380,000 for capitalized engineering costs.

For the year ended December 31, 2012, cash used in investing activities was \$13.0 million. This was comprised of \$11.6 million paid for the acquisition of substantially all of the assets of NTW on June 20, 2012. The remaining \$1.4 million was comprised of \$1.0 million for the purchase of property and equipment, \$100,000 for deposits on new property and equipment not yet delivered to our facilities, and \$300,000 for capitalized engineering costs.

Cash used in financing activities

Cash used in financing activities consists of proceeds from the sale of our common stock, and the borrowings and repayments under our credit facilities with our senior lender and repayment of our capital lease obligations and other notes payable.

For the year ended December 31, 2013, cash used in financing activities was \$7.7 million. This was comprised of repayments on our term loan of \$1.8 million, \$1.0 million for the repayment of capital lease obligations, \$644,000 for the repayment of notes to the former shareholders of Welding Metallurgy, \$1.4 million for dividends paid, \$3.6 million for the repayment of our revolving credit facility, \$103,000 for deferred financing costs, and \$85,000 related to Lease Impairment. These items were offset by \$1.0 million from the proceeds of a private placement of our common stock.

For the year ended December 31, 2012, cash provided by financing activities was \$11.3 million. The \$11.3 million results from cash received from financing activities of \$15.8 million reduced by cash applied to financing activities of \$4.5 million. This principally reflects the recapitalization that was effectuated to generate the cash to enable us to complete the NTW Acquisition and decrease our leverage. The components of the \$15.8 million are as follows: \$7.1 million in proceeds for the sale of our Common Stock completed in conjunction with the NTW Acquisition, increased borrowings under our revolving credit facility of \$4.8 million and an increase in our term loan of \$3.9 million. The \$4.5 million of outflows were comprised of repayments on our term loan of \$2.2 million, \$600 thousand for the repayment of capital lease obligations, \$600,000 for the repayment of notes to the former shareholders of Welding Metallurgy, and the repayment of \$100,000 of our Junior Subordinated Notes that did not convert to common stock. We paid \$600,000 in expenses related to the private placement of our common stock. Additionally, we paid dividends to our common stockholders of approximately \$400,000.

In June and July 2012, we issued 1,185,851 shares of our Common Stock in a Private Placement to Accredited Investors. The Company received \$6,528,000 net of commissions and expenses. Our agent, Taglich Brothers, Inc. ("Taglich Brothers" – see Item 7 below), received commissions in the amount of approximately \$569,000, along with 12,000 shares of common stock, and a Warrant to purchase 118,585 shares of Common Stock at \$6.30. The Company also paid approximately \$18,000 of legal fees on behalf of Taglich Brothers.

The proceeds from the sale of the Common Stock were used to partially finance the NTW Acquisition. Additionally, in conjunction with the Private Placement, we solicited the holders of our Junior Subordinated Notes to convert their

notes to Common Stock at a price of \$6.00 per share. On June 29, 2012, we issued 867,461 shares of our common stock in exchange for approximately \$5,204,000 of our Junior Subordinated Notes.

CONTRACTUAL OBLIGATIONS

The following table sets forth our future contractual obligations as of December 31, 2013:

| | Total | Payment due by period (in thousands) | | | |
|-----------------------------------|------------------|--------------------------------------|-----------------|-----------------|----------------------|
| | | Less than 1 year* | 1-3 years | 3-5 years | More than 5 years |
| Long term debt and capital leases | \$ 17,801 | \$ 15,118 | \$ 1,224 | \$ 1,459 | \$ - |
| Operating leases | 13,148 | 1,674 | 2,741 | 2,132 | 6,601 |
| Total | \$ 30,949 | \$ 16,792 | \$ 3,965 | \$ 3,591 | \$ 6,601 |

* The revolving line of credit with our senior lender is classified as due in less than 1 year

OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of December 31, 2013.

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our financial results.

Inventory Valuation

The Company values inventory at the lower of cost on a first-in-first-out basis or market.

AIM and NTW generally purchase inventory only when non-cancellable contracts for orders have been received for finished goods. AIM and NTW occasionally produce finished goods in excess of purchase order quantities in anticipation of future purchase order demand. Historically this excess has been used in fulfilling future purchase orders. The Company periodically evaluates inventory items that are not secured by purchase orders and establishes reserves for obsolescence accordingly. The Company also reserves for excess quantities, slow-moving goods, and for other impairments of value.

WMI generally produces pursuant to customer orders and maintains relatively lower inventory levels than AIM or NTW.

The Company presents inventory net of progress billings in accordance with the specified contractual arrangements with the United States Government, which results in the transfer of title of the related inventory from the Company to the United States Government, when such progress payments are received.

Capitalized Engineering Costs

The Company has contractual agreements with customers to produce parts, which the customers design. Though the Company has not designed and thus has no proprietary ownership of the parts, the manufacturing of these parts requires pre-production engineering and programming of our machines. The pre-production costs associated with a particular contract are capitalized and then amortized beginning with the first shipment of product pursuant to such contract. These costs are amortized on a straight line basis over the shorter of the estimated length of the contract, or three years.

If the Company is reimbursed for all or a portion of the pre-production expenses associated with a particular contract, only the unreimbursed portion would be capitalized. The Company may also progress bill customers for certain engineering costs being incurred. Such billings are recorded as progress billings (a reduction of the associated inventory) until the appropriate revenue recognition criteria have been met. The Terms and Conditions contained in customer purchase orders may provide for liquidated damages in the event that a stop-work order is issued prior to the final delivery of the product.

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." The Company recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable. Payments received in advance from customers for products delivered are recorded as customer deposits until earned, at which time revenue is recognized. The Terms and Conditions contained in our customer Purchase orders often provide for liquidated damages in the event that a stop work order is issued prior to the final delivery. The Company utilizes a Returned Merchandise Authorization or RMA process for determining whether to accept returned products. Customer requests to return products are reviewed by the contracts department and if the request is approved, a credit is issued upon receipt of the product. Net sales represent gross sales less returns and allowances. Freight out is included in operating expenses.

The Company recognizes certain revenues under a bill and hold arrangement with two of its large customers. For any requested bill and hold arrangement, the Company makes an evaluation as to whether the bill and hold arrangement qualifies for revenue recognition. The customer must initiate the request for the bill and hold arrangement. The customer must have made this request in writing in addition to their fixed commitment to purchase the item. The risk of ownership has passed to the customer, payment terms are not modified and payment will be made as if the goods had shipped.

Income Taxes

The Company accounts for income taxes in accordance with accounting guidance now codified as FASB ASC 740, "Income Taxes," which requires that the Company recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

The Company accounts for uncertainties in income taxes under the provisions of FASB ASC 740-10-05, "Accounting for Uncertainty in Income Taxes." The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Stock-Based Compensation

The Company accounts for stock-based compensation expense in accordance with FASB ASC 718, "Compensation – Stock Compensation." Under the fair value recognition provision of the ASC, stock-based compensation cost is estimated at the grant date based on the fair value of the award. The Company estimates the fair value of stock options and warrants granted using the Black-Scholes-Merton option pricing model.

Goodwill

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. Goodwill is not amortized, but is tested at least annually for impairment, or if circumstances change that will more likely than not reduce the fair value of the reporting unit below its carrying amount.

The Company accounts for the impairment of goodwill under the provisions of ASU 2011-08 (“ASU 2011-08”), “Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment.” ASU 2011-08 updated the guidance on the periodic testing of goodwill for impairment. The updated guidance gives companies the option to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

The Company performs impairment testing for goodwill annually, or more frequently when indicators of impairment exist, using a three-step approach. Step “zero” is a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Step one compares the fair value of the net assets of the relevant reporting unit (calculated using a discounted cash flow method) to its carrying value, a second step is performed to compute the amount of the impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the operations, and is compared to its carrying value. The shortfall of the fair value below carrying value represents the amount of goodwill impairment.

Long-Lived and Intangible Assets

Identifiable intangible assets are amortized using the straight-line method over the period of expected benefit. Long-lived assets and intangible assets subject to amortization to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. The Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. There has been no impairment as of December 31, 2013 and 2012.

JOBS Act

On April 5, 2012, the JOBS Act was signed into law. The JOBS Act contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. As an “emerging growth company,” we may, under Section 7(a)(2)(B) of the Securities Act, delay adoption of new or revised accounting standards applicable to public companies until such standards would otherwise apply to private companies. We may take advantage of this extended transition period until the first to occur of the date that we (i) are no longer an “emerging growth company” or (ii) affirmatively and irrevocably opt out of this extended transition period. We have elected to take advantage of the benefits of this extended transition period. Our consolidated financial statements may therefore not be comparable to those of companies that comply with such new or revised accounting standards. Until the date that we are no longer an “emerging growth company” or affirmatively and irrevocably opt out of the exemption provided by Securities Act Section 7(a)(2)(B), upon issuance of a new or revised accounting standard that applies to our consolidated financial statements and that has a different effective date for public and private companies, we will disclose the date on which adoption is required for non-emerging growth companies and the date on which we will adopt the recently issued accounting standard.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Financial Statements

The financial statements required by this item begin on page F-1 hereof.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation was conducted under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO"), its principal executive officer, and Chief Accounting Officer ("CAO"), its principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) as of December 31, 2013. Based on that evaluation, the CEO and CAO concluded that our disclosure controls and procedures were effective as of December 31, 2013.

Management's Report on Internal Control over Financial Reporting

Section 404 of the Sarbanes-Oxley Act of 2002 requires that management document and test the Company's internal control over financial reporting and include in this Annual Report on Form 10-K a report on management's assessment of the effectiveness of our internal control over financial reporting.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting refers to the process designed by, or under the supervision of Peter D. Rettaliata, our Chief Executive Officer, and Scott A. Glassman, our Chief Accounting Officer, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP, and includes those policies and procedures that:

- (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The management designed an evaluation process that meets the needs of its company and that provides reasonable assurance for its assessment based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Tread way Commission.

In connection with their review of our internal controls over financial reporting for the fiscal year ended December 31, 2013, our Chief Executive Officer and Chief Accounting Officer have concluded that our internal controls over financial reporting were effective as of December 31, 2013.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. The rules of the Securities and Exchange Commission do not require an attestation of the Management's report by our registered public accounting firm in this annual report.

Change in Internal Control over Financial Reporting

There have been no other changes in our internal control over financial reporting that occurred during our fiscal quarter and year ended December 31, 2013 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting..

ITEM 9B. OTHER INFORMATION.

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Our directors and executive officers are:

| Name: | Age | Position |
|---------------------|-----|--|
| Peter D. Rettaliata | 63 | President, CEO and Director |
| Dario A. Peragallo | 51 | President of AIM |
| Gary Settoducato | 52 | President of Welding Metallurgy |
| Scott A. Glassman | 36 | Chief Accounting Officer and Secretary |
| Seymour G. Siegel | 71 | Director |
| David J. Buonanno | 59 | Director |
| Michael N. Taglich | 48 | Chairman of the Board |
| Robert F. Taglich | 47 | Director |
| Robert Schroeder | 47 | Director |
| Michael Brand | 54 | Director |

Peter D. Rettaliata has been our President and Chief Executive Officer since November 30, 2005. He also served as President of our wholly-owned subsidiary, AIM, from 1994 to 2008. Prior to his involvement at AIM, Mr. Rettaliata was employed by Grumman Aerospace Corporation for twenty two years. Professionally, Mr. Rettaliata is the Chairman of "ADAPT", an organization of regional aerospace companies, a past member of the Board of Governors of the Aerospace Industries Association, and a member of the Executive Committee of the AIA Supplier Council. He is a graduate of Niagara University where he received a B.A. in History and the Harvard Business School where he completed the PMD Program. Mr. Rettaliata's extensive experience in the aerospace industry and his knowledge of our operations qualify him to serve as a director.

Dario Peragallo has been President of AIM since December 8, 2008. Prior to becoming President of AIM, he was Executive Vice President of Manufacturing for AIM. Mr. Peragallo has been associated with AIM for over 25 years. He became AIM's Director of Manufacturing in 2000. Mr. Peragallo became Executive Vice President with overall responsibility for engineering, manufacturing and customer-critical technical matters in 2003. He has been an active member of Diversity Business since 2000, an organization specializing in the promotion of small and minority owned businesses. He is a graduate of SUNY Farmingdale where he received a B.A. in Manufacturing Engineering. Mr. Peragallo oversees all engineering and production matters relating to AIM.

Gary Settoducato has been the President of WMI since August 2007. Prior to this appointment, Mr. Settoducato had been a senior executive of Air Industries Machining, Corp., the Company's primary operating subsidiary, and was responsible for contracts, procurement and integration. Mr. Settoducato has been associated with Air Industries for

(17) years, and has been in the aerospace industry for a total of (28) years. He is a graduate of Northrop Grumman's procurement training program, and has held senior management positions at several other aerospace manufacturers prior to his current tenure at Air Industries. Mr. Settoducato graduated summa cum laude from the C.W. Post Center of Long Island University in 1983 with a double major in marketing and management, and was the Valedictorian of his graduating class.

Scott Glassman has been our Chief Accounting Officer since December 8, 2008. Mr. Glassman had served as Controller of the Company since February 2007. Prior to joining the Company, Mr. Glassman was employed by First Data Corporation as Accounting Manager from June 2005 to January 2007, by Veeco Instruments Inc. as an SEC Reporting Specialist from January 2004 to May 2005, and by Grant Thornton LLP in a variety of positions from June 1999 to December 2003, most recently as an audit manager.

Michael N. Taglich has been Chairman of our Board of Directors and a Director since September 22, 2008. He is Chairman and President of Taglich Brothers, Inc. ("Taglich Brothers"), a New York City based securities firm which he co-founded in 1992 and which is focused on public and private micro- cap companies. From 1987 to 1992, Mr. Taglich served as a vice president at Weatherly Securities. He brings a broad depth and breadth of capital and business background to the Board, with extensive experience in exit strategies. Mr. Taglich is currently Chairman of the Board of SCOLR Pharma Inc., a publicly traded pharmaceutical company, and BioVentrix, Inc., a privately held medical device company whose products are directed at heart failure. He also serves as a director of Autonet Mobile, Inc. Mr. Taglich holds a B.S. degree in General and International Business from New York University and holds Series 27 and Series 7 security licenses.

Mr. Siegel is a CPA, inactive, and a principal emeritus at Rothstein Kass, a national firm of accountants and consultants, where he is a trusted advisor to business owners and responsible for business introductions. Mr. Siegel was a founder of Siegel Rich & Co. CPA's, which eventually merged into what is now known as WeiserMazars LLP, a large regional firm. He was a senior partner there until selling his interest and co-founding a business advisory firm, which later became a part of Rothstein Kass. He has been a director and officer of numerous businesses, philanthropic and civic organizations. As a professional director, he has served on the boards of about a dozen public companies over the last 25 years, generally as audit committee chairman. He is currently a director and chairman of the audit committees of Hauppauge Digital, Inc. and Premier Alliance Group, Inc. He was formerly a director of Oak Hall Capital Fund, Prime Motor Inns Limited Partnership, Noise Cancellation Technologies and Emerging Vision, Inc., among others. He received his Bachelor of Business Administration from the Bernard M. Baruch School of the City College of New York. Mr. Siegel is the Chairman of the Audit Committee of our Board. Mr. Siegel's extensive knowledge and experience in accounting matters and familiarity with the issues of manufacturing businesses qualify him to serve as a director of our company.

Robert F. Taglich has been a Director since October 3, 2008. Since 1992, he has been a managing director of Taglich Brothers, a New York City based securities firm which he co-founded. Prior to founding Taglich Brothers, Mr. Taglich was a vice president at Weatherly Securities. Mr. Taglich has served in various positions in the brokerage securities industry for the past 25 years. He currently sits on the board of privately held BioVentrix, Inc., a medical device company whose products are directed at heart failure. Mr. Taglich holds a Bachelor's degree from New York University.

David J. Buonanno has been a Director since June 26, 2009. He is a consultant to Dresser-Rand Corporation as well as other companies in the aerospace and defense industries. Mr. Buonanno has extensive experience in manufacturing, supply management and operations. He was employed by Sikorsky Aircraft, Inc., a subsidiary of United Technologies Corporation, as Vice President, Supply Management (from January 1997 to July 2006) and as Director, Systems Subcontracts (from November 1992 to January 1997). From May 1987 to November 1992, he was employed by General Electric Company and GE Astro Space, serving as Operations Manager for GE in 1992 and Manager, Program Materials Management of GE Astro Space from December 1989 to January 1992. From June 1977 to May 1987, he was employed by RCA and affiliated companies, including RCA Astro Space. Mr. Buonanno attended Lehigh University College of Electrical Engineering and holds a B.S. in Business Administration from Rutgers University. He completed the Program for Management Development at Harvard Business School in 1996. Mr. Buonanno extensive experience in the aerospace and defense industries and familiarity with the operations of companies in the industry qualify him to serve as a director.

Robert Schroeder has been a Director since October 3, 2008, and serves as a member of the Audit Committee. He is Vice President - Investment Banking of Taglich Brothers, Inc. and specializes in advisory services and capital raising for small public and private companies. Prior to that, Mr. Schroeder served as Senior Equity Analyst publishing sell-side research. Prior to joining Taglich Brothers, he served in various positions in the brokerage and public accounting industry. Mr. Schroeder received a B.S. degree in accounting and economics from New York University. He is a Chartered Financial Analyst and a member of the Association for Investment Management and Research and a member of the New York Society of Security Analysts.

Michael Brand has been a Director since May 2012. He was the President of Goodrich Landing Gear, a unit of Goodrich Corporation, from July 2005 to June, 2012. Prior to joining Goodrich for over 25 years he held senior management positions in the Aerospace industry. He began his career at General Electric Corporation and rose to senior management in its jet engine manufacturing operations. Mr. Brand is a graduate of Clarkson University, with advanced degrees and certificates from Xavier University and the Wharton School. Mr. Brand's extensive experience in the aerospace and defense industries and familiarity with the operations of companies in the industry qualify him to serve as a director.

Michael N. Taglich and Robert F. Taglich are brothers.

Board Leadership Structure and Risk Oversight

The Board does not have a policy requiring separation of the roles of Chief Executive Officer and Chairman of the Board. Nevertheless, Michael N. Taglich is Chairman of the Board and Peter D. Rettaliata is Chief Executive Officer of the Company.

The Board has determined that a non-employee director serving as Chairman is in the best interests of our stockholders at this time. This structure ensures a greater role of non-employee directors in the active oversight of our business, including risk management oversight, and in setting agendas and establishing Board priorities and procedures. This structure also allows the Chief Executive Officer to focus to a greater extent on the management of our day-to-day operations.

The Board of Directors as a whole is responsible for consideration and oversight of risks facing the Company, and is responsible for ensuring that material risks are identified and managed appropriately. Certain risks are overseen by committees of the Board of Directors and these committees make reports to the full Board of Directors, including reports on noteworthy risk-management issues. Members of the Company's senior management team regularly report to the full Board about their areas of responsibility and a component of these reports is risk within the area of responsibility and the steps management has taken to monitor and control such exposures. Additional review or reporting on risks is conducted as needed or as requested by the Board or committee.

Board Committees

We maintain the following committees of the Board of Directors: the Audit Committee, the Compensation Committee and the Nominating Committee. Each committee is comprised entirely of directors who are "independent" within the meaning of NYSE MKT Rule 803A(2). Each committee acts pursuant to a separate written charter, and each such charter has been adopted and approved by the Board of Directors. Copies of the committee charters are available on our website at airindustriesgroup.com under the heading "Investor Relations."

Audit Committee. Messrs. Siegel, Schroeder and Buonanno are members of the Audit Committee. Mr. Siegel serves as Chairman of the Audit Committee and also qualifies as an "audit committee financial expert," as that term is defined in Item 407(d)(5)(ii) of Regulation S-K. The Board has determined that each member of our Audit Committee meets the financial literacy requirements under the Sarbanes-Oxley Act and SEC rules and the independence requirements under NYSE MKT Rule 803A(2).

Our Audit Committee is responsible for preparing reports, statements and charters required by the federal securities laws, as well as:

- overseeing and monitoring the integrity of our consolidated financial statements, our compliance with legal and regulatory requirements as they relate to financial

statements or accounting matters, and our internal accounting and financial controls;

- preparing the report that SEC rules require be included in our annual proxy statement;
- overseeing and monitoring our independent registered public accounting firm's qualifications, independence and performance;
- providing the Board with the results of its monitoring and its recommendations; and
- providing to the Board additional information and materials as it deems necessary to make the Board aware of significant financial matters that require the attention of the Board.

Compensation Committee. Our Compensation Committee is composed of Messrs. Siegel, Buonanno and Brand. The Compensation Committee is responsible for:

- establishing the Company's general compensation policy, in consultation with the Company's senior management, and overseeing the development and implementation of compensation programs.
- reviewing and approving corporate goals and objectives relevant to the compensation of the CEO, and evaluating the performance of the CEO at least annually in light of those goals and objectives and communicating the results of such evaluation to the CEO and the Board, and has the sole authority to determine the CEO's compensation level based on this evaluation, subject to ratification by the independent directors on the Board. In determining the incentive component of CEO compensation, the Committee will consider, among other factors, the Company's performance and relative stockholder return, the value of similar incentive awards to CEOs at comparable companies, the awards given to the CEO in past years, and such other factors as the Committee may determine to be appropriate.
- reviewing and approving the compensation of all other executive officers of the Company, such other managers as may be directed by the Board, and the directors of the Company.
- overseeing the Board's benefit and equity compensation plans, overseeing the activities of the individuals and committees responsible for administering these plans, and discharging any responsibilities imposed on the Committee by any of these plans.
- approving issuances under, or any material amendments to, any stock option or other similar plan pursuant to which a person not previously an employee or director of the Company, as an inducement material to the individual's entering into employment with the Company, will acquire stock or options.
- in consultation with management, overseeing regulatory compliance with respect to compensation matters, including overseeing the Company's policies on structuring compensation programs to preserve related tax objectives.
- reviewing and approving any severance or similar termination payments proposed to be made to any current or former officer of the Company.
- preparing an annual report on executive compensation for inclusion in our proxy statement for the election of directors, if required under the applicable SEC rules.

Nominating Committee. Our Nominating Committee was organized in April 2013 and is composed of Messrs. Schroeder, Siegel and Brand. The purpose of the Nominating Committee is to seek and nominate qualified candidates for election or appointment to our Board of Directors. The Nominating Committee will seek candidates for election

and appointment that possess the integrity, leadership skills and competency required to direct and oversee the Company's management in the best interests of its stockholders, customers, employees, communities it serves and other affected parties.

A candidate must be willing to regularly attend Committee and Board of Directors meetings, to develop a strong understanding of the Company, its businesses and its requirements, to contribute his or her time and knowledge to the Company and to be prepared to exercise his or her duties with skill and care. In addition, each candidate should have an understanding of all corporate governance concepts and the legal duties of a director of a public company.

Stockholders may contact the Nominating Committee Chairman, the Chairman of the Board or the Corporate Secretary in writing when proposing a nominee. This correspondence should include a detailed description of the proposed nominee's qualifications and a method to contact that nominee if the Nominating Committee so chooses.

Stockholder Communications

Any stockholder who desires to contact any of our Directors can write to Air Industries Group, 1479 North Clinton Avenue, Bay Shore, NY 11706 Attention: Stockholder Relations. Your letter should indicate that you are an Air Industries Group stockholder. Depending on the subject matter, our stockholder relations personnel will:

- forward the communication to the Director(s) to whom it is addressed;
- forward the communication to the appropriate management personnel;
- attempt to handle the inquiry directly, for example where it is a request for information about the Company, or it is a stock-related matter; or
- not forward the communication if it is primarily commercial in nature or if it relates to an improper or irrelevant topic.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors, executive officers and beneficial owners of more than 10% of our common stock to file with the SEC reports of their holdings of, and transactions in, our common stock. Based solely upon our review of copies of such reports and written representations from reporting persons that were provided to us, we believe that our officers, directors and 10% stockholders complied with these reporting requirements with respect to 2013, except that that the statement of changes in beneficial ownership on Form 4 filed by Michael N. Taglich, Robert F. Taglich and Robert Schroeder reporting the grant of stock options was filed 10 days late in the case of Messrs. Taglich and 9 days late in the case of Mr. Schroeder.

Code of Ethics

We have adopted a written code of ethics that applies to our principal executive officers, senior financial officers and persons performing similar functions. Upon written request to our corporate secretary, we will provide you with a copy of our code of ethics, without cost.

ITEM 11. EXECUTIVE COMPENSATION

Summary Compensation Table

The following summary compensation table shows, for the periods indicated, information regarding the compensation awarded to, earned by or paid to our principal executive officer, our two most highly compensated executive officers other than our principal executive officer and our two most highly compensated employees not serving as executive officers of Air Industries Group. We refer to our principal executive officer and two most highly compensated executive officers other than our principal executive officer as our “named executive officers.”

Executive Compensation Table

| Name and principal Position | Year | Salary | Bonus | Stock awards | Option awards | Non-equity Incentive Plan Information | Nonqualified deferred compensation earnings | All other compensation | Total |
|-----------------------------|------|-------------|-------------|--------------|---------------|---------------------------------------|---|------------------------|-------------|
| (a) | (b) | (\$) (c) | (\$) (d) | (\$) (e) | (\$) (f) | (\$) (g) | (\$) (h) | (\$) (i) | (\$) (j) |
| | | | | | | | | | |

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| | | | | | | | | | |
|--------------------------|------|---------|--------|---|--------|---|---|-------|-------------|
| Peter D. Rettaliata | 2013 | 237,203 | 12,000 | - | 13,968 | - | - | - | 263,171 |
| CEO | 2012 | 230,901 | 32,500 | - | - | - | - | - | 263,401 |
| Dario A. Peragallo | 2013 | 235,676 | 11,000 | - | 16,761 | - | - | 5,988 | (1) 269,425 |
| President of AIM | 2012 | 228,236 | 32,500 | - | - | - | - | 5,988 | (1) 266,724 |
| Scott A. Glassman | 2013 | 143,937 | 6,400 | - | 3,723 | - | - | 3,000 | (1) 157,060 |
| Chief Accounting Officer | 2012 | 124,100 | 8,000 | - | - | - | - | 3,000 | (1) 135,100 |
| Gary Settoducato | 2013 | 196,028 | 7,500 | - | 16,761 | - | - | 6,586 | (1) 226,875 |
| President of WMI | 2012 | 178,365 | 35,000 | - | - | - | - | 6,348 | (1) 219,713 |

(1) Represents car allowance.

None of our executive officers or key employees named in the above table has an employment agreement providing for a fixed term of employment. All are employees at will terminable at any time without any severance, other than that payable to employees generally.

The annual base compensation of Messrs. Rettaliata, Peragallo, Glassman and Settaducotto is \$240,000, \$240,000, \$145,000 and \$175,000, respectively, and each individual is eligible for such cash bonuses and equity incentive awards as the Board from time to time determines to be appropriate. In addition, each of these individuals receives a car allowance of no more than \$7,500 per annum and is eligible to participate in such health and welfare plans as are made available to our executives generally.

Equity Awards – 2013

The following table shows the grant of equity awards in the form of options to our named executive officers during 2013. We did not grant any equity awards in the form of shares to any of the named executive officers during 2013 and consequently have omitted those columns from the table which would have described such awards.

GRANT OF PLAN-BASED AWARDS

| Name | Grant Date | All Other Option Awards: Number of Securities Underlying Options (#) | Grant Date Fair Value of Stock and Option Awards (\$) |
|---------------------|------------|---|---|
| Peter D. Rettaliata | 10/1/2013 | 18,750 | 13,968 |
| Dario A. Peragallo | 10/1/2013 | 22,500 | 16,761 |
| Scott A. Glassman | 10/1/2013 | 5,000 | 3,723 |
| Gary Settoducato | 10/1/2013 | 22,500 | 13,761 |

Outstanding Equity Awards at 2013 Fiscal Year-End

The following table shows certain information regarding outstanding equity awards held by our named executive officers as of December 31, 2013.

| Name | Option Awards | | Stock Awards | | | |
|---------------------|---|---|-----------------------|------------------------|---|---|
| | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price | Option Expiration Date | Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#) | Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested |
| Peter D. Rettaliata | 375 | - | 88.00 | 9/26/2015 | - | - |
| Peter D. Rettaliata | 375 | - | 171.20 | 9/15/2015 | - | - |
| Peter D. Rettaliata | 375 | - | 190.80 | 9/15/2015 | - | - |
| Peter D. Rettaliata | 375 | - | 114.00 | 9/15/2015 | - | - |
| Peter D. Rettaliata | 1,500 | - | 90.00 | 9/15/2015 | - | - |
| Peter D. Rettaliata | 51,716 | - | 4.50 | 7/29/2015 | - | - |
| Peter D. Rettaliata | - | 18,750 | 6.60 | 9/30/2018 | - | - |
| Dario Peragallo | 375 | - | 88.00 | 9/26/2015 | - | - |
| Dario Peragallo | 375 | - | 171.20 | 9/15/2015 | - | - |
| Dario Peragallo | 375 | - | 190.80 | 9/15/2015 | - | - |
| Dario Peragallo | 375 | - | 114.00 | 9/15/2015 | - | - |
| Dario Peragallo | 1,500 | - | 90.00 | 9/15/2015 | - | - |
| Dario Peragallo | 51,716 | - | 4.50 | 7/29/2015 | - | - |
| Dario Peragallo - | - | 22,500 | 6.60 | 9/30/2018 | - | - |
| Scott Glassman | 25 | - | 110.40 | 12/31/2015 | - | - |
| Scott Glassman | 12,168 | - | 4.50 | 7/29/2015 | - | - |
| Scott Glassman - | - | 5,000 | 6.60 | 9/30/2018 | - | - |
| Gary Settaducato | 75 | - | 96.00 | 12/31/2015 | - | - |
| Gary Settaducato | 113 | - | 110.40 | 12/31/2015 | - | - |
| | 44,589 | - | 4.50 | 12/31/2015 | - | - |

Gary
Settaducato
Gary
Settaducato

| | | | | | |
|---|--------|------|-----------|---|---|
| - | 22,500 | 6.60 | 9/30/2018 | - | - |
|---|--------|------|-----------|---|---|

Director Compensation

The directors may receive such remuneration as our Board of Directors may determine from time to time. Each director is entitled to be repaid or prepaid all traveling, hotel and incidental expenses reasonably incurred or expected to be incurred in attending meetings of our Board of Directors or committees of our Board of Directors or shareholder meetings or otherwise in connection with the discharge of his or her duties as a director. The compensation committee will assist the directors in reviewing and approving the compensation structure for our directors.

All directors hold office until the next annual meeting of shareholders and until their successors have been duly elected and qualified. Officers are elected by and serve at the discretion of the Board of Directors. Employee directors do not receive any compensation for their services as directors. Non-employee directors are entitled to receive compensation per year for serving as directors and may receive option grants from our company. In addition, non-employee directors are entitled to be reimbursed for their actual travel expenses for each Board of Directors meeting attended.

The following table sets forth certain information regarding the compensation paid to our directors during the fiscal year ended December 31, 2013.

DIRECTOR COMPENSATION

| Name | Fees Earned or Paid in Cash (\$) | Stock Awards (\$) | Option Awards (\$) | Non-Equity Incentive Plan Compensation (\$) | Non-Qualified Deferred Compensation Earnings (\$) | All Other Compensation (\$) | Total (\$) |
|--------------------|----------------------------------|-------------------|--------------------|---|---|-----------------------------|------------|
| Michael N. Taglich | 57,500 | - | 3,301 | - | - | - | 60,801 |
| Robert F. Taglich | 57,500 | - | 3,301 | - | - | - | 60,801 |
| Robert Schroeder | 24,000 | - | 3,301 | - | - | - | 27,301 |
| David J. Buonanno | 24,000 | - | 3,301 | - | - | - | 27,301 |
| Seymour G. Siegel | 36,000 | - | 3,301 | - | - | - | 39,301 |
| Michael Brand | 33,750 | - | 3,301 | - | - | - | 37,051 |

2013 Equity Incentive Plan

Our Board of Directors adopted the 2013 Equity Incentive Plan, (“the “2013 Plan”), in June 2013, and the plan was approved by the Company’s stockholders on July 2013. The 2013 Plan is virtually identical to and replaced the 2010 Equity Incentive Plan which was adopted in July of 2010. The Company reserved 600,000 shares of its Common Stock for various issuances. The 2013 Plan permits the Company to grant non-qualified and incentive stock options to employees, directors and consultants. The Plan is administered by the Compensation Committee of the Board and has a term of ten years from the date it was adopted by the Board.

We adopted the Plan to provide a means by which employees, directors, and consultants of our Company and those of our subsidiaries and other designated affiliates, which we refer to together as our affiliates, may be given an opportunity to purchase our Common Stock, to assist in retaining the services of such persons, to secure and retain the services of persons capable of filling such positions, and to provide incentives for such persons to exert maximum efforts for our success and the success of our affiliates.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information known to us regarding beneficial ownership of our common stock as of February 28, 2014 by (i) each person known by us to own beneficially more than 5% of our outstanding common stock, (ii) each of our directors and executive officers, and (iii) all of our officers and directors as a group. Except as otherwise indicated, we believe, based on information provided by each of the individuals named in the table below, that such individuals have sole investment and voting power with respect to such shares, subject to community property laws, where applicable. As of February 28, 2014 we had outstanding 5,868,068 shares of our common stock. Except as stated in the table, the address of the holder is c/o our company, 1479 North Clinton Avenue, Bay Shore, New York 11706.

| NAME | Number of Shares | | Percent of Class | |
|---|------------------|--------|------------------|---|
| Owner of More than 5% of Class: | | | | |
| Hillson Partners LP (1) | | | | |
| Hillson Private Partners II, LLLP (1) | 331,556 | | 5.65 | % |
| 110 North Washington Street, Suite 401 | | | | |
| Rockville, MD 20850 | | | | |
| Directors and Executive Officers: | | | | |
| Peter D. Rettaliata | 56,961 | (2) * | | |
| Michael N. Taglich | 420,673 | (3) | 7.12 | % |
| Seymour G. Siegel | 8,039 | (4) * | | |
| David J. Buonanno | 7,789 | (4) * | | |
| Robert F. Taglich | 439,174 | (3) | 7.44 | % |
| Robert Schroeder | 77,309 | (5) | 1.32 | % |
| Michael Brand | 6,750 | (6) * | | |
| Dario Peragallo | 57,500 | (2) * | | |
| Gary Settoducato | 44,796 | (7) * | | |
| Scott Glassman | 12,205 | (8) * | | |
| All Directors and officers as a group (10 persons) | 1,068,770 | (9) | 17.99 | % |

* Less than 1 %

(1) The general partner of Hillson Partners LP and Hillson Private Partners II, LLP is Danuel H Abramowitz, who has the sole power to vote and dispose of the shares.

(2) Includes 54,416 shares we may issue upon exercise of options.

(3) Includes 30,736 shares owned by Taglich Brothers, Inc. and other entities controlled by Mr. Taglich 31,190 share we may issue upon exercise of warrants and 6,750 shares we may issue upon exercise of options.

(4) Includes 7,250 shares we may issue upon exercise of options.

(5) Includes 20,005 shares we may issue upon exercise of warrants and 6,750 shares we may issue upon exercise of options.

(6) Includes 6,750 shares we may issue upon exercise of options.

(7) Includes 44,777 shares we may issue upon exercise of options.

(8) Includes 12,193 shares we may issue upon exercise of options.

(9) Includes 51,195 shares we may issue upon exercise of warrants and 207,302 shares we may issue upon exercise of options.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Transactions with Related Persons

Under Item 404 of SEC Regulation S-K, a related person transaction is any actual or proposed transaction, arrangement or relationship or series of similar transactions, arrangements or relationships, including those involving indebtedness not in the ordinary course of business, since the beginning of our last fiscal year, to which we or our subsidiaries were or are a party, or in which we or our subsidiaries were or are a participant, in which the amount involved exceeded or exceeds \$120,000 and in which any of our directors, nominees for director, executive officers, beneficial owners of more than 5% of any class of our voting securities, or any member of the immediate family of any of the foregoing persons, had or will have a direct or indirect material interest.

The Audit Committee is charged with responsibility for reviewing, approving and overseeing any transaction between the Company and any related person (as defined in Item 404 of Regulation S-K), including the propriety and ethical implications of any such transactions, as reported or disclosed to the Committee by the independent auditors, employees, officers, members of the Board or otherwise.

In connection with the private placement of our common stock in connection with the NTW Acquisition, we paid Taglich Brothers, Inc., as placement agent, a commission of 8.0% or \$569,208. In addition, we agreed to issue to Taglich Brothers, Inc., 12,000 shares of common stock of the Company as a non-accountable expense allowance and five-year warrants to purchase 118,585 shares of Common Stock, 10.0% of the number of shares sold in the Offering, at an exercise price of \$6.30.

Board Independence

Our Board of Directors has determined that Robert Schroeder, Seymour G. Siegel, David Buonanno and Michael Brand are "independent directors" within the meaning of NYSE MKT Rule 803A(2).

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

As required by our Audit Committee charter, our Audit Committee pre-approved the engagement of Rotenberg Meril Solomon Bertiger & Guttilla, P.C. for all audit and permissible non-audit services. The Audit Committee annually reviews the audit and permissible non-audit services performed by our principal accounting firm and reviews and approves the fees charged by our principal accounting firm. The Audit Committee has considered the role of Rotenberg Meril Solomon Bertiger & Guttilla, P.C. in providing tax and audit services and other permissible non-audit services to us and has concluded that the provision of such services, if any, was compatible with the maintenance of such firm's independence in the conduct of its auditing functions.

During fiscal year 2013 and fiscal year 2012, the aggregate fees which we paid to or were billed by Rotenberg Meril Solomon Bertiger & Guttilla, P.C. for professional services were as follows:

| | Year Ended December 31, | |
|------------------------|-------------------------|------------|
| | 2013 | 2012 |
| Audit Fees (1) | \$ 240,000 | \$ 281,630 |
| Audit Related Fees (2) | 49,602 | 41,411 |
| Tax Fees (3) | 43,149 | 47,295 |

| | | | |
|----|---------|----|---------|
| \$ | 332,751 | \$ | 370,336 |
|----|---------|----|---------|

(1) Fees for services to perform an audit or review in accordance with generally accepted auditing standards and services that generally only our independent registered public accounting firm can reasonably provide, such as the audit of our consolidated financial statements, the review of the financial statements included in our quarterly reports and for services that are normally provided by independent registered public accounting firms in connection with statutory and regulatory engagements.

(2) Fees for assurance and related services that are traditionally performed by our independent registered public accounting firm, such as audit attest services not required by statute or regulation, and consultation concerning financial accounting and reporting standards. The fees in 2012 are for services rendered relating to the filing of our Form 10.

(3) Fees for tax compliance. Tax compliance generally involves preparation of original and amended tax returns, claims for refunds and tax payment planning services.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Exhibit No. Description

- 2.1 Agreement and Plan of Merger dated July 29, 2013 between Air Industries Group, Inc. and Air Industries Group (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 2.2 Articles of Merger between Air Industries Group and Air Industries Group, Inc. filed with the Secretary of State of Nevada on August 28, 2013 (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 2.3 Certificate of Merger between Air Industries Group and Air Industries Group, Inc. filed with the Secretary of State of Nevada on August 29, 2013 (incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 3.1 Articles of Incorporation of Air Industries Group (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 3.2 By-Laws of the Registrant (incorporated by reference to Exhibit 3.4 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 4.1 Form of Warrant Agreement dated as of December 31, 2008 between the Registrant and Taglich Brothers, Inc. (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed January 7, 2009).
- 10.1 Contract of Sale, dated as of November 7, 2005, by and between KPK Realty Corp. and Gales Industries Incorporated for the purchase of the property known as 1460 North Fifth Avenue and 1479 North Clinton Avenue, Bay Shore, NY (incorporated by reference to Exhibit 10.6 of the Registrant's Current Report on Form 8-K filed December 6, 2005).

- 10.2 Mortgage and Security Agreement, dated as of November 30, 2005, by and between Air Industries Machining, Corp. and PNC Bank (incorporated by reference to Exhibit 10.20 of the Registrant's Current Report on Form 8-K filed December 6, 2005).
- 10.3 Long Term Agreement, dated as of August 18, 2000, between Air Industries Machining, Corp. and Sikorsky Aircraft Corporation (incorporated by reference to Exhibit 10.21 of the Registrant's Current Report on Form 8-K filed December 6, 2005).
- 10.4 Long Term Agreement, dated as of September 7, 2000, between Air Industries Machining, Corp. and Sikorsky Aircraft Corporation (incorporated by reference to Exhibit 10.22 of the Registrant's Current Report on Form 8-K filed December 6, 2005).
- 10.5 Stock Purchase Agreement, dated March 9, 2009, between Gales Industries Incorporated and John Gantt and Lugenia Gantt, the shareholders of Welding Metallurgy, Inc. (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed March 14, 2009).
- 10.6 Amendment No. 1 dated August 2, 2009 to the Stock Purchase Agreement, dated March 9, 2009, between Gales Industries Incorporated and John Gantt and Lugenia Gantt, the shareholders of Welding Metallurgy, Inc. (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K/A filed August 3, 2009).
- 10.7 7% Promissory Note of Registrant in the principal amount of \$2,000,000 in favor of John and Lugenia Gantt (incorporated by reference from the Registrant's Current Report on Form 8-K filed August 26, 2009).
- 10.8 Registration Rights Agreement dated as of August 24, 2009 by and among the Registrant and John and Lugenia Gantt (incorporated by reference from the Registrant's Current Report on Form 8-K filed August 26, 2009).
- 10.9 Amended and Restated Promissory Note dated as of August 26, 2009 payable to John and Lugenia Gantt (the "Amended and Restated Gantt Note") (incorporated by reference from Exhibit 10.46 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 (the "2007 Form 10-K").
- 10.10 Amendment dated as of October 9, 2009 to Amended and Restated Gantt Note (incorporated by reference from Exhibit 10.47 to the Registrant's 2007 Form 10-K).
- 10.11 Amended and Restated Revolving Credit, Term Loan and Security Agreement (the "PNC Loan Agreement") dated June 27, 2013 by and among PNC Bank, National Association, as Lender and Agent, and Air Industries Machining, Corp., Welding Metallurgy, Inc., Nassau Tool Works, Inc. and Air Industries Group, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed June 27, 2013).

- 10.12 Guarantor's Ratification by Air Industries Group, Inc. under PNC Agreement (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed June 27, 2013).
- 10.13 Securities Purchase Agreement for sale of junior subordinated notes and series B convertible preferred stock (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed October 7, 2010).
- 10.14 Junior Subordinated Note due 2010 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed October 7, 2010).
- 10.15 Asset Purchase Agreement dated as of June 20, 2012 among the Registrant, Nassau Tool Works, Inc., Vincent DiCarlo and Robert E. Hunt (incorporated by reference to Exhibit 10.22 to the Registrant's Form 10).
- 10.16 Assignment and Assumption Agreement dated as of June 20, 2012 between the Registrant and NTW Operating Inc. (incorporated by reference to Exhibit 10.23 to the Registrant's Form 10).
- 10.17 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.24 to the Registrant's Form 10).
- 10.18 Subscription documents for purchase of common stock and conversion of junior subordinated notes into common stock. (incorporated by reference to Exhibit 10.25 to the Registrant's Form 10).
- 10.19 Placement Agent Agreement dated as of May 21, 2012 between the Registrant and Taglich Brothers Inc. (incorporated by reference to Exhibit 10.26 to the Registrant's Form 10).
- 10.20 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-8 (Registration No. 333-191560) filed on October 4, 2013).
- 10.21 Common Stock Purchase Agreement dated October 25, 2013 with Kimura Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed October 29, 2013).
- 10.22 First Amendment to PNC Loan Agreement.
- 10.23 Amended and Restated PNC Loan Agreement.
- 10.24 Amended and Restated Revolving Credit Note issued under the PNC Loan Agreement.
- 10.25 Second Amendment to Term Note issued under the PNC Loan Agreement.
- 14.1 Code of Ethics (incorporated by reference to Exhibit 14.1 to the Registrant's Registration Statement on Form SB-2 (Registration No. 333-144561) filed July 13, 2009 and declared effective July 27, 2009).

21.1 Subsidiaries.

23.1 Consent of Rotenberg Meril Solomon Bertiger & Guttilla, P.C.

31.1 Certification of principal executive officer pursuant to Rule 13a-14 or Rule 15d-14 of Securities Exchange Act of 1934.

31.2 Certification of principal financial officer pursuant to Rule 13a-14 or Rule 15d-14 of the Exchange Act of 1934.

32.1 Certification of principal executive officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

32.2 Certification of principal financial officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

| | |
|-----------|--|
| 101.INS** | XBRL Instance Document |
| 101.SCH** | XBRL Taxonomy Extension Schema Document |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document |

* In accordance with Rule 406T of Regulation S-T, the XBRL information in Exhibit 101 to this annual report on Form 10-K shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (“Exchange Act”), or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: March 25, 2014

AIR INDUSTRIES GROUP

By: /s/ Peter D. Rettaliata
Peter D. Rettaliata
President and CEO
(principal executive officer)

By: /s/ Peter D. Rettaliata
Scott Glassman
Chief Accounting Officer and
Treasurer
(principal financial and
accounting officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant on March 25, 2014 in the capacities indicated.

| Signature | Capacity |
|--|--|
| /s/ Peter D. Rettaliata Peter D. Rettaliata | President, CEO and a Director |
| /s/ Scott Glassman Scott Glassman | Chief Accounting Officer and Treasurer |
| /s/ Michael N. Taglich Michael N. Taglich | Chairman of the Board |
| /s/ Seymour G. Siegel Seymour G. Siegel | Director |
| /s/ Robert F. Taglich Robert F. Taglich | Director |
| /s/ David J. Buonanno David J. Buonanno | Director |
| /s/ Robert Schroeder Robert Schroeder | Director |

/s/ Michael Brand
Michael Brand

Director

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
Air Industries Group

We have audited the accompanying consolidated balance sheets of Air Industries Group and Subsidiaries (the "Company") as of December 31, 2013 and 2012 and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. The consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013 and 2012 and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

ROTENBERG MERIL SOLOMON BERTIGER & GUTTILLA, P.C.
Saddle Brook, New Jersey
March 25, 2014

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AIR INDUSTRIES GROUP
Consolidated Balance Sheets

| | December 31, 2013 | December 31, 2012 |
|--|----------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and Cash Equivalents | \$ 561,000 | \$ 490,000 |
| Accounts Receivable, Net of Allowance for Doubtful Accounts of \$783,000 and \$705,000 | 8,584,000 | 11,631,000 |
| Inventory | 26,222,000 | 26,739,000 |
| Deferred Tax Asset | 1,051,000 | - |
| Prepaid Expenses and Other Current Assets | 510,000 | 546,000 |
| Deposits - Vendors | - | 133,000 |
| Total Current Assets | 36,928,000 | 39,539,000 |
| Property and Equipment, net | 6,523,000 | 5,883,000 |
| Capitalized Engineering Costs - net of Accumulated Amortization of \$3,879,000 and \$3,449,000 | 752,000 | 802,000 |
| Deferred Financing Costs, net, deposit and other assets | 605,000 | 590,000 |
| Intangible Assets, net | 4,726,000 | 5,889,000 |
| Deferred Tax Asset | 185,000 | - |
| Goodwill | 453,000 | 453,000 |
| TOTAL ASSETS | \$ 50,172,000 | \$ 53,156,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Current Portion | \$ 14,969,000 | \$ 19,211,000 |
| Accounts Payable and Accrued Expenses | 6,855,000 | 7,077,000 |
| Lease Impairment - Current | 71,000 | 85,000 |
| Deferred Gain on Sale - Current Portion | 38,000 | 38,000 |
| Customer Deposits | 251,000 | - |
| Dividends Payable | 717,000 | - |
| Income Taxes Payable | 1,496,000 | 1,448,000 |
| Total Current Liabilities | 24,397,000 | 27,859,000 |
| Long term liabilities | | |
| Notes Payable and Capitalized Lease Obligation - Net of Current Portion | 2,527,000 | 4,640,000 |
| Lease Impairment - Net of Current Portion | 56,000 | 127,000 |
| Deferred Gain on Sale - Net of Current Portion | 447,000 | 485,000 |
| Deferred Rent | 1,132,000 | 1,057,000 |

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| | | |
|--|---------------|---------------|
| TOTAL LIABILITIES | 28,559,000 | 34,168,000 |
| Contingencies | | |
| Stockholders' Equity | | |
| Preferred Stock Par Value \$.001-Authorized 1,000,000 and 8,003,716 shares at December 31, 2013 and 2012, respectively, none issued and outstanding at December 31, 2013 and 2012 | - | - |
| Common Stock - Par Value \$.001- Authorized 25,000,000 and 20,000,000 shares at December 31, 2013 and 2012, respectively, 5,844,093 and 5,711,093 Shares Issued and Outstanding as of December 31, 2013 and 2012, respectively | 6,000 | 6,000 |
| Additional Paid-In Capital | 36,799,000 | 37,913,000 |
| Accumulated Deficit | (15,192,000) | (18,931,000) |
| TOTAL STOCKHOLDERS' EQUITY | 21,613,000 | 18,988,000 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 50,172,000 | \$ 53,156,000 |

See notes to consolidated financial statements

AIR INDUSTRIES GROUP
Consolidated Statements of Income for the Year ended December 31,

| | 2013 | 2012 |
|---|---------------|---------------|
| Net Sales | \$ 62,833,000 | \$ 64,215,000 |
| Cost of Sales | 47,598,000 | 49,357,000 |
| Gross Profit | 15,235,000 | 14,858,000 |
| Operating Expenses | 10,622,000 | 8,874,000 |
| Income from operations | 4,613,000 | 5,984,000 |
| Interest and financing costs | (1,340,000) | (1,843,000) |
| Other (expense) income, net | 296,000 | (146,000) |
| Income before provision for income taxes | 3,569,000 | 3,995,000 |
| (Benefit from) Provision for income taxes | (170,000) | 1,447,000 |
| Net income | \$ 3,739,000 | \$ 2,548,000 |
| Income per share - basic | \$ 0.65 | \$ 0.54 |
| Income per share - diluted | \$ 0.63 | \$ 0.54 |
| Weighted average shares outstanding - basic | 5,739,014 | 4,680,581 |
| Weighted average shares outstanding - diluted | 5,932,726 | 4,759,246 |

See notes to consolidated financial statements

AIR INDUSTRIES GROUP
Consolidated Statements of Stockholders' Equity
for the Years Ended December 31, 2013 and 2012

| | Preferred Stock | | Common Stock | | Additional | Accumulated | Total |
|--|-----------------|--------|--------------|----------|--------------------|-----------------|-------------------------|
| | Shares | Amount | Shares | Amount | Paid-in Capital | Deficit | Stockholders' Equity |
| Balance, January 1, 2012 | - | \$ - | 3,579,114 | \$ 4,000 | \$ 26,141,000 | \$ (21,479,000) | \$ 4,666,000 |
| Issuance of Shares For Acquisition | - | - | 66,667 | - | 300,000 | - | 300,000 |
| Issuance of Shares For Private Placement | - | - | 1,185,851 | 1,000 | 6,527,000 | - | 6,528,000 |
| Issuance of Shares For conversion of Junior Subordinated Notes | - | - | 867,461 | 1,000 | 5,203,000 | - | 5,204,000 |
| Issuance of Shares For Costs Associated with Private Placement | - | - | 12,000 | - | - | - | - |
| Dividends Paid | - | - | - | - | (359,000) | - | (359,000) |
| Stock compensation expense | - | - | - | - | 101,000 | - | 101,000 |
| Net income | - | - | - | - | - | 2,548,000 | 2,548,000 |
| Balance, December 31, 2012 | - | - | 5,711,093 | 6,000 | 37,913,000 | (18,931,000) | 18,988,000 |
| Issuance of Shares For Private Placement | - | - | 133,000 | - | 997,000 | - | 997,000 |
| Dividends Paid | - | - | - | - | (1,432,000) | - | (1,432,000) |
| Dividends Payable | - | - | - | - | (717,000) | - | (717,000) |
| Stock compensation expense | - | - | - | - | 38,000 | - | 38,000 |
| Net income | - | - | - | - | - | 3,739,000 | 3,739,000 |
| Balance, December 31, 2013 | - | \$ - | 5,844,093 | \$ 6,000 | \$ 36,799,000 | \$ (15,192,000) | \$ 21,613,000 |

See notes to consolidated financial statements

AIR INDUSTRIES GROUP
Consolidated Statements of Cash Flows For the Year Ended December 31,

| | 2013 | 2012 |
|--|---------------------|----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Income | \$3,739,000 | \$2,548,000 |
| Adjustments to Reconcile Net Income to Net Cash provided by Operating Activities | | |
| Depreciation of property and equipment | 1,709,000 | 1,557,000 |
| Amortization of intangible assets | 1,163,000 | 693,000 |
| Amortization of capitalized engineering costs | 430,000 | 459,000 |
| Bad debt expense | 394,000 | 80,000 |
| Non-cash compensation expense | 38,000 | 101,000 |
| Amortization of deferred financing costs | 69,000 | 52,000 |
| Negative goodwill resulting from the bargain purchase acquisition | (361,000) | - |
| Gain on sale of real estate | (38,000) | (38,000) |
| Deferred Income Taxes | (1,236,000) | - |
| Adjustments to Lease Impairment | - | 53,000 |
| Changes in Assets and Liabilities | | |
| (Increase) Decrease in Operating Assets: | | |
| Accounts Receivable | 2,871,000 | (4,606,000) |
| Inventory | 440,000 | 1,136,000 |
| Prepaid Expenses and Other Current Assets | 35,000 | (216,000) |
| Deposits | 134,000 | (132,000) |
| Other Assets | 20,000 | 51,000 |
| Increase (Decrease) in Operating Liabilities | | |
| Accounts payable and accrued expenses | (892,000) | (1,534,000) |
| Deferred Rent | 75,000 | 82,000 |
| Income Taxes payable | 48,000 | 1,408,000 |
| Customer Deposits | 251,000 | - |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 8,889,000 | 1,694,000 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Cash paid for acquisition, net of cash acquired of \$7,000 and \$0 | (450,000) | (11,600,000) |
| Capitalized engineering costs | (380,000) | (292,000) |
| Purchase of property and equipment | (288,000) | (1,059,000) |
| Deposit for new property and equipment | - | (87,000) |
| NET CASH USED IN INVESTING ACTIVITIES | (1,118,000) | (13,038,000) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from Private Placement | 997,000 | 7,115,000 |
| Payment of Issuance costs for Private Placement | - | (587,000) |
| Notes payable - Sellers | (644,000) | (601,000) |
| Capital lease obligations | (996,000) | (608,000) |
| Notes payable-Jr. Subordinated Debt | - | (115,000) |
| Note payable - Revolver | (3,637,000) | 4,787,000 |
| Proceeds from note payable - Term Loan | - | 3,900,000 |

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| | | |
|--|---------------------|-------------------|
| Payments of note payable - Term Loan | (1,800,000) | (2,153,000) |
| Cash paid for deferred financing costs | (102,000) | (21,000) |
| Payments related to Lease Impairment | (85,000) | (101,000) |
| Dividends Paid | (1,433,000) | (359,000) |
| NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES | (7,700,000) | 11,257,000 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 71,000 | (87,000) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 490,000 | 577,000 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | \$561,000 | \$490,000 |
| Supplemental cash flow information | | |
| Cash paid during the period for interest | \$1,188,000 | \$1,577,000 |
| Supplemental cash flow information | | |
| Cash paid during the period for income taxes | \$1,061,000 | \$64,000 |
| Supplemental schedule of non-cash investing and financing activities | | |
| Junior Subordinated Note Converted to Common Stock | \$- | \$5,204,000 |
| Property and equipment acquired under capital lease | \$- | \$797,000 |
| Dividends payable | \$717,000 | \$- |
| Purchase of substantially all assets of Nassau Tool Works, Inc and assumption of liabilities in the acquisition as follows: | | |
| Fair Value of Tangible Assets acquired | \$- | \$7,941,000 |
| Intangible assets, subject to amortization | - | 4,975,000 |
| Goodwill | - | 162,000 |
| Liabilities assumed | - | (660,000) |
| Due to Seller of Old Nassau Tool | - | (518,000) |
| Common Stock | - | (300,000) |
| Cash paid for acquisition | \$- | \$11,600,000 |
| Purchase of certain assets of Decimal Industries, Inc | | |
| Fair Value of Tangible Assets acquired | \$975,000 | \$- |
| Due to Sellers of Decimal Industries | (660,000) | - |
| Cash paid for acquisition | \$315,000 | \$- |
| Purchase of stock of Miller Stuart, Inc | | |
| Fair Value of Tangible Assets acquired | \$513,000 | \$- |
| Cash acquired | (7,000) | - |
| Liabilities Assumed | (10,000) | - |
| Negative goodwill resulting from the bargain purchase acquisition | (361,000) | - |
| Cash paid for acquisition | \$135,000 | \$- |

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. FORMATION AND BASIS OF PRESENTATION

Organization

On August 30, 2013, Air Industries Group, Inc. (“Air Industries Delaware”) changed its state of incorporation from Delaware to Nevada as a result of a merger with and into its recently formed wholly-owned subsidiary, Air Industries Group, a Nevada corporation (“Air Industries Nevada” or “AIRI”) and the surviving entity, pursuant to an Agreement and Plan of Merger. The reincorporation was approved by the stockholders of Air Industries Delaware at its 2013 Annual Meeting of Stockholders. Air Industries Nevada is deemed to be the successor.

The accompanying consolidated financial statements presented are those of AIRI, and its wholly-owned subsidiaries; Air Industries Machining Corporation (“AIM”), Welding Metallurgy, Inc. (“WMI” or “Welding”), Miller Stuart, Inc. (“Miller Stuart”), a wholly-owned subsidiary of WMI and Nassau Tool Works, Inc. (“NTW”) (together, the “Company”).

Note 2. ACQUISITIONS

On November 6, 2013, the Company, through its WMI subsidiary, acquired all of the common stock of Miller Stuart for \$142,000 of which \$25,000 was due at the date of closing, with the remainder due on December 6, 2013. As a result of the acquisition, Miller Stuart became a division of WMI. Miller Stuart is a manufacturer of aerospace components whose customers include major aircraft manufacturers and the US Military. Miller Stuart specializes in electromechanical systems, harness and cable assemblies, electronic equipment and printed circuit boards. The acquisition of Miller Stuart will add to the existing customer base of AIRI and enhance the types of parts that AIRI can offer to its existing customers.

The acquisition of Miller Stuart was accounted for under FASB ASC 805, “Business Combinations”, and its results of operations have been included with WMI. The purchase price allocation is set forth below.

| | |
|---|------------|
| Fair Value of Tangible Assets acquired (including cash acquired of \$7,000) | \$513,000 |
| Liabilities assumed | (10,000) |
| Negative goodwill resulting from the bargain purchase acquisition | (361,000) |
| Total | \$142,000 |

As a result of the acquisition, the Company recognized a non-cash bargain purchase gain of \$361,000 which is included in other income (expense), net in the consolidated statements of income.

On July 1, 2013, the Company through its WMI subsidiary acquired certain assets including production equipment, inventory and intangible assets of Decimal Industries, Inc. (“Decimal”). The assets are being operated as part of WMI. Decimal is a long established Long Island based manufacturer of precision welded and brazed aerospace chassis and other components housing avionics, radars and other electronic devices in aircraft and naval vessels. Decimal’s customers include major aerospace contractors. The acquisition not only adds to the existing customer base, but brings new capabilities to WMI and the group.

The acquisition of Decimal was accounted for under FASB ASC 805, “Business Combinations”. The purchase price of the assets was \$975,000, which included inventory of approximately \$665,000 valued at a percentage of completion including anticipated profit on sale and certain fixed assets with an approximate value of \$310,000. The purchase price was paid as follows: \$315,000 in cash at closing with the balance payable in eight equal monthly installments

without interest in the amount of \$76,667 commencing in August 2013, with a final payment in the amount of \$46,766. The two owners of Decimal have become employees of the Company and are under contract until June 2018. As part of the transaction, the facility of Decimal has been leased for 12 months until June 2014. It is the Company's intention to combine and relocate the operations of Decimal into WMI's facility in Hauppauge. At December 31, 2013, \$277,000 was owed to the sellers of Decimal and is included in accounts payable and accrued expenses on the consolidated balance sheet.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On March 15, 2012, the Company, through a newly created subsidiary, NTW, entered into a contract with an unrelated company formerly known as Nassau Tool Works, Inc. (“Old Nassau Tool”) and its shareholders (the “NTW Sellers”) to purchase substantially all of the assets of Old Nassau Tool, and to assume certain of its liabilities, for \$12.0 million (\$12,000,000), subject to a positive or negative adjustment based on net working capital at closing. The acquisition (the “NTW Acquisition”) was completed on June 20, 2012, and the assets, liabilities and the business of Old Nassau Tool are now operated through our NTW subsidiary. The two former shareholders of NTW have joined the management team of the Company pursuant to Employment Agreements.

The NTW Acquisition was financed by a combination of debt and equity. The Company increased its borrowings from its existing revolving loan and term facilities which have been expanded (see Note 9), and raised equity from a Private Placement during June 2012 (see Note 11).

Old Nassau Tool, founded in 1959, was a manufacturer of aerospace components, principally landing gear for F-16 and F-18 fighter aircraft. In recent years approximately 80% of its net sales were direct to the United States Government, specifically the United States Navy and Air Force. AIRI believes that some of its products are ultimately shipped abroad to support foreign military sales by the United States Government. NTW supplies both individual components for repair and complete landing gear for refurbishment. The balance of NTW’s net sales involve machining, turning, deep-hole drilling, and trepanning projects for other aerospace manufacturers.

The NTW Acquisition results in a larger enterprise, with greater diversification of customers and aircraft platforms. The combined company has enhanced technical capabilities which the Company believes will lead to increased sales of landing gear product to its existing and prospective customers.

The NTW Acquisition was accounted for under ASC 805, “Business Combinations.” The total purchase price was allocated to assets acquired and liabilities assumed based on a study of their relative fair values. The final valuation has been completed. The purchase price allocation is set forth below.

| | |
|---|---------------------|
| Fair Value of Tangible Assets acquired | \$7,941,000 |
| Intangible assets, subject to amortization | 4,975,000 |
| Goodwill | 162,000 |
| Liabilities assumed | (660,000) |
| Total | \$12,418,000 |

The cost of the acquisition totaled \$12,418,000. The purchase price of the acquisition was as follows:

1. At closing, Old Nassau Tool was paid \$11,400,000.
2. The issuance of 66,667 shares of common stock valued at \$300,000.
3. \$200,000 paid in July after the release of a lien on certain property and equipment purchased.
4. \$518,000 to be paid as a working capital adjustment. See below.

Post closing of the NTW Acquisition, it was determined that an increase in the working capital adjustment in the amount of \$518,000 was necessary and is reflected in the purchase price allocation above. In addition, in July 2012, the Company paid \$107,000 of liabilities of Old Nassau Tool not assumed under the NTW Acquisition. Such amount will either be repaid or offset against amounts owed to Old Nassau Tool or the NTW Sellers. For financial statement

purposes, such amount has been offset against the working capital adjustment. At both December 31, 2013 and 2012, the amount due and payable to Old Nassau Tool totaled \$411,000 and is included on the consolidated balance sheet in accounts payable and accrued expenses.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principal Business Activity

The Company through its AIM subsidiary is primarily engaged in manufacturing aircraft structural parts, and assemblies for prime defense contractors in the aerospace industry in the United States. Welding is a specialty welding and products provider whose significant customers include the world's largest aircraft manufacturers, subcontractors, and original equipment manufacturers. NTW is a manufacturer of aerospace components, principally landing gear for F-16 and F-18 fighter aircraft. The Company's customers consist mainly of publically-traded companies in the aerospace industry.

Principles of Consolidation

The accompanying consolidated financial statements include accounts of the Company and its wholly-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid instruments with an original maturity of three months or less.

Accounts Receivable

Accounts receivable are reported at their outstanding unpaid principal balances net of allowances for uncollectible accounts. The Company provides for allowances for uncollectible receivables based on management's estimate of uncollectible amounts considering age, collection history, and any other factors considered appropriate. The Company writes off accounts receivable against the allowance for doubtful accounts when a balance is determined to be uncollectible.

Inventory Valuation

The Company values inventory at the lower of cost on a first-in-first-out basis or market.

AIM and NTW generally purchase inventory only when it has non-cancellable contracts for orders from its customers for finished goods. Welding generally produces pursuant to customer orders and maintains relatively low inventory levels. AIM and NTW occasionally produce finished goods in excess of purchase order quantities in anticipation of future demand; historically this excess has been used in fulfilling future purchase orders. The Company periodically evaluates inventory items that are not secured by purchase orders and establishes reserves for obsolescence accordingly. The Company also reserves for excess quantities, slow-moving goods, and for other impairments of value.

The Company presents inventory net of progress billings in accordance with the specified contractual arrangements with the United States Government, which results in the transfer of title of the related inventory from the Company to the United States Government, when such progress payments are received.

Capitalized Engineering Costs

The Company has contractual agreements with customers to produce parts, which the customers design. Though the Company has not designed and thus has no proprietary ownership of the parts, the manufacturing of these parts requires pre-production engineering and programming of the Company's machines. The pre-production costs associated with a particular contract are capitalized and then amortized beginning with the first shipment of product pursuant to such contract. These costs are amortized on a straight-line basis over the estimated length of the contract, or if shorter, three years.

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AIR INDUSTRIES GROUP
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If the Company is reimbursed for all or a portion of the pre-production expenses associated with a particular contract, only the unreimbursed portion would be capitalized. The Company may also progress bill customers for certain engineering costs being incurred. Such billings are recorded as progress billings (a reduction of the associated inventory) until the appropriate revenue recognition criteria have been met. The Terms and Conditions contained in customer purchase orders may provide for liquidated damages in the event that a stop-work order is issued prior to the final delivery of the product.

Property and Equipment

Property and equipment are carried at cost net of accumulated depreciation and amortization. Repair and maintenance charges are expensed as incurred. Property, equipment, and improvements are depreciated using the straight-line method over the estimated useful lives of the assets or the particular improvements. Expenditures for repairs and improvements in excess of \$1,000 that add to the productive capacity or extend the useful life of an asset are capitalized. Upon disposition, the cost and related accumulated depreciation are removed from the accounts and any related gain or loss is reflected in earnings.

Long-Lived and Intangible Assets

Identifiable intangible assets are amortized using the straight-line method over the period of expected benefit.

Long-lived assets and intangible assets subject to amortization to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. The Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. There has been no impairment as of December 31, 2013 and 2012.

Deferred Financing Costs

Costs incurred with obtaining and executing debt arrangements are capitalized and amortized using the effective interest method over the term of the related debt.

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." The Company recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable.

The Company recognizes certain revenues under a bill and hold arrangement with two of its large customers. For any requested bill and hold arrangement, the Company makes an evaluation as to whether the bill and hold arrangement qualifies for revenue recognition as follows:

- The customer requests that the transaction be on a bill and hold basis. A customer must initiate the request for any bill and hold arrangement. Upon request for a bill and hold, the Company requires a signed letter from the customer upon which the customer specifically requests the bill and hold arrangement. Upon receipt of the letter, the Company begins its evaluation process to determine whether a bill and hold arrangement can be granted.

- The customer has made fixed commitment to purchase in written documentation. All customers' orders are through firm written purchase orders.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- The goods are segregated from other inventory and are not available to fill any other customers' orders. The Company's goods are made to customers' or their customer's specifications and could not be sold to others.
- The risk of ownership has passed to the customer. The product is complete and ready for shipment. The earnings process is complete. An internal evaluation is made as to whether the product is complete and ready for shipment. This involves a review of the purchase order and a completed inspection process by the Company's quality control department.
- The date is determined by which the Company expects payment and the Company has not modified its normal billing and credit terms for this buyer. Payment is expected as if the goods had been shipped.
- The customer has the expected risk of loss in the event of a decline in the market value of goods. All goods are made to firm purchase orders with fixed prices. Any decline in value would not affect the pricing of the goods. The Company has not at any point, agreed to a price reduction on a bill and hold arrangement.

The Company had approximately \$773,000 or 1.2% of net sales that were billed but not shipped under such bill and hold arrangements as of December 31, 2013.

Payments received in advance from customers for products delivered are recorded as customer deposits until earned, at which time revenue is recognized. The Terms and Conditions contained in our customer purchase orders often provide for liquidated damages in the event that a stop work order is issued prior to the final delivery. The Company utilizes a Returned Merchandise Authorization or RMA process for determining whether to accept returned products. Customer requests to return products are reviewed by the contracts department and if the request is approved, a credit is issued upon receipt of the product. Net sales represent gross sales less returns and allowances.

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 whether to accrue for 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.

Credit and Concentration Risks

There were three customers that represented 56.0% and 65.3% of total sales for the years ended December 31, 2013 and 2012, respectively. This is set forth in the table below.

| Customer | Percentage of Sales | |
|----------|---------------------|------|
| | 2013 | 2012 |
| 1 | 27.7 | 27.6 |
| 2 | 18.3 | 26.3 |
| 3 | 10.0 | ** |
| 4 | * | 11.4 |

* Customer was less than 10% of sales for the year ended December 31, 2013

** Customer was less than 10% of sales for the year ended
December 31, 2012

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

There were two customers that represented 42.9% of gross accounts receivable at December 31, 2013 and three customers that represented 54.6% of gross accounts receivable at December 31, 2012. This is set forth in the table below.

| Customer | Percentage of Receivables | |
|----------|---------------------------|------------------|
| | December 2013 | December 2012 |
| 1 | 22.8 | 18.6 |
| 2 | 20.1 | 10.7 |
| 3 | * | 25.3 |

* Customer was less than 10% of Gross Accounts Receivable at December 31, 2013

During the year, the Company had occasionally maintained balances in its bank accounts that were in excess of the FDIC limit. The Company has not experienced any losses on these accounts.

AIM has several key sole-source suppliers of various parts that are important for one or more of our products. These suppliers are our only source for such parts and, therefore, in the event any of them were to go out of business or be unable to provide us parts for any reason, our business could be severely harmed.

Income Taxes

The Company accounts for income taxes in accordance with accounting guidance now codified as FASB ASC 740, "Income Taxes," which requires that the Company recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

The Company accounts for uncertainties in income taxes under the provisions of FASB ASC 740-10-05, "Accounting for Uncertainty in Income Taxes." The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Earnings per share

Basic earnings per share is computed by dividing the net income applicable to common stockholders by the weighted-average number of shares of common stock outstanding for the period. Potentially dilutive shares, using the treasury stock method, are included in the diluted per-share calculations for all periods when the effect of their inclusion is dilutive.

The following is a reconciliation of the denominators of basic and diluted earnings per share computations:

| | 2013 | 2012 |
|---|-----------|-----------|
| Weighted average shares outstanding used to compute basic earning per share | 5,739,014 | 4,680,581 |
| Effect of dilutive stock options and warrants | 193,712 | 78,665 |
| Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share | 5,932,726 | 4,759,246 |

The following securities have been excluded from the calculation as their effect would be anti-dilutive:

| | December 31, 2013 | December 31, 2012 |
|---------------|----------------------|----------------------|
| Stock Options | 24,548 | 11,948 |
| Warrants | - | 118,835 |
| | 24,548 | 130,783 |

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with FASB ASC 718, "Compensation – Stock Compensation." Under the fair value recognition provision of the ASC, stock-based compensation cost is estimated at the grant date based on the fair value of the award. The Company estimates the fair value of stock options and warrants granted using the Black-Scholes-Merton option pricing model.

Goodwill

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. The goodwill amount of \$453,000 relates to the acquisition of Welding (\$291,000) and the NTW Acquisition (\$162,000). Goodwill is not amortized, but is tested at least annually for impairment, or if circumstances occur that more likely than not reduce the fair value of the reporting unit below its carrying amount.

The Company accounts for the impairment of goodwill under the provisions of ASU 2011-08 ("ASU 2011-08"), "Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment." ASU 2011-08 updated the guidance on the periodic testing of goodwill for impairment. The updated guidance gives companies the option to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

The Company performs impairment testing for goodwill annually, or more frequently when indicators of impairment exist. As discussed above, the Company adopted ASU 2011-08 and performed a qualitative assessment in the fourth quarter of 2013 to determine whether it was more likely than not that the fair value of each of Welding and NTW was less than its carrying amount.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company has determined that there has been no impairment of goodwill at December 31, 2013 and 2012.

Freight Out

Freight out is included in operating expenses and amounted to \$64,000 and \$82,000 for the years ended December 31, 2013 and 2012, respectively.

JOBS Act

On April 5, 2012, the JOBS Act was signed into law. The JOBS Act contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. As an "emerging growth company," we may, under Section 7(a)(2)(B) of the Securities Act, delay adoption of new or revised accounting standards applicable to public companies until such standards would otherwise apply to private companies. An "emerging growth company" is one with less than \$1.0 billion in annual sales, has less than \$700 million in market value of its shares of common stock held by non-affiliates and issues less than \$1.0 billion of non-convertible debt over a three year period. We may take advantage of this extended transition period until the first to occur of the date that we (i) are no longer an "emerging growth company" or (ii) affirmatively and irrevocably opt out of this extended transition period. We have elected to take advantage of the benefits of this extended transition period. Until the date that we are no longer an "emerging growth company" or affirmatively and irrevocably opt out of the exemption provided by Securities Act Section 7(a)(2)(B), upon issuance of a new or revised accounting standard that applies to our consolidated financial statements and that has a different effective date for public and private companies, we will disclose the date on which adoption is required for non-emerging growth companies and the date on which we will adopt the recently issued accounting standard.

Recently Issued Accounting Pronouncements

Effective January 1, 2013, the Company adopted Accounting Standards Update ("ASU") 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02"). ASU 2013-02 requires the disclosure of amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present either on the face of the statement of operations or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts not reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. This guidance is effective prospectively for the Company for annual and interim periods beginning January 1, 2013. The adoption of ASU 2013-02 did not have a material effect on the Company's financial position, results of operations or cash flows.

On July 18, 2013, the FASB issued Accounting Standards Update No. 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). ASU 2013-11 is expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this update should be applied prospectively for annual and interim periods beginning after December 15, 2013. The Company is currently evaluating the impact of its pending adoption of ASU 2013-11 on its consolidated financial statements.

The Company does not believe that any other recently issued, but not yet effective, accounting standards if currently adopted would have a material effect on the accompanying consolidated financial statements.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Reclassifications

Certain account balances in 2012 have been reclassified to conform to the current period presentation.

Subsequent Events

Management has evaluated subsequent events through the date of this filing.

Note 4. ACCOUNTS RECEIVABLE

The components of accounts receivable at December 31, are detailed as follows:

| | December 31, 2013 | December 31, 2012 |
|---------------------------------|----------------------|----------------------|
| Accounts Receivable Gross | \$ 9,367,000 | \$ 12,336,000 |
| Allowance for Doubtful Accounts | (783,000) | (705,000) |
| Accounts Receivable Net | \$ 8,584,000 | \$ 11,631,000 |

The allowance for doubtful accounts for the years ended December 31, 2013 and 2012 is as follows:

| | Balance at Beginning of Year | Charged to Costs and Expenses | Deductions From Reserves | Balance at End of Year |
|------------------------------------|------------------------------------|-------------------------------------|--------------------------------|------------------------------|
| Year ended December 31, 2013 | | | | |
| Allowance for Doubtful Accounts | \$ 705,000 | \$ 400,000 | \$ 322,000 | \$ 783,000 |
| Year ended December 31, 2012 | | | | |
| Allowance for Doubtful Accounts | \$ 950,000 | \$ 262,000 | \$ 507,000 | \$ 705,000 |

Note 5. INVENTORY

The components of inventory at December 31, consisted of the following:

| | December 31, 2013 | December 31, 2012 |
|----------------------------|----------------------|----------------------|
| Raw Materials | \$ 6,002,000 | \$ 6,105,000 |
| Work In Progress | 15,665,000 | 16,730,000 |
| Finished Goods | 7,712,000 | 6,653,000 |
| Progress Payments Received | (416,000) | (525,000) |
| Inventory Reserve | (2,741,000) | (2,224,000) |

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| | | | | |
|-----------------|----|------------|----|------------|
| Total Inventory | \$ | 26,222,000 | \$ | 26,739,000 |
|-----------------|----|------------|----|------------|

The Company periodically evaluates inventory and establishes reserves for obsolescence, excess quantities, slow-moving goods, and for other impairment of value. The Company presents inventory net of progress billings in accordance with the specified contractual arrangements with the United States Government, which results in the transfer of title of the related inventory from the Company to the United States Government, when such progress payments are received.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6. PROPERTY AND EQUIPMENT

The components of property and equipment at December 31, consisted of the following:

| | December 31, 2013 | December 31, 2012 | |
|---------------------------------------|----------------------|----------------------|---------------|
| Machinery and Equipment | \$ 6,251,000 | \$ 5,801,000 | 5 - 8 years |
| Capital Lease Machinery and Equipment | 5,261,000 | 4,503,000 | 5 - 8 years |
| Tools and Instruments | 5,009,000 | 3,968,000 | 1.5 - 7 years |
| Automotive Equipment | 59,000 | 55,000 | 5 years |
| Furniture and Fixtures | 257,000 | 232,000 | 5 - 8 years |
| Leasehold Improvements | 646,000 | 612,000 | Term of Lease |
| Computers and Software | 357,000 | 318,000 | 4-6 years |
| Total Property and Equipment | 17,840,000 | 15,489,000 | |
| Less: Accumulated Depreciation | (11,317,000) | (9,606,000) | |
| Property and Equipment, net | \$ 6,523,000 | \$ 5,883,000 | |

Depreciation expense for the years ended December 31, 2013 and 2012 was approximately \$1,711,000 and \$1,557,000, respectively.

Note 7. INTANGIBLE ASSETS

The components of the intangibles assets at December 31, consisted of the following:

| | December 31, 2013 | December 31, 2012 | |
|--------------------------------|----------------------|----------------------|----------------|
| Customer Relationships | \$ 5,815,000 | \$ 5,815,000 | 5 to 14 years |
| Trade Names | 770,000 | 770,000 | 20 years |
| Technical Know-how | 660,000 | 660,000 | 10 years |
| Non-Compete | 50,000 | 50,000 | 5 years |
| Professional Certifications | 15,000 | 15,000 | .25 to 2 years |
| Total Intangible Assets | 7,310,000 | 7,310,000 | |
| Less: Accumulated Amortization | (2,584,000) | (1,421,000) | |
| Intangible Assets, net | \$ 4,726,000 | \$ 5,889,000 | |

The expense for amortization of the intangibles for the years ended December 31, 2013 and 2012 was approximately \$1,163,000 and \$693,000, respectively.

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Future amortization of intangibles is as follows:

| For the year ending | Amount |
|------------------------|--------------|
| December 31, 2014 | \$ 1,163,000 |
| December 31, 2015 | 1,163,000 |
| December 30, 2016 | 1,163,000 |
| December 31, 2017 | 617,000 |
| December 31, 2018 | 102,000 |
| Thereafter | 518,000 |
| Total | \$ 4,726,000 |

Note 8. SALE AND LEASEBACK TRANSACTION

On October 24, 2006, the Company consummated a Sale - Leaseback Arrangement, whereby the Company sold the buildings and real property comprising its corporate headquarters in Bay Shore, New York (the "Property") for a purchase price of \$6,200,000. The Company accounted for the transaction under the provisions of FASB ASC 840-40, "Leases – Sale-Leaseback Transactions." The Company realized a gain on the sale of \$1,051,000 of which \$300,000 was recognized during the year ended December 31, 2006. The remaining \$751,000 is being recognized ratably over the remaining term of the twenty year lease at approximately \$38,000 per year. The gain is included in Other Income in the accompanying Consolidated Statement of Income. The unrecognized portion of the gain in the amount of \$485,000 and \$523,000 as of December 31, 2013 and 2012, respectively, is classified as Deferred Gain on Sale in the accompanying Consolidated Balance Sheet.

Simultaneous with the closing of the sale of the Property, the Company entered into a 20-year triple-net lease (the "Lease") with the Purchaser for the property. Base annual rent is approximately \$540,000 for the first five years, \$560,000 for the sixth year, and thereafter increases 3% per year. The Lease grants AIM an option to renew the Lease for an additional period of five years. The Company has on deposit with the Purchaser \$127,500 as security for the performance of its obligations under the Lease. In addition, the Company deposited \$393,000 with the landlord as security for the completion of certain repairs and upgrades to the Property. This amount is included in the caption Deferred Finance costs, net, Deposit and Other Assets on the accompanying Consolidated Balance Sheet. Pursuant to the terms of the Lease, the Company is required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance. The lease also contains customary representations, warranties, obligations, conditions and indemnification provisions and grants the Purchaser customary remedies upon a breach of the lease by the Company, including the right to terminate the Lease and hold the Company liable for any deficiency in future rent. See Note 13 Commitments and Contingencies.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

| | December 31, 2013 | December 31, 2012 |
|---|----------------------|----------------------|
| Revolving credit note payable to PNC Bank N.A. ("PNC") | \$12,029,000 | \$15,667,000 |
| Term loan, PNC | 1,948,000 | 3,748,000 |
| Capital lease obligations | 1,787,000 | 2,060,000 |
| Notes payable to sellers of WMI | 732,000 | 1,376,000 |
| Junior subordinated notes | 1,000,000 | 1,000,000 |
| Subtotal | 17,496,000 | 23,851,000 |
| Less: Current portion of notes and capital obligations | (14,969,000) | (19,211,000) |
| Notes payable and capital lease obligations, net of current portion | \$2,527,000 | \$4,640,000 |

PNC Bank N.A. ("PNC")

The Company has a credit facility with PNC (the "Loan Facility") secured by substantially all of its assets. The Loan Facility has been amended many times during its term. The Company entered into the latest amendment to the Loan Facility in December 2013 and paid an amendment fee of \$25,000. The Loan Facility now provides for maximum borrowings of \$22,000,000 consisting of the following:

- (i) a \$20,000,000 revolving loan (includes inventory sub-limit of \$12,500,000) and
- (ii) a \$1,948,000 term loan.

Under the terms of the Loan Facility the revolving credit note now bears interest at (a) the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one half of one percent (2.50%) with respect to Eurodollar Rate Loans. Prior to the amendment the revolving credit note bore interest at the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and three quarters of one percent (2.75%) with respect to Eurodollar Rate Loans. The revolving credit note had an interest rate of 4.0% and 5.50% per annum at December 31, 2013 and 2012, respectively, and an outstanding balance of \$12,029,000 and \$15,667,000, respectively. The maturity date of the revolving credit note is November 30, 2016.

Each day, the Company's cash collections are swept directly by the bank to reduce the revolving loans and we then borrow according to a borrowing base. As such, the Company generally has no cash on hand. Because the revolving loans contain a subjective acceleration clause which could permit PNC to require repayment prior to maturity, the loans are classified with the current portion of notes and capital lease obligations.

Under the terms of the Loan Facility, the maturity date of the term loan is the first business day (as defined) of January 2015. The term loan now bears interest equal to (a) the sum of the Alternate Base Rate plus one and three quarters of one percent (1.75%) with respect to Domestic Rate Loans or (b) the sum of the Eurodollar Rate plus three percent (3.00%) with respect to Eurodollar Rate Loans. Prior to the amendment the term loan bore interest, at the option of the Company equal to (a) the sum of the Alternate Base Rate plus one and three quarters of one percent (1.75%) with respect to Domestic Rate Loans or (b) the sum of the Eurodollar Rate plus three and one half of one percent (3.50%)

with respect to Eurodollar Rate Loans. Repayment under the term loan shall consist of 19 consecutive monthly principal installments, the first 18 of which will be in the amount of \$150,000 commencing on the first business day of July 2013, with the 19th and final payment of any unpaid balance of principal and interest payable on the first business day of January 2015. Additionally, upon a request from PNC no later than the last day of any applicable fiscal quarter, there is a prepayment equal to 50% of Excess Cash Flow (as defined) for each fiscal quarter commencing with the fiscal quarter ended June 30, 2013 (formerly September 30, 2012), payable upon the delivery of the financial statements for such fiscal period to PNC, but no later than 45 days after the end of the fiscal quarter. PNC did not make such a request for the quarter ended December 31, 2013. At December 31, 2013 and 2012, the balance due under the term loan was \$1,948,000 and \$3,748,000, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

To the extent that the Company disposes of collateral used to secure the Loan Facility, other than inventory, the Company must promptly repay the draws on the credit facility in the amount equal to the net proceeds of such sale.

The terms of the Loan Facility require that, among other things, the Company maintain a specified Fixed Charge Coverage Ratio. In addition, the Company is limited in the amount of Capital Expenditures it can make. The Company is also limited to the amount of Dividends it can pay its shareholders as defined in the Loan Facility. As of both December 31, 2013 and 2012, the Company was in compliance with all terms of the Loan Facility.

The Company's receivables are payable directly into a lockbox controlled by PNC (subject to the terms of the Loan Facility). PNC may use some elements of subjective business judgment in determining whether a material adverse change has occurred in the Company's condition, results of operations, assets, business, properties or prospects allowing it to demand repayment of the Loan Facility.

As of December 31, 2013 the future minimum principal payments for the term loan are as follows:

| For the year ending | Amount |
|-----------------------|--------------|
| December 31, 2014 | \$ 1,800,000 |
| December 31, 2015 | 148,000 |
| PNC Term Loan | |
| Payable | 1,948,000 |
| Less: Current portion | (1,800,000) |
| Long-term portion | \$ 148,000 |

Interest expense related to these credit facilities amounted to approximately \$928,000 and \$1,006,000 for the years ended December 31, 2013 and 2012, respectively.

Capital Leases Payable – Equipment

The Company is committed under several capital leases for manufacturing and computer equipment. All leases have bargain purchase options exercisable at the termination of each lease. Capital lease obligations totaled \$1,787,000 and \$2,060,000 as of December 31, 2013 and 2012, respectively, with various interest rates ranging from 7.0% to 9.5%.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2013, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

| For the year ending | Amount |
|--|--------------|
| December 31, 2014 | \$ 569,000 |
| December 31, 2015 | 569,000 |
| December 31, 2016 | 466,000 |
| December 31, 2017 | 315,000 |
| December 31, 2018 | 144,000 |
| Total future minimum lease payments | 2,063,000 |
| Less: imputed interest | (276,000) |
| Less: current portion | (449,000) |
| Total Long Term Portion | \$ 1,338,000 |

On July 1, 2013, coincident with the acquisition of Decimal, the Company satisfied approximately \$454,000 of capital leases that had maturities of less than one year remaining. As a result of this satisfaction, PNC now has the first lien on the equipment that was previously leased under the capital leases.

Notes Payable - Sellers

As of December 31, 2013 and 2012, the balance owed to the sellers of Welding is:

| | December 31, 2013 | December 31, 2012 |
|-----------------------------|----------------------|----------------------|
| Former Welding Stockholders | \$ 732,000 | \$ 1,376,000 |
| Less: Current Portion | (691,000) | (644,000) |
| Total long-term portion | \$ 41,000 | \$ 732,000 |

In connection with the acquisition of Welding on August 24, 2007, the Company incurred a note payable (“Note”) to the former stockholders of Welding. Our obligation under the Note is subordinate to our indebtedness to PNC.

The Note and payment terms were adjusted and/or amended several times. On October 1, 2010, the Company entered into a letter agreement with the former stockholders of Welding. It was agreed that all interest that had been accrued and not yet paid under prior arrangements would be capitalized into the principal balance of the note, making the new balance of the note \$2,397,967. Payments on the note began on October 1, 2010. It was further agreed that payments would be made according to the following schedule: equal monthly installments of \$40,000 on the first business day of each month until December 31, 2011, followed by equal monthly installments of \$60,000 on the first business day of each month commencing on January 1, 2012 and continuing until the entire principal amount of the obligation is paid in full, which is estimated to be in January 2015. Interest shall accrue at the rate of 7% per annum, and each payment will first apply to interest and then to principal. At December 31, 2013 and 2012, the balance owed under the note was \$732,000 and \$1,376,000, respectively.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2013, the future minimum payments for the note payable to the former stockholders of Welding are as follows:

| For the year ending | Amount |
|---|------------|
| December 31, 2014 | \$ 691,000 |
| December 31, 2015 | 41,000 |
| Former WMI Stockholders Notes Payable | 732,000 |
| Less: Current portion | (691,000) |
| Long-term portion | \$ 41,000 |

Interest expense related to notes payable to the former stockholder was \$76,000 and \$119,000 for the years ended December 31, 2013 and 2012, respectively.

Junior Subordinated Notes

In 2008 and 2009, the Company sold in a series of private placements to accredited investors \$5,990,000 of principal amount in Junior Subordinated Notes. The notes bear interest at the rate of 1% per month (or 12% per annum).

In connection with the offering of the Company's Junior Subordinated Notes, the Company issued to Taglich Brothers, Inc. ("Taglich Brothers"), as placement agent, a Junior Subordinated Note in the principal amount of \$510,000. The terms of the note issued to Taglich Brothers are identical to the notes. In connection with the amounts raised in 2009, the Company issued to Taglich Brothers a Junior Subordinated Note on the same terms as the Junior Subordinated Notes referred to above for commission of \$44,500.

In conjunction with the Private Placement of our common stock to raise money for the NTW Acquisition, the Company solicited the holders of our Junior Subordinated Notes to convert their notes to Common Stock at a price of \$6.00 per share. On June 29, 2012, the Company issued 867,461 shares of its Common Stock in exchange for approximately \$5,204,000 of its Junior Subordinated Notes. On July 26, 2012, the Company repaid \$115,000 of its Junior Subordinated Notes along with the accrued interest thereon of approximately \$1,000.

The due dates of the remaining Junior Subordinated Notes were extended from November 18, 2013 to mature on November 30, 2016 and are subordinated to the Company's obligations to PNC.

The balance owed on the Junior Subordinated Notes at both December 31, 2013 and 2012 amounted to \$1,000,000.

Interest expense on the Junior Subordinated Notes amounted to \$120,000 and \$439,000 for the years ended December 31, 2013 and 2012, respectively.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

The components of accounts payable at December 31, are detailed as follows:

| | December 31, 2013 | December 31, 2012 |
|------------------------|----------------------|----------------------|
| Accounts Payable | \$ 5,142,000 | \$ 5,713,000 |
| Accrued Expenses | 793,000 | 697,000 |
| Due to Decimal sellers | 277,000 | - |
| Due to NTW sellers | 411,000 | 411,000 |
| Accrued Interest | 84,000 | 138,000 |
| Accrued Payroll | 118,000 | 99,000 |
| 401K payable | 30,000 | 19,000 |
| | \$ 6,855,000 | \$ 7,077,000 |

Note 11. STOCKHOLDERS' EQUITY

Common Stock Issuances

On October 28, 2013, the Company sold 133,000 shares of its common stock pursuant to a Common Stock Purchase Agreement for \$7.50 a share for gross proceeds of \$997,000. The Company reserves the right to pay Taglich Brothers a placement agent fee in connection with the sale in an amount not to exceed \$20,000.

The Purchase and Sale Agreement contained a provision such that if at any time prior to April 30, 2014, the Company, in a transaction in which it receives gross proceeds in excess of \$1,000,000, issues or otherwise sells or distributes shares of its preferred stock, common stock or options, warrants, rights or other securities to purchase or convertible into shares of its preferred stock or common stock, hereinafter, the "New Securities," (other than compensatory options to purchase no more than 500,000 shares issued to the directors, employees or regularly engaged consultants of the Company) at its option, the buyer may elect to return all, but not less than all, of the shares to the Company and subscribe for the New Securities to be sold or distributed by the Company. In such event, the buyer shall receive the number of New Securities as is equal to the result obtained by dividing the Aggregate Purchase Price by the price per share at which the New Securities are being sold by the Company.

During June and July of 2012, the Company issued 1,185,851 shares of its Common Stock in a Private Placement to Accredited Investors. The Company received \$6,528,000 net of commissions and expenses.

Our agent, Taglich Brothers, received commissions in the amount of approximately \$569,000, along with 12,000 shares of common stock, and warrants to purchase approximately 119,000 shares of Common Stock at \$6.30. The Company also paid approximately \$18,000 of legal fees on behalf of Taglich Brothers.

The proceeds from the sale of the Common Stock were used to finance the NTW Acquisition.

On June 29, 2012, in conjunction with the Private Placement, we issued 867,461 shares of our common stock in exchange for approximately \$5,204,000 of our Junior Subordinated Notes.

As part of the NTW Acquisition, we issued 66,667 shares of common stock to the stockholders of Old Nassau Tool.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dividends

On October 17, 2012, the Board of Directors approved and the Company announced a quarterly dividend of \$0.0625 per common share to be paid on November 15, 2012 to all shareholders of record as of the close of business on October 31, 2012. The approximate amount of the dividend paid was \$359,000.

On March 11, 2013, the Board of Directors approved and the Company announced a quarterly dividend of \$0.0625 per common share to be paid on April 1, 2013 to all shareholders of record as of the close of business on March 15, 2013. The approximate amount of the dividend is \$359,000.

On June 20, 2013, the Board of Directors approved and the Company announced a quarterly dividend of \$0.0625 per common share paid on July 5, 2013 to all shareholders of record as of the close of business on July 1, 2013. The approximate amount of the dividend was \$358,000.

On September 17, 2013, the Board of Directors approved and the Company announced a quarterly dividend of \$0.125 per common share paid on October 15, 2013 to all shareholders of record as of the close of business on September 30, 2013. The approximate amount of the dividend was \$716,000.

On December 30, 2013, the Board of Directors approved and the Company announced a quarterly dividend of \$0.125 per common share paid on January 24, 2014 to all shareholders of record as of the close of business on January 9, 2014. The approximate amount of the dividend was \$717,000.

Derivative Liabilities

In connection with the issuances of equity instruments or debt, the Company may issue options or warrants to purchase common stock. In certain circumstances, these options or warrants may be classified as liabilities, rather than as equity. In addition, the equity instrument or debt may contain embedded derivative instruments, such as conversion options or listing requirements, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative liability instrument. The Company accounts for derivative liability instruments under the provisions of FASB ASC 815, "Derivatives and Hedging."

Warrants Issued To Taglich Brothers

As discussed above, the Company issued warrants to Taglich Brothers. Such warrants contain "cashless exercise" provisions. As a result, the value of the warrants has to be recognized as a liability. In addition, the Company would be required to revalue the derivative liability at the end of each reporting period with the change in value reported on the consolidated statement of income. The Company did not account for the derivative liability in its consolidated financial statements as it was determined to not be material.

Down Round Feature

As discussed above, the Company issued shares of common stock under a Common Stock Purchase Agreement which contained a "down round" feature. Based on an evaluation as discussed in ASC No. 815-15, "Embedded Derivatives" and ASC No. 815-40-15, "Contracts in Entity's Own Equity - Scope and Scope Exceptions," the Company determined that the down round feature in the common stock issued was not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a

lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the down round feature should be bifurcated from the common stock and accounted for as a derivative liability.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company did not value the derivative liability at October 25, 2013, the date of consummation of the Stock Purchase Agreement. One of the key determinants of the Company's decision to not value the derivative liability was the high likelihood that a future financing would not occur that would trigger the down round feature. Whether a future equity financing would occur would be determined by the cash needs of the Company and management's willingness to trigger the down round feature. As of September 30, 2013, the Company was operating profitably and had generated net cash through operations for the trailing nine months of \$3,556,000. Further, at such time the Company was not anticipating any material acquisitions or significant capital expenditures that would require the Company to seek additional cash financing. Moreover, although the Company might seek additional capital to complete a new acquisition, it was only likely to seek to complete an acquisition if it was accretive to earnings. If triggering the down round feature would render an acquisition dilutive rather than accretive, it was unlikely that the acquisition would be made until after the down round feature expired.

Under generally accepted accounting principals, the Company is required to mark-to-market the derivative liability at the end of each reporting period. The Company did not value the derivative liability at December 31, 2013. At such date, the Company determined that it was still not likely that an equity financing would occur prior to April 30, 2014, the expiration date of the down round feature. Such conclusion was based upon the discussion noted above. In addition the Company had remained profitable through the fourth quarter of 2013, continued to generate significant cash from operations and had significant availability under its revolving credit facility. Moreover, although the Company might seek additional equity capital to complete a new acquisition, it was only likely to seek to complete an acquisition if it was accretive to earnings. If triggering the down round feature would render an acquisition dilutive rather than accretive, it was unlikely that the acquisition would be made until after the down round feature expired.

Note 12. EMPLOYEE BENEFITS PLANS

The Company employs both union and non-union employees and maintains several benefit plans.

Union

Substantially the entire workforce at AIM is subject to a union contract with the United Service Workers Union TUJAT Local 355, EIN 11-1772919 (the "Union"). The contract expires on December 31, 2015.

Medical benefits for union employees are provided through a policy with Insperity, the costs of which are substantially borne by the Company. In addition, the Company is obligated to make contributions for union dues and a security fund (defined contribution plan) for the benefit of each union employee. Contributions to the security fund amounted to \$247,000 and \$267,000 for the years ended December 31, 2013 and 2012, respectively.

The Company adopted ASU No. 2011-09, "Compensation - Retirement Benefits-Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer's Participation in a Multiemployer Plan" ("ASU 2011-09"). ASU 2011-09 requires additional disclosures about an employer's participation in a multiemployer pension plan. Previously, disclosures were limited primarily to the historical contributions made to the plans. ASU 2011-09 applies to nongovernmental entities that participate in multiemployer plans. The Union's retirement plan is a defined contribution plan. As such, the Company is not responsible for the obligations of other companies in the Union's retirement plan and no further disclosures are required.

Others

All other Company employees, including those of Welding and NTW, are covered under a co-employment agreement with Insperity.

The Company has two defined contribution plans under Section 401(k) of the Internal Revenue Code (the "Plans"). Pursuant to the Plans, qualified employees may contribute a percentage of their pretax eligible compensation to the Plan. The Company does not match any contributions that employees may make to either Plan.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13. COMMITMENTS AND CONTINGENCIES

Real Estate Leases

The Company leases its facilities under various operating lease agreements, which contain renewal options and escalation provisions. Rent expense was \$1,978,000 and \$1,570,000 for the years ended December 31, 2013 and 2012, respectively. The Company is responsible for paying all operating costs under the terms of the leases. As of December 31, 2013, the aggregate future minimum lease payments are as follows:

| For the year ending | Plant Avenue Annual Rent | Fifth Avenue Annual Rent | Lamar Street Annual Rent | Reith Street Annual Rent | Total Rents |
|---------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|---------------------|
| December 31, 2014 | \$614,000 | \$664,000 | \$360,000 | \$36,000 | \$1,674,000 |
| December 31, 2015 | 633,000 | 684,000 | 360,000 | - | \$1,677,000 |
| December 31, 2016 | - | 704,000 | 360,000 | - | \$1,064,000 |
| December 31, 2017 | - | 725,000 | 360,000 | - | \$1,085,000 |
| December 31, 2018 | - | 747,000 | 300,000 | - | \$1,047,000 |
| Thereafter | - | 6,601,000 | - | - | \$6,601,000 |
| Total Rents | \$1,247,000 | \$10,125,000 | \$1,740,000 | \$36,000 | \$13,148,000 |

The leases provide for scheduled increases in base rent. Rent expense is charged to operations using the straight-line method over the term of the lease which results in rent expense being charged to operations at inception of the lease in excess of required lease payments. This excess is shown as deferred rent in the accompanying consolidated balance sheets.

One of the Company's former subsidiaries was located in the Plant Avenue facility and following discontinuing operations, a portion of the facility was vacant. The Company recorded a charge for \$579,000 at December 31, 2009 representing the estimated discounted future cost of part of the Plant Avenue facility.

As of December 31, 2013, the estimated discounted future cost will be charged to expense as follows:

| | |
|--|------------------|
| For the year ending | Amount |
| December 31, 2014 | \$ 71,000 |
| December 31, 2015 | 56,000 |
| Total future minimum lease payments | 127,000 |
| Less: current portion | (71,000) |
| Total Long-Term Portion | \$ 56,000 |

On July 1, 2010, the Company entered into a sublease with a third party to rent a portion of the vacant space at the Plant Avenue facility. Under the terms of the sublease, the sub-tenant occupied approximately 17,787 square feet for the months of July 2010 through October 2010. Beginning in November 2010, the sub-tenant occupied approximately 27,787 square feet. The space was being subleased for \$3.00 per square foot, with a discount in the first month of 50%. The sublease was a month-to-month lease and could be terminated by either party with 90 days written notice. This sublease was terminated on June 30, 2013.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14. INCOME TAXES

The provision for income taxes as at December 31, are set forth below:

| | 2013 | 2012 |
|---|---------------------|--------------------|
| Current | | |
| Federal | \$1,135,000 | \$1,093,000 |
| State | 339,000 | 354,000 |
| Prior year overaccruals | | |
| Federal | (185,000) | - |
| State | (223,000) | - |
| Total Expense | 1,066,000 | 1,447,000 |
| Deferred Tax Benefit | (1,236,000) | - |
| Net (Benefit) Expense for Income Taxes | \$(170,000) | \$1,447,000 |

The following is a reconciliation of our income tax rate computed using the federal statutory rate to our actual income tax rate as of December 31,

| | 2013 | | 2012 | |
|-----------------------------------|-----------|----------|-----------|----------|
| Federal Tax Rate | 34 | % | 34 | % |
| Effect of State Taxes | 6 | % | 8 | % |
| State Franchise Taxes | 1 | % | 0 | % |
| Net Operating Loss Carry Forward | 0 | % | -9 | % |
| Permanent Differences | -3 | % | 0 | % |
| Prior Year over accrual - Federal | -5 | % | 0 | % |
| Prior Year Over Accrual - State | -4 | % | 0 | % |
| Change in Valuation Allowance | -35 | % | 0 | % |
| Others | 1 | % | 3 | % |
| Total | -5 | % | 36 | % |

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The components of net deferred tax assets as of December 31, are set forth below:

| | December 31, 2013 | December 31, 2012 |
|---|----------------------|----------------------|
| Deferred tax assets: | | |
| Current: | | |
| Bad debts | 313,000 | 282,000 |
| Inventory - 263A adjustment | 729,000 | 569,000 |
| Account payable, accrued expenses and reserves | 9,000 | 9,000 |
| Total current deferred tax asset before valuation allowance | 1,051,000 | 860,000 |
| Valuation Allowance | - | (860,000) |
| Total current deferred tax asset after valuation allowance | \$1,051,000 | \$- |
| Non- Current | | |
| Capital loss carry forwards | \$1,088,000 | \$1,088,000 |
| Section 1231 loss carry forward | 4,000 | 86,000 |
| Stock based compensation - options and restricted stock | 521,000 | 506,000 |
| Capitalized engineering costs | 503,000 | 447,000 |
| Deferred rent | 453,000 | 423,000 |
| Amortization - NTW Transaction | 475,000 | 138,000 |
| Lease Impairment | 51,000 | 85,000 |
| Deferred gain on sale of real estate | 194,000 | 209,000 |
| Total deferred tax assets before valuation allowance | 3,289,000 | 2,982,000 |
| Valuation allowance | (1,092,000) | (1,409,000) |
| Total deferred tax assets after valuation allowance | 2,197,000 | 1,573,000 |
| Deferred tax liabilities: | | |
| Property and equipment | (1,497,000) | (997,000) |
| Goodwill - NTW Transaction | (7,000) | - |
| Amortization - Welding Transaction | (508,000) | (576,000) |
| Total Deferred Tax Liability | (2,012,000) | (1,573,000) |
| Net deferred tax asset | \$1,236,000 | \$- |

During 2013, the Company determined that it no longer needed to provide a valuation allowance on the net deferred tax assets except for the capital loss and section 1231 loss carryforwards. This was based upon the fact that management believes that the net deferred tax assets are more likely than not to be realized. The valuation allowance at December 31, 2013 and 2012 amounted to \$1,092,000 and \$2,269,000, respectively.

The Company has a capital loss carry forward from the sale of Sigma Metals, Inc., a former subsidiary of the Company of \$2,719,000 which will expire in fiscal 2015.

At December 31, 2013 and 2012, the Company had no material unrecognized tax benefits and no adjustments to liabilities or operations were required. The Company does not expect that its unrecognized tax benefits will materially increase within the next twelve months. The Company recognizes interest and penalties related to uncertain tax

positions in interest expense. As of December 31, 2013 and 2012, the Company has not recorded any provisions for accrued interest and penalties related to uncertain tax positions.

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AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In certain cases, the Company's uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. The Company files federal and state income tax returns in jurisdictions with varying statutes of limitations. The 2010 through 2013 tax years generally remain subject to examination by federal and state tax authorities.

Note 15. STOCK OPTIONS AND WARRANTS

Stock-Based Compensation

On June 3, 2013, the Company's Board of Directors adopted and on July 29, 2013, the Company's stockholders approved the 2013 Equity Incentive Plan (the "2013 Plan"). The 2013 Plan is virtually identical to and replaced the 2010 Equity Incentive Plan which was adopted in July 2010. The Company reserved 600,000 shares of its Common Stock for various issuances. The 2013 Plan permits the Company to grant non-qualified and incentive stock options to employees, directors, and consultants.

During the years ended December 31, 2013 and 2012, the Board of Directors approved the issuance of 13,500 and 21,000 options, respectively, to the non-employee members of the Company's Board of Directors. These options vested immediately.

On October 1, 2013, the Board of Directors approved the issuance of 99,747 options, to certain management employees. These options vest ratably over three years. There were no employee options issued during 2012.

The Company recorded expenses of \$38,000 and \$101,000 in its consolidated statement of income for the years ended December 31, 2013 and 2012, respectively, and such amounts were included as a component of general and administrative expense.

The fair values of stock options granted were estimated using the Black-Sholes option-pricing model with the following assumptions for the years ended December 31:

| | 2013 | | 2012 | |
|--|---------|---|---------|---|
| Risk-free interest rates | 0.71 - | | 0.66 - | |
| | 1.75 | % | 0.73 | % |
| Expected life | 5 | | 5 | |
| Expected volatility | 25 | % | 25 | % |
| Dividend yield | 5.6 | % | - | |
| Weighted-average grant date fair value per share | \$ 0.83 | | \$ 1.31 | |

The expected life is the number of years that the Company estimates, based upon history, that options will be outstanding prior to exercise or forfeiture. Expected life is determined using the "simplified method" permitted by Staff Accounting Bulletin No. 107. In addition to the inputs referenced above regarding the option pricing model, the Company adjusts the stock-based compensation expense for estimated forfeiture rates that are revised prospectively according to forfeiture experience. The stock volatility factor is based on the New York Stock Exchange ARCA Defense Index. The Company did not use the volatility rate for its common stock as the Company determined that its common stock is thinly traded.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the status of the Company's stock options as of December 31, 2013, and changes during the two years then ended are presented below.

| | Options | Wtd. Avg. Exercise Price |
|--------------------------------------|-----------|--------------------------------|
| Balance, December 31, 2011 | 306,316 | \$ 10.27 |
| Granted during the period | 21,000 | 5.61 |
| Exercised during the period | - | - |
| Terminated/Expired during the period | - | - |
| Balance, December 31, 2012 | 327,316 | \$ 10.27 |
| Granted during the period | 113,247 | 6.85 |
| Exercised during the period | (18,523) | 4.50 |
| Terminated/Expired during the period | - | - |
| Balance, December 31, 2013 | 422,040 | \$ 9.34 |
| Exercisable at December 31, 2013 | 340,838 | \$ 10.05 |

The following table summarizes information about stock options at December 31, 2013:

| Range of Exercise Prices | Remaining Number Outstanding | Wtd. Avg. Life | Wtd. Avg. Exercise Price |
|--------------------------------|------------------------------------|----------------------|--------------------------------|
| \$0.00 - 5.00 | 275,535 | 2 years | \$ 4.40 |
| \$5.01 - 90.00 | 132,597 | 6 years | 7.45 |
| \$90.01 - 100.00 | 5,888 | 1 years | 92.18 |
| \$100.01 - 110.00 | 833 | 1 years | 108.00 |
| \$110.01 - 170.00 | 3,529 | 1 years | 111.89 |
| \$170.01 - 200.00 | 3,958 | 1 years | 181.00 |
| | 422,340 | 3 years | \$ 9.34 |

As of December 31, 2013, there was \$140,000 of unrecognized compensation cost related to non-vested stock option awards, which is to be recognized over the remaining weighted average vesting period of four years.

The aggregate intrinsic value at December 31, 2013 was \$1,565,785. The aggregate intrinsic value was calculated based on the positive difference between the closing market price of the Company's Common Stock and the exercise price of the underlying options.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Warrants

The following tables summarize the Company's outstanding warrants as of December 31, 2013 and changes during the two years then ended:

| | Warrants | Wtd. Avg. Exercise Price |
|--------------------------------------|-----------|--------------------------------|
| Balance, December 31, 2011 | 19,865 | \$ 99.26 |
| Granted during the period | 118,585 | 6.30 |
| Exercised during the period | - | - |
| Terminated/Expired during the period | (19,615) | 99.97 |
| Balance, December 31, 2012 | 118,835 | \$ 99.26 |
| Granted during the period | - | - |
| Exercised during the period | - | - |
| Terminated/Expired during the period | (250) | 43.60 |
| Balance, December 31, 2013 | 118,585 | \$ 6.30 |
| Exercisable at December 31, 2013 | 118,835 | \$ 6.30 |

The following table summarizes information about warrants at December 31, 2013:

| Exercise Price | Warrants | Wtd. Avg. Life | Wtd. Avg. Exercise Price |
|-------------------|----------|----------------------|--------------------------------|
| \$6.30 | 118,585 | 3 years | \$ 6.30 |
| | 118,585 | 3 years | \$ 6.30 |

Note 16. RELATED PARTY TRANSACTIONS

In connection with the offering of the Company's Common Stock to accredited investors in June and July 2012, Taglich Brothers, placement agent for the offering, received commissions in the amount of approximately \$569,000, along with 12,000 shares of common stock, and warrants to purchase approximately 119,000 shares of Common Stock at \$6.30. The Company also paid approximately \$18,000 of legal fees on behalf of Taglich Brothers.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17. SEGMENT REPORTING

In accordance with FASB ASC 280, "Segment Reporting", the Company discloses financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available and regularly evaluated by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company is operating in three segments. AIM manufactures components and subassemblies for the defense and aerospace industry. NTW is a manufacturer of aerospace components, principally landing gear for F-16 and F-18 fighter aircraft. The financial information of NTW is only included as of the date of acquisition (June 20, 2012). WMI provides specialty welding services and metal fabrications to the defense and commercial aerospace industry. For segment reporting purposes, Miller Stuart is included with WMI. While each of these segments service the same industries and a similar customer base, we evaluate the performance of each segment separately in deciding how to allocate resources and in accessing profitability.

Beginning on January 1, 2013, the Company began to allocate all of the corporate selling and general and administrative costs of AIRI to its three subsidiaries. For 2013, these are allocated 50% to AIM and 25% to each of WMI and NTW. For 2012, such costs have been reclassified to reflect an allocation of AIRI corporate costs to its subsidiaries. These were reclassified 75% to AIM and 25% to WMI during the first six months of 2012 and 50% to AIM and 25% each to each of WMI and NTW beginning with the third quarter of 2012.

AIR INDUSTRIES GROUP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31,

2013

2012

| AIM | | | |
|-----------------------|----|--------------|---------------|
| Net Sales | \$ | 34,997,000 | \$ 42,075,000 |
| Gross Profit | | 6,305,000 | 8,218,000 |
| Pre Tax Income | | 2,368,000 | 3,260,000 |
| Assets | | 21,889,000 | 24,673,000 |
| WMI | | | |
| Net Sales | | 13,630,000 | 14,907,000 |
| Gross Profit | | 3,482,000 | 4,030,000 |
| Pre Tax Loss | | (203,000) | 1,138,000 |
| Assets | | 11,619,000 | 10,818,000 |
| NTW | | | |
| Net Sales | | 14,206,000 | 7,233,000 |
| Gross Profit | | 5,448,000 | 2,610,000 |
| Pre Tax Income | | 1,905,000 | 796,000 |
| Assets | | 11,318,000 | 14,410,000 |
| Corporate | | | |
| Net Sales | | - | - |
| Gross Profit | | - | - |
| Pre Tax Loss | | (501,000) | (1,199,000) |
| Assets | | 9,647,000 | 13,200,000 |
| Consolidated | | | |
| Net Sales | | 62,833,000 | 64,215,000 |
| Gross Profit | | 15,235,000 | 14,858,000 |
| Pre Tax Income | | 3,569,000 | 3,995,000 |
| Provision for Taxes | | (170,000) | 1,447,000 |
| Net Income | | 3,739,000 | 2,548,000 |
| Elimination of Assets | | (4,301,000) | (9,945,000) |
| Assets | | 50,172,000 | 53,156,000 |