

AIR INDUSTRIES GROUP  
Form 10-Q  
November 14, 2014

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED September 30, 2014

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.

Commission file number 001-35927

Air Industries Group  
(Exact name of Registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

80-0948413  
(IRS Employer  
Identification No.)

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

(631) 968-5000  
(Issuer's telephone number)

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 preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer (do not check if smaller reporting company)  Smaller reporting company

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

As of November 12, 2014, the registrant had outstanding 7,100,491 shares of common stock.

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, or Exchange Act. 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. 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.

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. Factors that could cause actual results to differ materially from those reflected in the forward-looking statements include, but are not limited to, those discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013 and elsewhere in this report and the risks discussed in our other filings with the SEC.

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 the securities laws of the United States.

## PART I

## FINANCIAL INFORMATION

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AIR INDUSTRIES GROUP  
Condensed Consolidated  
Balance Sheets

|  | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--|--------------------------------------|----------------------|
| <b>ASSETS</b>  |                                      |                      |
| Current Assets   |                                      |                      |
| Cash and Cash Equivalents  | \$ 1,568,000                         | \$ 561,000           |
| Accounts Receivable, Net of Allowance for<br>Doubtful Accounts<br>of \$1,084,000 and \$783,000       | 8,806,000                            | 8,584,000            |
| Inventory  | 30,686,000                           | 26,222,000           |
| Deferred Tax Asset   | 1,310,000                            | 1,051,000            |
| Prepaid Expenses and Other Current Assets  | 209,000                              | 510,000              |
| <b>Total Current Assets</b>  | <b>42,579,000</b>                    | <b>36,928,000</b>    |
| Property and Equipment, net  | 5,743,000                            | 6,523,000            |
| Capitalized Engineering Costs - net of<br>Accumulated Amortization<br>of \$4,184,000 and \$3,879,000 | 693,000                              | 752,000              |
| Deferred Financing Costs, net, deposit and other<br>assets   | 680,000                              | 605,000              |
| Intangible Assets, net   | 3,854,000                            | 4,726,000            |
| Deferred Tax Asset   | 947,000                              | 185,000              |
| Goodwill   | 4,620,000                            | 453,000              |
| <b>TOTAL ASSETS</b>  | <b>\$ 59,116,000</b>                 | <b>\$ 50,172,000</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                      |
| Current liabilities  |                                      |                      |
| Notes Payable and Capitalized Lease<br>Obligations - Current Portion                                 | \$ 16,315,000                        | \$ 14,969,000        |
| Accounts Payable and Accrued Expenses  | 6,280,000                            | 6,855,000            |
| Lease Impairment - Current   | 60,000                               | 71,000               |
| Deferred Gain on Sale - Current Portion  | 38,000                               | 38,000               |
| Customer Deposit   | 174,000                              | 251,000              |
| Dividends Payable  | -                                    | 717,000              |
| Income Taxes Payable   | 382,000                              | 1,496,000            |
| <b>Total Current Liabilities</b>   | <b>23,249,000</b>                    | <b>24,397,000</b>    |
| Long-term liabilities  |                                      |                      |
| Notes Payable and Capitalized Lease<br>Obligation - Net of Current Portion                           | 3,191,000                            | 2,527,000            |
| Lease Impairment - Net of Current Portion  | 12,000                               | 56,000               |
| Deferred Gain on Sale - Net of Current Portion   | 418,000                              | 447,000              |
| Deferred Rent  | 1,189,000                            | 1,132,000            |
| <b>TOTAL LIABILITIES</b>   | <b>28,059,000</b>                    | <b>28,559,000</b>    |

## Stockholders' Equity

|   |                      |                      |
|---|----------------------|----------------------|
| Preferred Stock Par Value \$.001-Authorized<br>1,000,000 shares at September 30, 2014 and<br>December 31, 2013, respectively, none issued<br>and outstanding at September 30, 2014 and<br>December 31, 2013, respectively                                     | -                    | -                    |
| Common Stock - Par Value \$.001- Authorized<br>25,000,000 shares at September 30, 2014 and<br>December 31, 2013, respectively,<br>7,100,491 and 5,862,346 Shares Issued and<br>Outstanding as of<br>September 30, 2014 and December 31, 2013,<br>respectively | 7,000                | 6,000                |
| Additional Paid-In Capital  | 44,905,000           | 36,799,000           |
| Accumulated Deficit   | (13,855,000 )        | (15,192,000 )        |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>31,057,000</b>    | <b>21,613,000</b>    |
| <b>TOTAL LIABILITIES AND<br/>STOCKHOLDERS' EQUITY</b>   | <b>\$ 59,116,000</b> | <b>\$ 50,172,000</b> |

See notes to condensed consolidated financial statements

AIR INDUSTRIES GROUP  
Condensed Consolidated Statements of  
Income  
(Unaudited)

|   | Three Months Ended |              | Nine Months Ended |              |
|---|--------------------|--------------|-------------------|--------------|
|   | September 30,      |              | September 30,     |              |
|   | 2014               | 2013         | 2014              | 2013         |
| Net Sales                                     | \$15,154,000       | \$16,052,000 | \$43,967,000      | \$45,016,000 |
| Cost of Sales                                 | 11,597,000         | 12,309,000   | 33,012,000        | 33,996,000   |
| Gross Profit                                  | 3,557,000          | 3,743,000    | 10,955,000        | 11,020,000   |
| Operating Expenses                            | 2,997,000          | 2,712,000    | 8,909,000         | 7,733,000    |
| Income from operations                        | 560,000            | 1,031,000    | 2,046,000         | 3,287,000    |
| Interest and financing costs                  | (260,000 )         | (281,000 )   | (867,000 )        | (1,027,000 ) |
| Other (expense) income, net                   | (1,000 )           | (11,000 )    | (64,000 )         | (97,000 )    |
| Income before benefit from income taxes       | 299,000            | 739,000      | 1,115,000         | 2,163,000    |
| Benefit from income taxes                     | (81,000 )          | (1,795,000 ) | (222,000 )        | (876,000 )   |
| Net income                                    | \$380,000          | \$2,534,000  | \$1,337,000       | \$3,039,000  |
| Income per share - basic                      | \$0.05             | \$0.44       | \$0.21            | \$0.53       |
| Income per share - diluted                    | \$0.05             | \$0.43       | \$0.20            | \$0.52       |
| Weighted average shares outstanding - basic   | 7,092,655          | 5,711,093    | 6,415,402         | 5,711,093    |
| Weighted average shares outstanding - diluted | 7,388,686          | 5,854,015    | 6,711,742         | 5,828,037    |

See notes to condensed consolidated financial statements

AIR INDUSTRIES GROUP  
Condensed Consolidated Statements of Cash Flows For the  
Nine Months Ended September 30,  
(Unaudited)

|  | 2014                | 2013              |
|--|---------------------|-------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                |                     |                   |
| Net Income   | \$ 1,337,000        | \$ 3,039,000      |
| Adjustments to Reconcile Net Income to Net                 |                     |                   |
| Cash (used in) provided by Operating Activities            |                     |                   |
| Depreciation of property and equipment                     | 1,680,000           | 1,242,000         |
| Amortization of intangible assets                          | 872,000             | 872,000           |
| Amortization of capitalized engineering costs              | 306,000             | 316,000           |
| Bad debt expense   | 299,000             | 275,000           |
| Non-cash compensation expense                              | 25,000              | 15,000            |
| Amortization of deferred financing costs                   | 33,000              | 46,000            |
| Gain on sale of real estate                                | (28,000 )           | (28,000 )         |
| Deferred Income Taxes                                      | (1,021,000 )        | (1,625,000 )      |
| <b>Changes in Assets and Liabilities</b>                   |                     |                   |
| (Increase) Decrease in Operating Assets:                   |                     |                   |
| Accounts Receivable  | (119,000 )          | 807,000           |
| Inventory  | (4,401,000 )        | (1,295,000 )      |
| Prepaid Expenses and Other Current Assets                  | 332,000             | 359,000           |
| Deposits   | (1,000 )            | 125,000           |
| Other Assets   | (84,000 )           | (37,000 )         |
| Increase (Decrease) in Operating Liabilities               |                     |                   |
| Accounts payable and accrued expenses                      | (795,000 )          | (362,000 )        |
| Deferred Rent  | 56,000              | 56,000            |
| Income Taxes payable                                       | (1,114,000 )        | (249,000 )        |
| Customer Deposits  | (77,000 )           | -                 |
| <b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b> | <b>(2,700,000 )</b> | <b>3,556,000</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                |                     |                   |
| Cash paid for acquisitions                                 | (4,476,000 )        | (468,000 )        |
| Cash acquired in acquisition                               | 5,000               | -                 |
| Capitalized engineering costs                              | (247,000 )          | (316,000 )        |
| Purchase of property and equipment                         | (384,000 )          | (136,000 )        |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>               | <b>(5,102,000 )</b> | <b>(920,000 )</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                |                     |                   |

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|  |              |              |
|--|--------------|--------------|
| Proceeds from Private Placement                        | 9,530,000    | -            |
| Costs to raise capital                                 | (968,000 )   | -            |
| Notes payable - Sellers                                | (513,000 )   | (479,000 )   |
| Capital lease obligations                              | (248,000 )   | (899,000 )   |
| Note payable - Revolver                                | 3,202,000    | 1,164,000    |
| Proceeds from note payable - Term Loan                 | 1,328,000    | -            |
| Payments of note payable - Term Loan                   | (759,000 )   | (1,350,000 ) |
| Cash paid for deferred financing costs                 | (25,000 )    | (10,000 )    |
| Payments related to Lease Impairment                   | (55,000 )    | (65,000 )    |
| Dividends Paid   | (2,683,000 ) | (716,000 )   |
| NET CASH PROVIDED BY (USED IN)<br>FINANCING ACTIVITIES | 8,809,000    | (2,355,000 ) |

|   |              |            |
|---|--------------|------------|
| NET INCREASE IN CASH AND CASH<br>EQUIVALENTS        | 1,007,000    | 281,000    |
| CASH AND CASH EQUIVALENTS AT<br>BEGINNING OF PERIOD | 561,000      | 490,000    |
| CASH AND CASH EQUIVALENTS AT<br>END OF PERIOD       | \$ 1,568,000 | \$ 771,000 |

|  |            |            |
|--|------------|------------|
| Supplemental cash flow information       |            |            |
| Cash paid during the period for interest | \$ 753,000 | \$ 935,000 |

|  |              |              |
|--|--------------|--------------|
| Supplemental cash flow information           |              |              |
| Cash paid during the period for income taxes | \$ 2,011,000 | \$ 1,061,000 |

|  |              |            |
|--|--------------|------------|
| Supplemental schedule of non-cash investing and financing activities |              |            |
| Dividends payable  | \$ -         | \$ 716,000 |
| Conversion of Junior Subordinated Notes                              | \$ 1,000,000 | \$ -       |

|  |              |  |
|--|--------------|--|
| Purchase of stock of Woodbine Products |              |  |
| Fair Value of Tangible Assets acquired | \$ 472,000   |  |
| Goodwill                               | 2,402,000    |  |
| Liabilities assumed                    | (19,000 )    |  |
| Common Stock issued                    | (290,000 )   |  |
| Cash paid for acquisition              | \$ 2,565,000 |  |

|  |              |  |
|--|--------------|--|
| Purchase of stock of Eur-Pac Corporation |              |  |
| Fair Value of Tangible Assets acquired   | \$ 409,000   |  |
| Goodwill                                 | 1,659,000    |  |
| Liabilities assumed                      | (170,000 )   |  |
| Common Stock issued                      | (195,000 )   |  |
| Cash paid for acquisition                | \$ 1,703,000 |  |

|  |            |  |
|--|------------|--|
| Purchase of stock of Electronic Connection Corporation |            |  |
| Fair Value of Tangible Assets acquired                 | \$ 129,000 |  |
| Goodwill   | 106,000    |  |
| Cash Acquired  | 5,000      |  |
| Liabilities Assumed                                    | (31,000 )  |  |
| Cash paid for acquisition                              | \$ 209,000 |  |

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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    |

See notes to condensed consolidated financial statements

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AIR INDUSTRIES GROUP  
NOTES TO CONDENSED 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 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 condensed 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, Woodbine Products, Inc. (“Woodbine”), a wholly-owned subsidiary of WMI, Eur-Pac Corporation (“Eur-Pac”), Electronic Connection Corporation (“ECC”), a wholly-owned subsidiary of Eur-Pac and Nassau Tool Works, Inc. (“NTW”) (together, the “Company”).

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission, from which the accompanying condensed balance sheet dated December 31, 2013 was derived.

Note 2. ACQUISITION

Woodbine

On April 1, 2014, the Company, through its wholly-owned subsidiary Welding, acquired all of the common stock of Woodbine for \$2.4 million and 30,000 shares of the common stock of AIRI. The common stock was valued at \$9.68 per share, which was the closing share price on April 1, 2014. Additionally, a working capital adjustment in the amount of \$165,000 was paid to the former stockholders of Woodbine during June of 2014. The Company financed the acquisition of Woodbine by increasing its borrowings on its existing revolving loan and term loan facilities (see Note 7).

Woodbine is a long established manufacturer of aerospace components whose customers include major aircraft component suppliers. Woodbine specializes in welded and brazed chassis structures housing electronics in aircraft. Woodbine’s products and customers are very complementary to those of Decimal Industries, Inc., which was acquired in July 2013.



AIR INDUSTRIES GROUP  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The acquisition of Woodbine was accounted for under FASB ASC 805, “Business Combinations” (“ASC 805”). The purchase price allocation is set forth below.

|                               |             |
|-------------------------------|-------------|
| Fair Value of Tangible Assets |             |
| acquired                      | \$472,000   |
| Goodwill                      | 2,402,000   |
| Liabilities assumed           | (19,000 )   |
| Total                         | \$2,855,000 |

#### Eur-Pac

On June 1, 2014, the Company acquired all of the common stock of Eur-Pac for \$1,625,000 and 20,000 shares of the common stock of AIRI. The common stock was valued at \$9.78 per share, which was the closing share price on that date. Additionally, a working capital adjustment in the amount of \$78,000 was paid in August 2014. The Company financed the acquisition of Eur-Pac with the proceeds of its Registered Direct Offering (see Note 8).

Eur-Pac specializes in military packaging and supplies. Eur-Pac’s primary business is “kitting” of supplies for all branches of the United States Defense Department including ordnance parts, hose assemblies, hydraulic, mechanical and electrical assemblies.

The acquisition of Eur-Pac was accounted for under ASC 805. The purchase price allocation is set forth below.

|                               |             |
|-------------------------------|-------------|
| Fair Value of Tangible Assets |             |
| acquired                      | \$409,000   |
| Goodwill                      | 1,659,000   |
| Liabilities assumed           | (170,000 )  |
| Total                         | \$1,898,000 |

#### ECC

On September 1, 2014, the Company through its wholly-owned subsidiary Eur-Pac, acquired all of the common stock of ECC for \$209,000. The Company financed the acquisition from its regular working capital. ECC is a manufacturer of stripped, terminated, bonded and tinned lead wires, used by a variety of contractors, manufacturers and OEMs.

The acquisition of ECC was accounted for under ASC 805. The purchase price allocation is set forth below.

|                               |           |
|-------------------------------|-----------|
| Fair Value of Tangible Assets |           |
| acquired                      | \$129,000 |
| Goodwill                      | 106,000   |
| Cash Acquired                 | 5,000     |
| Liabilities Assumed           | (31,000 ) |
| Total                         | \$209,000 |

#### AMK

On October 1, 2014, the Company acquired all of the common stock of AMK Technical Services (“AMK”), for \$6,953,000, subject to a working capital adjustment. The purchase price included a preliminary working capital adjustment of \$203,000. At closing, the Company paid \$4,453,000 and issued a Seller Note and Mortgage of \$2,500,000. The note bears interest at the rate of 5% per annum and interest and principal are due and payable on or

before December 31, 2014. The note is secured by a mortgage on the property.

AIR INDUSTRIES GROUP  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

This acquisition will be accounted for under ASC 805. The purchase price allocation has not yet been completed. AMK is a long established provider of sophisticated welding and machining services for diversified aerospace and industrial customers.

Note 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principal Business Activities

The Company, through AIM, is primarily engaged in manufacturing aircraft structural parts, and assemblies for prime defense contractors in the aerospace industry in the United States. Welding and AMK are specialty welding and products providers 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 publicly-traded companies in the aerospace industry. Eur-Pac, as discussed above, specializes in military packaging and supplies.

Inventory Valuation

Inventory at September 30, 2014 and 2013 was computed based on a "gross profit" method.

The Company valued inventory at December 31, 2013 at the lower of cost on a first-in-first-out basis or market.

Credit and Concentration Risks

There were three customers that represented 68.3% and 58.9% of total net sales for the three months ended September 30, 2014 and 2013, respectively. This is set forth in the table below.

| Customer | Percentage of Net Sales |             |
|----------|-------------------------|-------------|
|          | 2014                    | 2013        |
|          | (Unaudited)             | (Unaudited) |
| 1        | 30.1                    | 21.6        |
| 2        | 27.6                    | 26.7        |
| 3        | 10.6                    | **          |
| 4        | *                       | 10.6        |

\* Customer was less than 10% of net sales for the quarter ended September 30, 2014

\*\* Customer was less than 10% of net sales for the quarter ended September 30, 2013

There were two customers that represented 48.8% of net sales and three customers that represented 58.7% of net sales for the nine months ended September 30, 2014 and 2013, respectively. This is set forth in the table below.

AIR INDUSTRIES GROUP  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

| Customer | Percentage of Net Sales |                     |
|----------|-------------------------|---------------------|
|          | 2014<br>(Unaudited)     | 2013<br>(Unaudited) |
| 1        | 30.0                    | 27.5                |
| 2        | 18.8                    | 19.1                |
| 3        | *                       | 12.1                |

\* Customer was less than 10% of net sales for the nine months ended September 30, 2014

There were four customers that represented 73.3% and two customers that represented 42.9% of gross accounts receivable at September 30, 2014 and December 31, 2013, respectively. This is set forth in the table below.

| Customer | Percentage of Gross Accounts Receivable |             |
|----------|---|-------------|
|          | September                               | December    |
|          | 30,<br>2014<br>(Unaudited)              | 31,<br>2013 |
| 1        | 25.0                                    | 20.1        |
| 2        | 24.7                                    | 22.8        |
| 3        | 12.0                                    | *           |
| 4        | 11.6                                    | *           |

\* Customer was less than 10% of gross accounts receivables at December 31, 2013

The Company has 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 sole-source suppliers of various parts that are used in one or more of its products. If any of these sole source suppliers were to go out of business or be unable to provide it parts for any reason, AIM would be required to develop new suppliers or to re-engineer its products, or both, which could delay shipment of products and have a material adverse effect on its operating results.

#### 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 calculation for all periods when the effect of their inclusion is dilutive.



AIR INDUSTRIES GROUP  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

|   | Three Months Ended<br>September 30, |                     | Nine Months Ended<br>September 30, |                     |
|---|-------------------------------------|---------------------|------------------------------------|---------------------|
|   | 2014<br>(Unaudited)                 | 2013<br>(Unaudited) | 2014<br>(Unaudited)                | 2013<br>(Unaudited) |
| Weighted average shares outstanding used to compute basic earning per share                             | 7,092,655                           | 5,711,093           | 6,415,402                          | 5,711,093           |
| Effect of dilutive stock options and warrants   | 296,031                             | 142,922             | 296,341                            | 116,944             |
| Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share | 7,388,686                           | 5,854,015           | 6,711,743                          | 5,828,037           |

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

|               | Three and Nine Months Ended             |   |
|---------------|---|---|
|               | September<br>30,<br>2014<br>(Unaudited) | September<br>30,<br>2013<br>(Unaudited) |
| Stock Options | 17,048                                  | 17,048                                  |
| Warrants      | 46,800                                  | -                                       |
|               | 63,848                                  | 17,048                                  |

#### 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. Stock-based compensation amounted to \$10,000 and \$9,000 for the three months ended September 30, 2014 and 2013, respectively, and \$25,000 and \$15,000 for the nine months ended September 30, 2014 and 2013 respectively, and was included in operating expenses on the accompanying Condensed Consolidated Statement of Income.

#### 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 \$4,620,000 relates to the acquisition of WMI (\$291,000), NTW (\$162,000), Woodbine (\$2,402,000), Eur-Pac (\$1,659,000) and ECC (\$106,000). Goodwill is not amortized, but is tested at least annually for impairment, or if circumstances occur that more likely than not will reduce the fair value of the reporting unit below its carrying amount.

The Company has determined that there has been no impairment of goodwill at September 30, 2014 and December 31, 2013.

#### Recently Issued Accounting Pronouncements

Effective January 1, 2014, the Company adopted 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. This guidance is effective prospectively for the Company for annual and interim periods beginning January 1, 2014. The adoption of ASU 2013-11 did not have a material effect on the Company's financial position, results of operations or cash flows.

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In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). The amendments in ASU 2014-09 affect any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in ASC 605, “Revenue Recognition” and most industry-specific guidance and creates ASC 606, “Revenue from Contracts with Customers.”

The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

ASU 2014-09 is effective for public entities for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the effects of the adoption of ASU 2014-09 on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period” (“ASU No. 2014-12”). ASU No. 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. An entity should recognize compensation cost in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. ASU 2014-12 becomes effective for interim and annual periods beginning on or after December 15, 2015. Early adoption is permitted. The adoption of ASU 2014-12 is not expected to have a significant impact on the Company’s 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 financial statements.

#### Subsequent Events

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

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Note 4. ACCOUNTS RECEIVABLE

The components of accounts receivable are detailed as follows:

|                                 | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|---------------------------------|--------------------------------------|----------------------|
| Accounts Receivable Gross       | \$ 9,890,000                         | \$ 9,367,000         |
| Allowance for Doubtful Accounts | (1,084,000)                          | (783,000 )           |
| Accounts Receivable Net         | \$ 8,806,000                         | \$ 8,584,000         |

Note 5. PROPERTY AND EQUIPMENT

The components of property and equipment consisted of the following:

|                                       | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |               |
|---------------------------------------|--------------------------------------|----------------------|---------------|
| Machinery and Equipment               | \$ 6,537,000                         | \$ 6,251,000         | 5 - 8 years   |
| Capital Lease Machinery and Equipment | 5,261,000                            | 5,261,000            | 5 - 8 years   |
| Tools and Instruments                 | 5,491,000                            | 5,009,000            | 1.5 - 7 years |
| Automotive Equipment                  | 140,000                              | 59,000               | 5 years       |
| Furniture and Fixtures                | 260,000                              | 257,000              | 5 - 8 years   |
| Leasehold Improvements                | 646,000                              | 646,000              | Term of Lease |
| Computers and Software                | 369,000                              | 357,000              | 4-6 years     |
| Total Property and Equipment          | 18,704,000                           | 17,840,000           |               |
| Less: Accumulated Depreciation        | (12,961,000)                         | (11,317,000)         |               |
| Property and Equipment, net           | \$ 5,743,000                         | \$ 6,523,000         |               |

Depreciation expense for the three months ended September 30, 2014 and 2013 was approximately \$512,000 and \$441,000, respectively. Depreciation expense for the nine months ended September 30, 2014 and 2013 was approximately \$1,680,000 and \$1,242,000, respectively.

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Note 6. INTANGIBLE ASSETS

The components of intangible assets consisted of the following:

|                                   | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |                |
|-----------------------------------|--------------------------------------|----------------------|----------------|
| 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<br>Amortization | (3,456,000)                          | (2,584,000)          |                |
| Intangible Assets, net            | \$ 3,854,000                         | \$ 4,726,000         |                |

Amortization expense for the three months ended September 30, 2014 and 2013 was approximately \$291,000 and \$291,000, respectively. Amortization expense for the nine months ended September 30, 2014 and 2013 was approximately \$872,000 and \$872,000, respectively.

Note 7. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consisted of the following:

|  | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--|--------------------------------------|----------------------|
| Revolving credit note payable to PNC<br>Bank N.A. ("PNC")              | \$ 15,232,000                        | \$ 12,029,000        |
| Term Loan A, PNC   | 2,517,000                            | 1,948,000            |
| Capital lease obligations  | 1,539,000                            | 1,787,000            |
| Notes payable to sellers of WMI  | 218,000                              | 732,000              |
| Junior subordinated notes  | -                                    | 1,000,000            |
| Subtotal   | 19,506,000                           | 17,496,000           |
| Less: Current portion of notes and<br>capital obligations              | (16,315,000)                         | (14,969,000)         |
| Notes payable and capital lease<br>obligations, net of current portion | \$ 3,191,000                         | \$ 2,527,000         |

PNC Bank N.A. ("PNC")

The Company has a loan facility with PNC (the "Loan Facility") secured by substantially all of its assets.

On April 1, 2014, the Loan Facility was amended and the Company paid a loan amendment fee of \$15,000. These amendments added Woodbine as a borrower on the Loan Facility and increased the maximum borrowings to \$22,676,000 less repayments of Term Loan A made on or after the closing date. The maximum borrowings consisted of the following:

- (i) a \$20,000,000 revolving loan (includes inventory sub-limit of \$12,500,000) and
- (ii) \$2,676,000 for Term Loan A.

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On June 9, 2014, the Loan Facility was further amended. These amendments added Eur-Pac as a borrower on the Loan Facility and increased the maximum borrowings to \$25,613,000 less repayments of Term Loan A made on or after the closing date. The maximum borrowings consisted of the following:

- (i) a \$23,000,000 revolving loan (includes inventory sub-limit of \$15,000,000) and
- (ii) \$2,613,000 for Term Loan A.

On October 1, 2014, the Loan Facility was again amended coincident with the acquisition of AMK (see Note 2). This amendment added AMK as a borrower on the Loan Facility and increased the maximum borrowings to \$29,112,000 less repayments of Term Loan A made on or after the closing date. The amendment also allowed for a Seller Mortgage and Note in the amount of \$2,500,000, granted by AMK and Air Group in favor of the former owner of AMK. The maximum borrowings consist of the following:

- (i) a \$23,000,000 revolving loan (includes inventory sub-limit of \$15,000,000);
- (ii) \$2,613,000 term loan, less repayments for Term Loan A and
- (iii) a new term loan of \$3,500,000 ("Term Loan B").

Under the terms of the Loan Facility the revolving credit note 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. The revolving credit note had an interest rate of 4.0 % per annum at both September 30, 2014 and December 31, 2013, and an outstanding balance of \$15,232,000 and \$12,029,000, 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 loan and the Company then borrows according to a borrowing base. As such, the Company generally has no cash on hand. Because the revolving loan contains 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 prior to the amendment discussed below, the maturity date of Term Loan A was the first business day (as defined) of January 2015. Term Loan A bore 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. Repayment under Term Loan A consisted of 19 consecutive monthly principal installments, the first 18 of which were \$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.

On April 1, 2014, the Company borrowed an additional \$1,328,000. The repayment of Term Loan A was amended on that date to thirty-two consecutive monthly principal installments, the first thirty-one of which shall be in the amount of \$31,859 commencing on the first business day of May 2014, and continuing on the first business day of each month thereafter, with a thirty-second and final payment of any unpaid balance of principal and interest on the last business day of November 2016. Term Loan A 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. At September 30, 2014 and December 31, 2013, the balance due under Term Loan A was \$2,517,000 and \$1,948,000, respectively.

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 an amount equal to the net proceeds of such sale.

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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 September 30, 2014 and December 31, 2013, 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 September 30, 2014 the future minimum principal payments for Term Loan A are as follows:

| For the twelve months<br>ending | Amount       |
|---------------------------------|--------------|
| September 30, 2015              | \$ 382,000   |
| September 30, 2016              | 382,000      |
| September 30, 2017              | 1,753,000    |
| PNC Term Loan Payable           | 2,517,000    |
| Less: Current portion           | (382,000 )   |
| Long-term portion               | \$ 2,135,000 |

Interest expense related to the Loan Facility amounted to approximately \$186,000 and \$197,000 for the three months ended September 30, 2014 and 2013, respectively, and \$597,000 and \$737,000 for the nine months ended September 30, 2014 and 2013, respectively.

On October 1, 2014, the Company borrowed \$3,500,000 under Term Loan B for the acquisition of AMK. The repayment of Term Loan B consists of sixty consecutive monthly principal installments, the first fifty-nine of which shall be in the amount of \$58,333 commencing on the first business day of December 2014, and continuing on the first business day of each month thereafter, with a sixtieth and final payment of any unpaid balance of principal and interest on the last business day of November 2019. Term Loan B bears interest at the same rate as Term Loan A. The first interest payment was on the first business day of November 2014.

#### 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 \$1,539,000 and \$1,787,000 as of September 30, 2014 and December 31, 2013, respectively, with various interest rates ranging from 7.0% to 9.5%.

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As of September 30, 2014, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

| For the twelve months<br>ending        | Amount       |
|--|--------------|
| September 30, 2015                     | \$ 584,000   |
| September 30, 2016                     | 532,000      |
| September 30, 2017                     | 377,000      |
| September 30, 2018                     | 197,000      |
| September 30, 2019                     | 29,000       |
| Thereafter                             | 11,000       |
| Total future minimum lease<br>payments | 1,730,000    |
| Less: imputed interest                 | (191,000 )   |
| Less: current portion                  | (483,000 )   |
| Total Long Term Portion                | \$ 1,056,000 |

Notes Payable – Sellers of WMI

In connection with the acquisition of WMI on August 24, 2007, the Company incurred a note payable (“Note”) to the former stockholders of WMI. The obligation under the Note is subordinate to the Company’s indebtedness to PNC. As of September 30, 2014 and December 31, 2013, the balance owed to the sellers of WMI is \$218,000 and \$732,000, respectively.

|                             | September<br>30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|-----------------------------|---|----------------------|
| Former Welding Stockholders | \$ 218,000                              | \$ 732,000           |
| Less: Current Portion       | (218,000)                               | (691,000)            |
| Total long-term portion     | \$ -                                    | \$ 41,000            |

The Note and payment terms have been adjusted and/or amended several times. On October 1, 2010, the Company entered into a letter agreement with the former stockholders of WMI 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 September 30, 2014 and December 31, 2013, the balance owed under the note was \$218,000 and \$732,000, respectively.

Interest expense related to the note payable to the former stockholders of WMI was \$6,000 and \$17,000 for the three months ended September 30, 2014 and 2013, respectively, and \$27,000 and \$61,000 for the nine months ended September 30, 2014 and 2013, 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).

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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 our Junior Subordinated Notes along with the accrued interest thereon of approximately \$1,000.

On June 3, 2014, in conjunction with our Registered Direct Offering (see Note 8), the holders of our remaining Junior Subordinated Notes converted their notes to Common Stock at a price of \$9.00 per share. On the same date, the Company paid the remaining accrued interest of \$1,000 that was due to the holders.

The balance owed on the Junior Subordinated Notes at September 30, 2014 was \$0 and at December 31, 2013 amounted to \$1,000,000. Interest expense on the Junior Subordinated Notes amounted to \$0 and \$30,000 for the three months ended September 30, 2014 and 2013, respectively and \$61,000 and \$90,000 for the nine months ended September 30, 2014 and 2013, respectively.

## Note 8. STOCKHOLDERS' EQUITY

## Common Stock Issuances

During the nine months ended September 30, 2014, the Company issued 4,439 shares of its common stock pursuant to the cashless exercise of Warrants and 9,426 share of its common stock pursuant to the cashless exercise of Stock Options.

On April 1, 2014, in connection with the acquisition of Woodbine, the Company issued 30,000 shares of its common stock to the former stockholders of Woodbine.

On June 3, 2014, in connection with its Registered Direct Offering ("the Offering"), the Company issued 1,170,000 shares of its common stock. These securities were offered pursuant to the Company's effective "shelf" registration statement on Form S-3 (File NO. 333-191748), which was declared effective by the Securities and Exchange Commission on December 11, 2013. Taglich Brothers acted as the exclusive placement agent for the Offering (see Note 10). The gross proceeds of the offering were \$10,530,000 comprised of \$9,530,000 in cash and \$1,000,000 in the conversion of our Junior Subordinated Notes (see Note 7). The Company paid to Taglich Brothers a commission of approximately \$842,000 and warrants to purchase up to 46,800 shares of common stock at a per share price of \$11.25. Additionally, the Company paid legal fees on behalf of Taglich Brothers in the amount of \$75,000 and paid a qualified independent underwriter approximately \$50,000 for their services. The Company netted cash of approximately \$8,562,000 from the Offering. A portion of these funds were used to finance the acquisition of Eur-Pac Corporation (see Note 2).

On June 4, 2014, in connection with the acquisition of Eur-Pac, the Company issued 20,000 shares of its common stock to the former stockholders of Eur-Pac.

Dividends

On October 10, 2014, the Board of Directors approved and the Company announced a quarterly dividend of \$0.15 per common share paid on November 3, 2014 to all shareholders of record as of the close of business on October 20, 2014. The approximate amount of the dividend was \$1,065,000.

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On June 19, 2014, the Board of Directors approved and the Company announced a quarterly dividend of \$0.15 per common share paid on July 10, 2014 to all shareholders of record as of the close of business on June 30, 2014. The approximate amount of the dividend was \$1,064,000.

On March 26, 2014, the Board of Directors approved and the Company announced a quarterly dividend of \$0.15 per common share paid on April 22, 2014 to all shareholders of record as of the close of business on April 15, 2014. The approximate amount of the dividend was \$885,000.

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 \$734,000.

#### Stock Options

On June 3, 2013, the Board of Directors adopted the Company's 2013 Equity Incentive Plan ("2013 Plan"). The 2013 plan is virtually identical to and is intended to replace, the Company's 2010 Equity Incentive Plan. The proposal to approve the 2013 Plan was approved by the affirmative vote of the Company's stockholders on July 29, 2013.

#### Warrants

As discussed above, the Company issued Taglich Brothers warrants to purchase up to 46,800 shares of Common Stock at a per share price of \$11.25. The warrants are exercisable for cash or on a cashless basis commencing on June 2, 2015 and expiring on June 2, 2019.

#### Derivative Liability

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."

#### Note 9. INCOME TAXES

The provision for income taxes as at September 30, are set forth below:

|                                  | 2014<br>(Unaudited) | 2013<br>(Unaudited) |
|----------------------------------|---------------------|---------------------|
| Current                          |                     |                     |
| Federal                          | \$ 1,061,000        | \$ 922,000          |
| State                            | 18,000              | 277,000             |
| Prior year (over) under accruals |                     |                     |
| Federal                          | 10,000              | (206,000 )          |
| State                            | (290,000 )          | (244,000 )          |
| Total Expense                    | 799,000             | 749,000             |

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|                              |               |               |
|------------------------------|---------------|---------------|
|                              |               |               |
| Deferred Tax Benefit         | (1,021,000)   | (1,625,000)   |
| Net Benefit for Income Taxes | \$ (222,000 ) | \$ (876,000 ) |

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The components of net deferred tax assets as of September 30, 2014 and December 31, 2013 are set forth below:

|  | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--|--------------------------------------|----------------------|
| Deferred tax assets:   |                                      |                      |
| Current:   |                                      |                      |
| Bad debts  | 434,000                              | 313,000              |
| Inventory - 263A adjustment                                      | 867,000                              | 729,000              |
| Account payable, accrued expenses and reserves                   | 9,000                                | 9,000                |
| Total current deferred tax                                       | \$ 1,310,000                         | \$ 1,051,000         |
| Non- Current:  |                                      |                      |
| Capital loss carry forwards                                      | \$ 1,088,000                         | \$ 1,088,000         |
| Section 1231 loss carry forward                                  | 4,000                                | 4,000                |
| Stock based compensation - options and restricted stock          | 526,000                              | 521,000              |
| Capitalized engineering costs                                    | 528,000                              | 503,000              |
| Deferred rent  | 475,000                              | 453,000              |
| Amortization - NTW Transaction                                   | 597,000                              | 475,000              |
| Lease Impairment   | 29,000                               | 51,000               |
| Deferred gain on sale of real estate                             | 183,000                              | 194,000              |
| Total non-current deferred tax assets before valuation allowance | 3,430,000                            | 3,289,000            |
| Valuation allowance  | (1,092,000 )                         | (1,092,000 )         |
| Total non-current deferred tax assets after valuation allowance  | 2,338,000                            | 2,197,000            |
| Deferred tax liabilities:  |                                      |                      |
| Property and equipment   | (922,000 )                           | (1,497,000 )         |
| Goodwill - NTW Transaction                                       | (10,000 )                            | (7,000 )             |
| Amortization - Welding Transaction                               | (458,000 )                           | (508,000 )           |
| Total Deferred Tax Liability                                     | (1,390,000 )                         | (2,012,000 )         |
| Net non-current deferred tax assets                              | \$ 948,000                           | \$ 185,000           |

During the year ended December 31, 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 believed that the net deferred tax assets were more likely than not to be realized. The valuation allowance at both September 30, 2014 and December 31, 2013 was \$1,092,000.

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



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Note 10. RELATED PARTY TRANSACTIONS

The Company's chairman of the board and a second director are principals of Taglich Brothers. As discussed above, Taglich Brothers acted as the exclusive placement agent for the Offering.

Note 11. 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 four segments. AIM manufactures components and subassemblies for the defense and aerospace industry. NTW manufactures aerospace components, principally landing gear for F-16 and F-18 fighter aircraft. WMI provides specialty welding services and metal fabrications to the defense and commercial aerospace industry and the results of Woodbine are included within the WMI segment beginning on April 1, 2014, the date it was acquired. Eur-Pac's primary business is "kitting" of supplies for all branches of the United States Defense Department including ordnance parts, hose assemblies, hydraulic, mechanical and electrical assemblies. The results of Eur-Pac are included from its date of acquisition. The results of ECC are included within Eur-Pac as of September 1, 2014, the date it was acquired. 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 assessing profitability.

Beginning on January 1, 2013, the Company began to allocate all of the corporate selling and general and administrative costs of AIRI to three of its subsidiaries. For both 2014 and 2013, these are allocated 50% to AIM and 25% to each of WMI and NTW. There was no corporate allocation made to Eur-Pac during 2014.

AIR INDUSTRIES GROUP  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Financial information about the Company's operating segments for the three months ended September 30, 2014 and 2013 are as follows:

|                           | Three Months Ended September 30, |              |
|---------------------------|----------------------------------|--------------|
|                           | 2014                             | 2013         |
|                           | (Unaudited)                      | (Unaudited)  |
| <b>AIM</b>                |                                  |              |
| Net Sales                 | \$ 9,678,000                     | \$ 9,863,000 |
| Gross Profit              | 1,744,000                        | 1,926,000    |
| Pre Tax Income            | 723,000                          | 949,000      |
| Assets                    | 20,952,000                       | 25,336,000   |
| <b>WMI</b>                |                                  |              |
| Net Sales                 | 3,339,000                        | 3,800,000    |
| Gross Profit              | 815,000                          | 953,000      |
| Pre Tax Loss              | (352,000 )                       | (126,000 )   |
| Assets                    | 18,386,000                       | 10,334,000   |
| <b>NTW</b>                |                                  |              |
| Net Sales                 | 731,000                          | 2,389,000    |
| Gross Profit              | 284,000                          | 864,000      |
| Pre Tax (Loss) Income     | (503,000 )                       | 25,000       |
| Assets                    | 11,970,000                       | 13,005,000   |
| <b>EPC</b>                |                                  |              |
| Net Sales                 | 1,406,000                        | -            |
| Gross Profit              | 714,000                          | -            |
| Pre Tax Income            | 492,000                          | -            |
| Assets                    | 2,858,000                        | -            |
| <b>Corporate</b>          |                                  |              |
| Net Sales                 | -                                | -            |
| Gross Profit              | -                                | -            |
| Pre Tax Loss              | (61,000 )                        | (109,000 )   |
| Assets                    | 15,772,000                       | 9,964,000    |
| <b>Consolidated</b>       |                                  |              |
| Net Sales                 | 15,154,000                       | 16,052,000   |
| Gross Profit              | 3,557,000                        | 3,743,000    |
| Pre Tax Income            | 299,000                          | 739,000      |
| Benefit From Income Taxes | (81,000 )                        | (1,795,000 ) |
| Net Income                | 380,000                          | 2,534,000    |
| Elimination of Assets     | (10,822,000)                     | (4,852,000 ) |
| Assets                    | 59,116,000                       | 53,787,000   |



AIR INDUSTRIES GROUP  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Financial information about the Company's operating segments for the nine months ended September 30, 2014 and 2013 are as follows:

|                           | Nine Months Ended September 30, |                     |
|---------------------------|---------------------------------|---------------------|
|                           | 2014<br>(Unaudited)             | 2013<br>(Unaudited) |
| <b>AIM</b>                |                                 |                     |
| Net Sales                 | \$ 23,944,000                   | \$ 25,528,000       |
| Gross Profit              | 4,315,000                       | 4,986,000           |
| Pre Tax Income            | 1,208,000                       | 2,037,000           |
| Assets                    | 20,952,000                      | 25,336,000          |
| <b>WMI</b>                |                                 |                     |
| Net Sales                 | 10,414,000                      | 10,246,000          |
| Gross Profit              | 2,758,000                       | 2,694,000           |
| Pre Tax Loss              | (886,000 )                      | (131,000 )          |
| Assets                    | 18,386,000                      | 10,334,000          |
| <b>NTW</b>                |                                 |                     |
| Net Sales                 | 7,926,000                       | 9,242,000           |
| Gross Profit              | 3,025,000                       | 3,340,000           |
| Pre Tax Income            | 441,000                         | 746,000             |
| Assets                    | 11,970,000                      | 13,005,000          |
| <b>EPC</b>                |                                 |                     |
| Net Sales                 | 1,683,000                       | -                   |
| Gross Profit              | 857,000                         | -                   |
| Pre Tax Income            | 587,000                         | -                   |
| Assets                    | 2,858,000                       | -                   |
| <b>Corporate</b>          |                                 |                     |
| Net Sales                 | -                               | -                   |
| Gross Profit              | -                               | -                   |
| Pre Tax Loss              | (235,000 )                      | (489,000 )          |
| Assets                    | 15,772,000                      | 9,964,000           |
| <b>Consolidated</b>       |                                 |                     |
| Net Sales                 | 43,967,000                      | 45,016,000          |
| Gross Profit              | 10,955,000                      | 11,020,000          |
| Pre Tax Income            | 1,115,000                       | 2,163,000           |
| Benefit From Income Taxes | (222,000 )                      | (876,000 )          |
| Net Income                | 1,337,000                       | 3,039,000           |
| Elimination of Assets     | (10,822,000)                    | (4,852,000 )        |
| Assets                    | 59,116,000                      | 53,787,000          |



## ITEM 2. 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 unaudited financial statements and the notes to those statements included in this Form 10-Q. This discussion contains forward-looking statements that involve risks and uncertainties. You should specifically consider the various risks identified in our Form 10-K for the year ended December 31, 2013, which was filed on March 25, 2014, that could cause actual results to differ materially from those anticipated in these forward-looking statements.

### Business Overview

We are an aerospace company operating primarily in the defense industry, though the proportion of our business represented by the commercial sector is increasing. We design and manufacture structural parts and assemblies that focus on flight safety, including landing gear, arresting gear, engine mounts, flight controls, Nacelle Struts, which transmit the thrust of a jet engine to the body of the aircraft, and other components. We also provide sheet metal fabrication of aerostructures, tube bending and welding services.

As a result of recent acquisitions, we specialize in the production of electromechanical systems, harness and cable assemblies, electronic equipment and printed circuit boards, and the assembly of packages or "kits" containing supplies for all branches of the United States Defense Department, including ordnance parts, hose assemblies, hydraulic, mechanical and electrical assemblies.

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, Pratt & Whitney's Geared fan jet engine, the US Navy F-18 and USAF F-16 fighter aircraft, and in the commercial sector, Boeing's 777, Airbus' 380 commercial airliners, and other commercial airliners.

Since July 2013 we have acquired several businesses:

- On July 1, 2013 we acquired the business and operations of Decimal Industries, Inc. ("Decimal") in an asset acquisition. These operations have been absorbed into Welding Metallurgy, Inc. ("WMI").
- On November 6, 2013, we acquired 100% of the stock of Miller Stuart Inc., ("MSI"). MSI continues to operate as an independent business unit and its results are reported in the WMI segment.
- On April 1, 2014, we acquired 100% of the stock of Woodbine Products, Inc. ("WPI"). We are incorporating the operations of WPI into WMI.
- On June 1, 2014, we acquired 100% of the stock of Eur-Pac Corporation ("EPC") of Waterbury, Connecticut. For the immediate future EPC will continue to operate as an independent business unit.
- On September 1, 2014 we acquired 100% of the stock of Electronic Connection Corporation ("ECC") of Bloomfield, CT. We are now in the process of incorporating the operations of ECC into EPC.
- On October 1, 2014 we acquired 100% of the stock of AMK Technical Services ("AMK") of South Windsor; CT. AMK will be operated as an independent business unit.

During the third quarter of 2014, we had five operating subsidiaries – Air Industries Machining Corp. ("AIM"), WMI, Nassau Tool Works, Inc. ("NTW"), MSI and EPC, including ECC since September 1, 2014, which we divide into four

operating segments.

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. Decimal, now part of WMI, was founded in 1968 and its principal business is the fabrication of welded and brazed chassis structures housing electronics, radars and avionics for the aerospace industry. WPI, now part of WMI, was founded in 1954 and its principal business is the fabrication of precision sheet metal assemblies for the aerospace industry.

The predecessor of our subsidiary, 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 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.

EPC was founded in 1947 and specializes in military packaging and supplies all branches of the United States Defense Department with ordnance parts and kits, hose assemblies, hydraulic, mechanical and electrical assemblies. ECC, now part of EPC, was founded in 1989 and specializes in wire harnesses and leads for the aerospace and other industries.

AMK Technical Services has been a provider of welding services to the Aerospace industry since 1964. For more than ten years it was owned by Dynamic Materials Corporation (DMC) and was part of what once was an aerospace group of companies owned by DMC. With the divestiture of AMK, Dynamic Materials has exited the aerospace business. AMK's business is concentrated with aircraft jet engine and ground turbine manufacturers. The acquisition of AMK by Air Industries is the first of what we hope to be a number of acquisitions in the engine segment of the aerospace industry.

The aerospace market is highly competitive in both the defense and commercial sectors 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 commercial aerospace and defense industries continue to consolidate and major contractors seek to streamline 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 produce more complex and complete assemblies for our customers

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 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 production 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. The profit margin of the various products we sell varies based upon a number of factors, including the complexity of the product, the intensity of the competition for such product and, in some cases, the ability to deliver replacement parts on short notice. Thus, in assessing our performance from one period to another, a reader must understand that changes in profit margin can be the result of shifts in the mix of products sold.

A very large percentage of the products we produce are used on military as opposed to civilian aircraft. These products can be replacement spare parts for aircraft already in the fleet of the armed services, or for the production of new aircraft. Reductions to the Defense Department budget have reduced the demand for both production and replacement spares. This has reduced our sales. The impact has been felt most severely at AIM and NTW and, to a lesser degree, at our other subsidiaries. In response to the reduction in military sales, we are focusing greater efforts on the civilian aircraft market. We were awarded a multi-year contract by a leading aerostructures manufacturer to provide Nacelle thrust struts. The contract is valued at \$39 million and these components will be used in a new geared turbofan jet engine manufactured by one of the world's leading providers of aircraft engines. This engine is also expected to be used on several new commercial jetliners. Based on projections of sales from our customers, we expect

that the majority of revenue from this contract will be in calendar 2016 and beyond.

#### Results of Operations

The following discussion of our results of operations constitutes management's review of the factors that affected our financial and operating performance for the three and nine months ended September 30, 2014 and September 30, 2013. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report.

For the three and nine months ended September 30, 2014, we had four operating segments, AIM, WMI (including MSI and WPI) NTW, and EPC and separately reported our corporate overhead. For the three and nine months ended September 30, 2013, we had three operating segments, AIM, WMI (not including MSI and WPI) and NTW and separately reported our corporate overhead. The results of operations of Decimal, MSI, WPI, EPC and ECC have been reflected within our financial reports since the dates of their acquisition, July 1, 2013, November 6, 2013, April 1, 2014, June 1, 2014, and September 1, 2014 respectively.

## Results of Operations

Three months ended September 30, 2014 and 2013:

### Selected Financial Information:

#### Statement of Operations Data (Unaudited)

|                              | 2014          | 2013          |
|------------------------------|---------------|---------------|
| Net sales                    | \$ 15,154,000 | \$ 16,052,000 |
| Cost of sales                | 11,597,000    | 12,309,000    |
| Gross profit                 | 3,557,000     | 3,743,000     |
| Operating and interest costs | 3,257,000     | 2,993,000     |
| Other income (expense) net   | (1,000 )      | (11,000 )     |
| Income taxes (Benefit)       | (81,000 )     | (1,795,000 )  |
| Net Income                   | \$ 380,000    | \$ 2,534,000  |

#### Balance Sheet Data

|                            | September 30, 2014<br>(Unaudited) | December 31,<br>2013 |
|----------------------------|-----------------------------------|----------------------|
| Cash and cash equivalents  | \$ 1,568,000                      | \$ 561,000           |
| Working capital            | 19,330,000                        | 12,531,000           |
| Total assets               | 59,116,000                        | 50,172,000           |
| Total stockholders' equity | 31,057,000                        | 21,613,000           |

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

Three Months Ended September 30,

|                           | 2014<br>(Unaudited) | 2013<br>(Unaudited) |
|---------------------------|---------------------|---------------------|
| <b>AIM</b>                |                     |                     |
| Net Sales                 | \$ 9,678,000        | \$ 9,863,000        |
| Gross Profit              | 1,744,000           | 1,926,000           |
| Pre Tax Income            | 723,000             | 949,000             |
| Assets                    | 20,952,000          | 25,336,000          |
| <b>WMI</b>                |                     |                     |
| Net Sales                 | 3,339,000           | 3,800,000           |
| Gross Profit              | 815,000             | 953,000             |
| Pre Tax Loss              | (352,000 )          | (126,000 )          |
| Assets                    | 18,386,000          | 10,334,000          |
| <b>NTW</b>                |                     |                     |
| Net Sales                 | 731,000             | 2,389,000           |
| Gross Profit              | 284,000             | 864,000             |
| Pre Tax (Loss) Income     | (503,000 )          | 25,000              |
| Assets                    | 11,970,000          | 13,005,000          |
| <b>EPC</b>                |                     |                     |
| Net Sales                 | 1,406,000           | -                   |
| Gross Profit              | 714,000             | -                   |
| Pre Tax Income            | 492,000             | -                   |
| Assets                    | 2,858,000           | -                   |
| <b>Corporate</b>          |                     |                     |
| Net Sales                 | -                   | -                   |
| Gross Profit              | -                   | -                   |
| Pre Tax Loss              | (61,000 )           | (109,000 )          |
| Assets                    | 15,772,000          | 9,964,000           |
| <b>Consolidated</b>       |                     |                     |
| Net Sales                 | 15,154,000          | 16,052,000          |
| Gross Profit              | 3,557,000           | 3,743,000           |
| Pre Tax Income            | 299,000             | 739,000             |
| Benefit From Income Taxes | (81,000 )           | (1,795,000 )        |
| Net Income                | 380,000             | 2,534,000           |
| Elimination of Assets     | (10,822,000)        | (4,852,000 )        |
| Assets                    | 59,116,000          | 53,787,000          |

Consolidated net sales from operations for the three months ended September 30, 2014 were approximately \$15,154,000, a decrease of \$(898,000) or (5.6 %) compared with \$16,052,000 for the three months ended September 30, 2013.

- Net sales at AIM for the three months ended September 30, 2014 were \$9,678,000, a decrease of approximately \$(185,000) or (1.9%) compared with \$9,863,000 for the three months ended September 30, 2013. The decrease in sales at AIM results from continuing low levels of defense spending and continued delays in manufacturing landing gear product for the Navy's E2-D aircraft due to late shipments from various suppliers and defective raw materials. We had previously stated that our backlog indicated and we anticipated a stronger third quarter and this has been the case. We also anticipate a stronger fourth quarter compared with the fourth quarter of 2013.
- Net sales at WMI for the three months ended September 30, 2014 were \$3,339,000, a decrease of approximately \$(461,000) or (12.1%) compared with \$3,800,000 for the three months ended September 30, 2013. Net sales at WMI for 2014 included sales of \$363,000 from new acquisitions. Of these sales, \$99,000 related to MSI, which was acquired on November 6, 2013, and \$264,000 related to WPI, which was acquired on April 1, 2014.
- Net sales at NTW for the three months ended September 30, 2014 were \$731,000, a decrease of \$(1,658,000) or (69.4%) compared with net sales of \$2,389,000 for the three months ended September 30, 2013. This decline was anticipated due to a delay in receiving expected orders for the US Navy relating to landing gear for F-18 aircraft. We have begun to receive these orders and expect a return to higher sales in the fourth quarter of 2014 and through all of 2015.
- Net sales at EPC were \$1,406,000 for the three months ended September 30, 2014. EPC was acquired on June 1, 2014. Net sales at EPC included \$97,000 in sales from ECC for the period September 1, to September 30, 2014.

As indicated in the table below, three customers represented 69.3% and 58.9%, respectively, of total net sales for the three months ended September 30, 2014 and 2013, respectively.

| Customer                      | Percentage of Net Sales |                     |
|-------------------------------|-------------------------|---------------------|
|                               | 2014<br>(Unaudited)     | 2013<br>(Unaudited) |
| Goodrich Landing Gear Systems | 31.1                    | 21.6                |
| Sikorsky Aircraft             | 27.6                    | 26.7                |
| GKN Aerospace                 | 10.6                    | **                  |
| Northrup Grumman Corporation  | *                       | 10.6                |

\* Customer was less than 10% of net sales for the quarter ended September 30, 2014

\*\* Customer was less than 10% of net sales for the quarter ended September 30, 2013

#### Gross Profit:

Air Industries Group calculates gross profit for each operating subsidiary using a gross profit percentage method, using the gross profit percentage for the prior year as the percentage for the subsequent year. The gross profit percentage is different for each subsidiary. Consolidated gross profit will be disproportionately affected, positively or

negatively, by increased or decreased sales among the subsidiaries. Consolidated gross profit from operations for the three months ended September 30, 2014 was \$3,557,000, a decrease of approximately \$(186,000) or (5%), compared to approximately \$3,743,000 for the comparable period in 2013. For the three months ended September 30, 2014, gross profit as a percentage of sales was 23.5% and was comparable to the 23.3% for the prior year.

- AIM: Gross profit from operations for the three months ended September 30, 2014 was \$1,744,000, a decrease of approximately \$(182,000) or (9.5%), compared to approximately \$1,926,000 for the comparable period in 2013.
- WMI: Gross profit from operations for the three months ended September 30, 2014 was \$815,000, a decrease of approximately \$(138,000) or (14.5%), compared to approximately \$953,000 for the comparable period in 2013. For the three months ended September 30, 2014, the gross profit as a percentage of sales was 24.4% as compared to 25.1% for the prior year. The products of WPI are generally sold at a higher gross profit margin than WMI's traditional products, a lower gross profit at MSI partially offset the beneficial impact of WPI's higher profit margins.
- NTW: Gross profit from operations for the three months ended September 30, 2014 was \$284,000, a decrease of approximately \$(580,000) or (67.1%), compared to approximately \$864,000 for the comparable period in 2013 due to the previously mentioned lower sales.
- EPC: Gross profit from operations for the three months ended September 30, 2014 was \$713,000. EPC was acquired on June 1, 2014, and from September 1, 2014, its results include those of ECC.

Selling, General & Administrative ("SG&A"): Consolidated SG&A costs for the three months ended September 30, 2014 totaled \$2,997,000 an increase of \$285,000 or 10.5% compared to \$2,712,000 for the three months ended September 30, 2013. The acquisition of EPC on June 1, 2014 and ECC on September 1, 2014 increased SG&A costs by approximately \$221,000 and accounted for approximately 78% of the increase. The principal components of SG&A costs were:

- AIM: SG&A costs for the three months ended September 30, 2014 totaled approximately \$850,000, an increase of \$27,000 or 3.3% compared to \$823,000 for the comparable period 2013.
- WMI: SG&A costs for the three months ended September 30, 2014 totaled approximately \$1,137,000, an increase of \$86,000 or approximately 8.2% compared to \$1,051,000 for the comparable period in 2013. The increase in SG&A costs at WMI reflects the additions of the operations of Decimal, MSI and WPI and the costs expected as a result of the effort to consolidate their operations into WMI. Once we fully integrate all of these operations into one cohesive operating unit, we anticipate a reduction of these costs.
  - NTW: SG&A costs totaled approximately \$788,000 for the three months ended September 30, 2014, a decrease of \$(51,000) or approximately (6.1%) compared to \$839,000 for the comparable period in 2013.
- EPC: SG&A costs, including those of ECC from September 1, 2014, the date it was acquired, totaled \$221,000.

#### Interest and Financing Costs; Income Taxes and Net Income:

Interest and financing costs were approximately \$260,000 for the three months ended September 30, 2014, a decrease of approximately \$(21,000) or (7.5%) as compared to \$281,000 for the comparable period in 2013. Interest expense decreased primarily as a result of lower loan balances and, to a lesser degree, lower interest rates.

Income taxes were a benefit of approximately \$(81,000) for the three months ended September 30, 2014 and a benefit of \$(1,795,000) for the three months ended September 30, 2013. The income tax benefit in 2013 was the result of the Company determining that it no longer needed to provide a valuation allowance on certain deferred tax assets. This was based upon the fact that management believed that due to the sustained profitability of the Company and the probability that such profitability would continue, the net deferred tax assets was more likely than not to be realized.

Net income for the three months ended September 30, 2014 was \$380,000, and declined by \$(2,154,000) (85%) compared to net income of \$2,534,000 for the comparable period in 2013.

Nine months ended September 30, 2014 and 2013:

Selected Financial Information:

Statement of Operations Data (Unaudited)

|                              | 2014          | 2013          |
|------------------------------|---------------|---------------|
| Net sales                    | \$ 43,967,000 | \$ 45,016,000 |
| Cost of sales                | 33,012,000    | 33,996,000    |
| Gross profit                 | 10,955,000    | 11,020,000    |
| Operating and interest costs | 9,776,000     | 8,760,000     |
| Other income (expense) net   | (64,000 )     | (97,000 )     |
| Income taxes (Benefit)       | (222,000 )    | (876,000 )    |
| Net Income                   | \$ 1,337,000  | \$ 3,039,000  |

Balance Sheet Data

|                            | September 30, 2014<br>(Unaudited) | December 31,<br>2013 |
|----------------------------|-----------------------------------|----------------------|
| Cash and cash equivalents  | \$ 1,568,000                      | \$ 561,000           |
| Working capital            | 19,330,000                        | 12,531,000           |
| Total assets               | 59,116,000                        | 50,172,000           |
| Total stockholders' equity | 31,057,000                        | 21,613,000           |

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

Nine Months Ended September 30,

|                           | 2014<br>(Unaudited) | 2013<br>(Unaudited) |
|---------------------------|---------------------|---------------------|
| <b>AIM</b>                |                     |                     |
| Net Sales                 | \$ 23,944,000       | \$ 25,528,000       |
| Gross Profit              | 4,315,000           | 4,986,000           |
| Pre Tax Income            | 1,208,000           | 2,037,000           |
| Assets                    | 20,952,000          | 25,336,000          |
| <b>WMI</b>                |                     |                     |
| Net Sales                 | 10,414,000          | 10,246,000          |
| Gross Profit              | 2,758,000           | 2,694,000           |
| Pre Tax Loss              | (886,000 )          | (131,000 )          |
| Assets                    | 18,386,000          | 10,334,000          |
| <b>NTW</b>                |                     |                     |
| Net Sales                 | 7,926,000           | 9,242,000           |
| Gross Profit              | 3,025,000           | 3,340,000           |
| Pre Tax Income            | 441,000             | 746,000             |
| Assets                    | 11,970,000          | 13,005,000          |
| <b>EPC</b>                |                     |                     |
| Net Sales                 | 1,683,000           | -                   |
| Gross Profit              | 857,000             | -                   |
| Pre Tax Income            | 587,000             | -                   |
| Assets                    | 2,858,000           | -                   |
| <b>Corporate</b>          |                     |                     |
| Net Sales                 | -                   | -                   |
| Gross Profit              | -                   | -                   |
| Pre Tax Loss              | (235,000 )          | (489,000 )          |
| Assets                    | 15,772,000          | 9,964,000           |
| <b>Consolidated</b>       |                     |                     |
| Net Sales                 | 43,967,000          | 45,016,000          |
| Gross Profit              | 10,955,000          | 11,020,000          |
| Pre Tax Income            | 1,115,000           | 2,163,000           |
| Benefit From Income Taxes | (222,000 )          | (876,000 )          |
| Net Income                | 1,337,000           | 3,039,000           |
| Elimination of Assets     | (10,822,000)        | (4,852,000 )        |
| Assets                    | 59,116,000          | 53,787,000          |

Consolidated net sales from operations for the nine months ended September 30, 2014 were approximately \$43,967,000, a decrease of \$(1,049,000) or (2.3%) compared with \$45,016,000 for the nine months ended September 30, 2013.

- Net sales at AIM for the nine months ended September 30, 2014 were \$23,944,000, a decrease of approximately \$(1,584,000) or (6.2%) compared with \$25,528,000 for the nine months ended September 30, 2013. The decrease in sales at AIM results from continuing low levels of defense spending and continued delays in manufacturing landing gear product for the Navy's E2-D aircraft due to late shipments from various suppliers and defective raw materials. We had previously stated that our backlog indicated and we anticipated a stronger third quarter and this has been the case. We are also anticipating a stronger fourth quarter compared with the fourth quarter of 2013.
- Net sales at WMI for the nine months ended September 30, 2014 were \$10,414,000, an increase of approximately \$168,000 or 1.6% compared with \$10,246,000 for the nine months ended September 30, 2013. Net sales at Welding for 2014 included sales of \$1,001,000 from new acquisitions. Of these new sales, \$198,000 was attributable to MSI which was acquired in 2013 and \$803,000 related to WPI which was acquired on April 1, 2014.
- Net sales at NTW for the nine months ended September 30, 2014 were \$7,926,000, a decrease of \$(1,316,000) or (14.2%) compared with net sales of \$9,242,000 for the nine months ended September 30, 2013. This decline was anticipated due to a delay in receiving expected orders for the US Navy relating to landing gear for F-18 aircraft. We have begun to receive these orders and expect a return to higher sales in the fourth quarter of 2014 and through all of 2015.
- Net sales at EPC were \$1,683,000 for the period June 1, 2014 (the date of acquisition of EPC) through September 30, 2014. Net sales at EPC included \$97,000 in sales from ECC for the period September 1, the date of acquisition of ECC, to September 30, 2014.

As indicated in the table below, two customers represented 48.8% of net sales and three customers represented 58.7% of sales for the nine months ended September 30, 2014 and 2013, respectively.

| Customer                               | Percentage of Net Sales |                     |
|--|-------------------------|---------------------|
|  | 2014<br>(Unaudited)     | 2013<br>(Unaudited) |
| Sikorsky Aircraft                      | 30.0                    | 27.5                |
| Goodrich Landing Gear<br>Systems       | 18.8                    | 19.1                |
| United States Department<br>of Defense | *                       | 12.1                |

\* Customer was less than 10% of net sales for the nine months ended September 30, 2014

#### Gross Profit:

Air Industries Group calculates gross profit for each operating subsidiary using a gross profit percentage method, using the gross profit percentage for the prior year as the percentage for the subsequent year. The gross profit percentage is different for each subsidiary. Consolidated gross profit will be disproportionately affected, positively or negatively, by increased or decreased sales among the subsidiaries. Consolidated gross profit from operations for the nine months ended September 30, 2014 was \$10,955,000, a decrease of approximately \$(1,049,000) or (0.6%), compared to approximately \$11,020,000 for the comparable period in 2013. For the nine months ended September 30,

2014, gross profit as a percentage of sales was 24.9% and was comparable to the 24.5% for the prior year.

- AIM: Gross profit from operations for the nine months ended September 30, 2014 was \$4,315,000 a decrease of approximately \$(671,000) or (13.5%), compared to approximately \$4,986,000 for the comparable period in 2013.

- WMI: Gross profit from operations for the nine months ended September 30, 2014 was \$2,758,000 an increase of approximately \$(64,000) or (2.4%), compared to approximately \$2,694,000 for the comparable period in 2013. For the nine months ended September 30, 2014, the gross profit as a percentage of sales was 26.5% as compared to 26.3% for the prior year. The products of WPI are generally sold at a higher gross profit margin than WMI's traditional products, a lower gross profit at MSI partially offset the beneficial impact of WPI's higher profit margins.
- NTW: Gross profit from operations for the nine months ended September 30, 2014 was \$3,025,000, a decrease of approximately \$(315,000) or (9.4%), compared to approximately \$3,340,000 for the comparable period in 2013.
- EPC: Gross profit from operations for the period June 1, 2014 through September 30, 2014 was \$857,000. The results of EPC include those of ECC from the date it was acquired, September 1, 2014.

#### Selling, General & Administrative ("SG&A"):

Consolidated SG&A costs for the nine months ended September 30, 2014 totaled \$8,909,000 and increased by \$1,176,000 or 15.2% compared to \$7,733,000 for the nine months ended September 30, 2013. An increase in SG&A costs at WMI, principally as a result of the Decimal, MSI, and WPI acquisitions, accounted for 71% of the increase and SG&A costs at EPC accounted for 23% of the increase.

The principal components of SG&A costs were:

- AIM: SG&A costs for the nine months ended September 30, 2014 totaled approximately \$2,488,000, an increase of \$83,000 or 3.5% compared to \$2,405,000 for the comparable period 2013.
- WMI: SG&A costs for the nine months ended September 30, 2014 totaled approximately \$3,567,000, an increase of \$832,000 or approximately 30.4% compared to \$2,735,000 for the comparable period in 2013. The increase in SG&A costs at WMI reflects the additions of the operations of Decimal, MSI and WPI and increases expected as a result of the effort to consolidate the operations of these businesses into WMI. Once we fully integrate all of these operations into one cohesive operating unit, we anticipate a reduction of these costs.
- NTW: SG&A costs totaled approximately \$2,583,000 for the nine months ended September 30, 2014, a decrease of \$11,000 or less than one-percent compared to \$2,594,000 for the comparable period in 2013.
- EPC: SG&A costs totaled \$270,000 for the period June 1, 2014 through September 30, 2014. The results of EPC include those of ECC from the date it was acquired, September 1, 2014.

#### Interest and Financing Costs; Income Taxes and Net Income:

Interest and financing costs were approximately \$867,000 for the nine months ended September 30, 2014, a decrease of approximately \$(160,000) or (15.6%) as compared to \$1,027,000 for the comparable period in 2013. Interest expense decreased primarily as a result of lower loan balances and, to a lesser degree, lower interest rates.

Income taxes were a benefit of approximately \$(222,000) for the nine months ended September 30, 2014 and a benefit of approximately \$(876,000) for the nine months ended September 30, 2013. The income tax benefit for 2014 resulted from a reversal of over accruals of income tax expense recorded in fiscal 2013 and the reduction of deferred tax liabilities primarily related to property and equipment. The benefit in 2013 was the result of the Company determining that it no longer needed to provide a valuation allowance on certain deferred tax assets. This was based upon the fact that management believed that due to the sustained profitability of the Company and the probability that

such profitability would continue, the net deferred tax assets is more likely than not to be realized.

Net income for the nine months ended September 30, 2014 was \$1,337,000, a decrease of \$1,702,000 or (56%) compared to net income of \$3,039,000 for the comparable period in 2013.

## LIQUIDITY AND CAPITAL RESOURCES

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

Our Loan Facility with PNC has been amended three times in 2014, most recently on October 1, 2014 in connection with the acquisition of AMK. The Loan Facility now provides for maximum borrowings under a revolving loan of \$23,000,000 (including an inventory sub-limit of \$15,000,000) limited to the borrowing base as defined and two term loans, one, initially in the amount of \$2,613,000, and a second one, which was effective with the October 1st amendment, initially in the amount of \$3,500,000. The maturity date of the first term loan is November 30, 2016, and it is to be paid in thirty-one consecutive monthly principal installments, which commenced on the first business day of September 2014, and continue on the first business day of each month thereafter. The first thirty of the installments shall be in the amount of \$31,859, with a thirty-first and final payment of any unpaid balance of principal and interest on the last business day of November 2016. The maturity date of the second term loan is the first business day of November 2019, and it is to be paid in sixty consecutive monthly principal installments, which commence on the first business day of December 2014, and continue on the first business day of each month thereafter. The first fifty-nine of the installments shall be in the amount of \$58,333, with a sixtieth and final payment of any unpaid principal and interest on the first business day of November 2019.

On April 1, 2014, we acquired, through WMI, all of the common stock of WPI for \$2.4 million and 30,000 shares of the common stock of AIRI, valued at \$9.68 per share, which was the closing share price on April 1, 2014. Additionally, a working capital adjustment in the amount of approximately \$165,000 was paid in September of 2014.

On September 1, 2014, we acquired all of the common stock of EPC for \$1,625,000 and 20,000 shares of the common stock of AIRI, valued at \$9.78 per share, which was the closing price on that date. Additionally, a working capital adjustment was due to the former stockholders of EPC in the amount of approximately \$78,000 and was paid in August 2014.

On September 3, 2014, in connection with our Registered Direct Offering (“the Offering”), we issued 1,170,000 shares of our common stock pursuant to a “shelf” registration statement on Form S-3 (File NO. 333-191748), declared effective by the Securities and Exchange Commission on December 11, 2013. Taglich Brothers, Inc. acted as the exclusive placement agent for the offering. The gross proceeds of the offering were \$10,530,000, comprised of \$9,530,000 in cash and \$1,000,000 in the conversion of our Junior Subordinated Notes. We paid Taglich Brothers a commission of approximately \$842,000 and issued to it warrants to purchase up to 46,800 shares of common stock at a per share price of \$11.25. Additionally, the Company paid legal fees on behalf of Taglich Brothers in the amount of \$75,000 and paid a qualified independent underwriter approximately \$50,000 for its services. We netted cash of approximately \$8,562,000 from the Offering. The proceeds were used to acquire EPC, pay down debt, and applied to working capital.

On October 1, 2014, we acquired all of the common stock of AMK Technical Services, (“AMK”) for \$6,953,000, subject to a working capital adjustment. The acquisition was financed by a new term loan from PNC in the amount of \$3,500,000, a mortgage on the property of AMK in the amount of \$2,500,000 in favor of the sellers of AMK, with the remainder coming from our general working capital.

As of September 30, 2014, our debt for borrowed monies in the amount of \$19,506,000 consisted of the revolving credit note due to PNC in the amount of \$15,232,000, the term loans due to PNC in the amount of \$2,517,000, and a note due the sellers of WMI in the aggregate amount of \$218,000 and capitalized lease obligations of \$1,539,000. This

represents an increase of \$2,010,000 in our debt for borrowed monies at December 31, 2013 of \$17,496,000, when the revolving note due to PNC was \$12,029,000, the term loan due to PNC was \$1,948,000, the note due the sellers of WMI was \$732,000, the principal of the outstanding Junior Subordinated Notes was \$1,000,000 and capitalized lease obligations were \$1,787,000. The increase in the amount outstanding under the revolving credit note principally reflects amounts borrowed to support our acquisitions and the increase in our inventory.

### 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 and are then borrowed according to a borrowing base to support our operations.

As of September 30, 2014, there is approximately \$518,000 due to NTW Dissolution, the party from which we acquired the business now operated by NTW. 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. The \$518,000 will be offset by \$107,000 that is due to Air Industries Group for the payment of certain liabilities that were not assumed in the transaction.

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. On January 24, 2014, we paid a dividend equal to \$0.125 per share or \$733,000 to all shareholders of record as of January 9, 2014. On April 22, 2014, we paid a dividend equal to \$0.15 per share or \$885,000 to all shareholders of record as of April 15, 2014. On July 10, 2014, we paid a dividend equal to \$0.15 per share of \$1,064,000 to all shareholders of record as of June 30, 2014 and on November 3, 2014, we paid a dividend equal to \$0.15 per share or \$1,065,000 to all shareholders of record as of October 20, 2014. We have paid quarterly dividends to our shareholders each quarter commencing with the first quarter of 2013.

### Cash Flow

The following table summarizes our net cash flow from operating, investing and financing activities for the periods indicated below (in thousands):

|  | Nine months ended<br>September 30, 2014<br>(unaudited) | Nine months ended<br>September 30, 2013<br>(unaudited) |
|--|--|--|
| <b>Cash (used in) provided by</b>                |  |  |
| Operating activities                             | \$ (2,700 )  | \$ 3,556   |
| Investing activities                             | (5,102 )   | (920 )   |
| Financing activities                             | 8,809  | (2,355 )   |
| <b>Net increase in cash and cash equivalents</b> | <b>\$ 1,007</b>  | <b>\$ 281</b>  |

### Cash (Used In) Provided By Operating Activities

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

For the nine months ended September 30, 2014, our net cash used in operating activities of \$2,700,000 was comprised of net income of \$1,337,000 less \$6,203,000 of cash used by changes in operating assets and liabilities plus adjustments for non-cash items of \$2,166,000. Adjustments for non-cash items consisted primarily of depreciation of property and equipment of \$1,680,000, amortization of capitalized engineering costs, intangibles and other items of \$1,211,000, bad debt expense of \$299,000 representing all amounts more than 120 days past due, and non-cash compensation of \$25,000. These non-cash items were offset by \$28,000 of deferred gain on the sale of real estate and \$1,021,000 of deferred income taxes. The increase in operating assets and liabilities consisted of a net increase in Operating Assets of \$4,273,000 and a net decrease in Operating Liabilities of \$1,930,000. The increase in Operating Assets was comprised of an increase in accounts receivable of \$119,000 due to the timing of shipments to and cash

receipts from customers, an increase in inventory of \$4,401,000, partially offset by a net decrease in prepaid expenses and other current assets of \$247,000. The net decrease in Operating Liabilities was comprised of decreases in accounts payable and accrued expenses of \$795,000 due to the timing of the receipt and payment of invoices, a decrease in income taxes payable of \$1,114,000 and decreases in customer deposits of \$77,000, partially offset by an increase in deferred rent of \$56,000.

#### 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 below and in footnote 3 Summary of Significant Accounting Policies in our Consolidated Financial Statements for the year ended December 31, 2013.

For the nine months ended September 30, 2014 cash used in investing activities was \$5,102,000. This was comprised of \$4,471,000 for the acquisitions of WPI, EPC, and ECC, net of cash acquired, \$247,000 for capitalized engineering costs and \$385,000 for the purchase of property and equipment.

#### Cash Provided By (Used In) Financing Activities

Cash provided by (used in) financing activities consists of the net proceeds from the sale of our equity securities, dividend payments, the borrowings and repayments under our credit facilities with our senior lender, and increases in and repayment of capital lease obligations and other notes payable.

For the nine months ended September 30, 2014 cash provided by financing activities was \$8,809,000. This was comprised of \$8,562,000 in net proceeds from the offering of our common stock, additional borrowings of \$1,328,000 under our term loan and \$3,202,000 under our revolving credit facility, partially offset by repayments on our term loan of \$759,000, repayments under our capital leases of \$248,000, and \$513,000 paid to the former shareholders of WMI; \$2,683,000 used for dividends, deferred financing costs of \$25,000 and \$55,000 related to Lease Impairment.

#### OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of September 30, 2014.

#### Critical Accounting Policies

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

##### Inventory Valuation

For interim reporting, the Company computes its inventory based on a “gross profit” method.

For annual reporting, 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 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. 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.

We present 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 to the United States Government, when such progress payments are received.

##### Capitalized Engineering Costs

We have contractual agreements with customers to produce parts, which the customers design. Though we have not designed and thus have 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 we are reimbursed for all or a portion of the pre-production expenses associated with a particular contract, only the unreimbursed portion would be capitalized. We may also progress bill customers for certain engineering costs. 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

We recognize 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. We utilize 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.

We recognize certain revenues under a bill and hold arrangement with two of our large customers. For any requested bill and hold arrangement, we evaluate whether the bill and hold arrangement qualifies for revenue recognition. For a bill and hold arrangement to qualify for revenue recognition, the customer must initiate the request for the arrangement, in writing in addition to making their fixed commitment to purchase the item typically contained in the purchase order. The revenue is recognized when the risk of ownership has passed to the customer provided payment terms are not modified and payment will be made as if the goods had been shipped.

## Income Taxes

We account for income taxes in accordance with accounting guidance now codified as FASB ASC 740, "Income Taxes," which requires that we 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.

We account 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

We account 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. We estimate 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.

We account 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.

We perform 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. We record 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 to fair value.

## Item 4. Controls and Procedures

## (a) Evaluation of Disclosure Controls and Procedures.

Our senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act") designed to ensure that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision of and with the participation of management, including the Chief Executive Officer and our Chief Accounting Officer. Based on that evaluation, our Chief Executive Officer and our Chief Accounting Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

## (b) Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recently completed fiscal quarter which is the subject of this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

## OTHER INFORMATION

## Item 1A. Risk Factors.

Reference is made to the risks and uncertainties disclosed in our 2013 Form 10-K, which are incorporated by reference into this report. Prospective investors are encouraged to consider the risks described in our 2013 Form 10-K, our Management's Discussion and Analysis of Financial Condition and Result of Operation contained in this Report and other information publicly disclosed or contained in documents we file with the Securities and Exchange Commission before purchasing our common stock.

## Item 6 - Exhibits

- 31.1 Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of the Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of the Principal Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Principal Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation
- 101.DEF XBRL Taxonomy Extension Definition
- 101.LAB XBRL Taxonomy Extension Label
- 101.PRE XBRL Taxonomy Extension Presentation

SIGNATURES

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

Dated: November 14, 2014

AIR INDUSTRIES GROUP, INC.

By: /s/ Peter D. Rettaliata  
Peter D. Rettaliata  
President and Chief Executive  
Officer