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Research Report – Update

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

Air Industries Group

Speculative Buy

John Nobile
September 30, 2016

AIRI $4.53 — (NYSE MKT)

	2014A	2015A	2016E	2017E
Revenues (millions)	$64.3	$80.4	$81.0	$85.3
Earnings (loss) per share	$0.10	($0.11)	($0.17)	($0.10)

52-Week range	$9.17 – $3.85	Fiscal year ends:	December
Common shares out as/of 8/11/16	7.6 million	Revenue per share (TTM)	$10.43
Approximate float	6.8 million	Price/Sales (TTM)	0.4X
Market capitalization	$34 million	Price/Sales (FY2017)E	0.5X
Tangible book value/share	$2.61	Price/Earnings (TTM)	NMF
Price/tangible book value	1.7X	Price/Earnings (FY2017)E	NMF

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

Key investment considerations:

Maintaining Speculative Buy rating but lowering twelve-month price target to $6.00 per share (previously $11.00 per share) due primarily to dilution and a diminished valuation.

AIRI's sales in 1H16 were down 4%. However, a robust firm backlog (approximately $95 million to be shipped over the next 18 months) and strong 1H16 bookings (up approximately 30%) suggest a return to growth starting in 4Q16.

2016 sales will have a full year's contribution from the 2015 acquisitions of Compac and Sterling and benefit from a recent (September 2016) $3.1 million contract at Eur-Pac. 2017 sales should benefit from an anticipated 4% increase in operations & maintenance (O&M) spending and a continued ramp in revenue from a commercial contract for nacelle thrust struts (structural members that attach aircraft engines to aircraft engine housings).

For 2016 we project revenue of $81 million and a loss of ($0.17) per share, down from $90.6 million revenue and EPS of $0.24 previously to primarily reflect 1H16 results.

For 2017, we project revenue of $85.3 million and a loss of ($0.10) per share. Sales will be driven by increased O&M spending and a continued ramp in revenue from a $38 million commercial contract that was awarded in 2013 for nacelle thrust struts.

2Q16 revenue (10-Q released 8/18/16) increased 2% to $19.4 million. The net loss was ($0.04) per share versus a net loss of ($0.08) per share in 2Q15. We projected (on 12/15/15) 2Q16 revenue of $22.5 million and EPS of $0.06.

****Please view our disclosures on pages 15 - 17.***

Recommendation and Valuation

We are maintaining our Speculative Buy rating on Air Industries Group (AIRI) but lowering our twelve-month price target to $6.00 per share (previously $11.00 per share) due primarily to dilution and a diminished valuation. Dilution will come from an additional 2.2 million shares upon conversion of outstanding convertible preferred stock and the exercise of stock options and warrants.

Shares of AIRI are currently trading at a multiple of 0.4X trailing twelve-month (TTM) sales, down from 0.8X at the end of 2015. The aerospace & defense industry currently trades at P/S multiple of 0.7X (excludes market caps over $100 million). We believe AIRI's depressed multiple since 2015 is due to lackluster sales in 1H16 (down 4%). With a return to sales growth that we project for 2017, AIRI's P/S multiple should improve. We applied a multiple of 0.7X (down from 1X previously) to our 2017 sales projection of $9.22 per share, discounted to account for execution risks, to obtain a year ahead value of approximately $6.00 per share.

2016 Developments

Air Industries Receives $3.1 Million Award for US Army Tank – In September 2016, Air Industries announced it will begin first deliveries of component kits under a contract totaling a $3.1 million awarded by the US Government, Defense Logistics Agency.

Eur-Pac, a unit of Air Industries' Aerostructures and Electronics segment, will supply 35 complete kits, each containing 220 parts, for the US Army. The first deliveries will commence in late September 2016 with the balance completed in the fourth quarter of 2016. This single contract represents more than 50% of the annual revenue of Eur-Pac.

Air Industries Receives $2.3 million in Landing Gear Contracts – In June 2016, Air Industries announced it was awarded two contracts totaling $2.3M by Helicopter Tech Inc. of King of Prussia, Pennsylvania. Air Industries will produce a major landing gear component for the KC-135 aircraft.

Under the contracts, Air Industries will produce parts over a 24-month period with the first production deliveries commencing early 2018.

Air Industries and Meyer Tool to Co-Locate in Poland – In June 2016, Air Industries announced it has signed an agreement with Meyer Tool Co. to co-locate Air Industries welding capabilities into Meyer's Kalisz, Poland facility.

By combining Meyer's EDM, water-jet and grinding capabilities with AIRI's welding expertise, the facility will be a "one-stop shop" in close proximity to AIRI's major customers. Construction of the facility has begun, and product manufacturing is slated to commence in September 2016.

Business Overview

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

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

Source: Air Industries Group

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

Complex Machining accounted for 53% of 2015 revenue. Products include electromechanical devices, mixer (primary flight control) assemblies, rotor-hub components for Blackhawk helicopters, arresting gear for the E2C/D Hawkeye, C2A Greyhound and US Navy Fighters, vibration absorbing assemblies for Sikorsky helicopters, landing gear components for the F-35 Joint Strike Fighter (JSF), and many other subassembly packages.

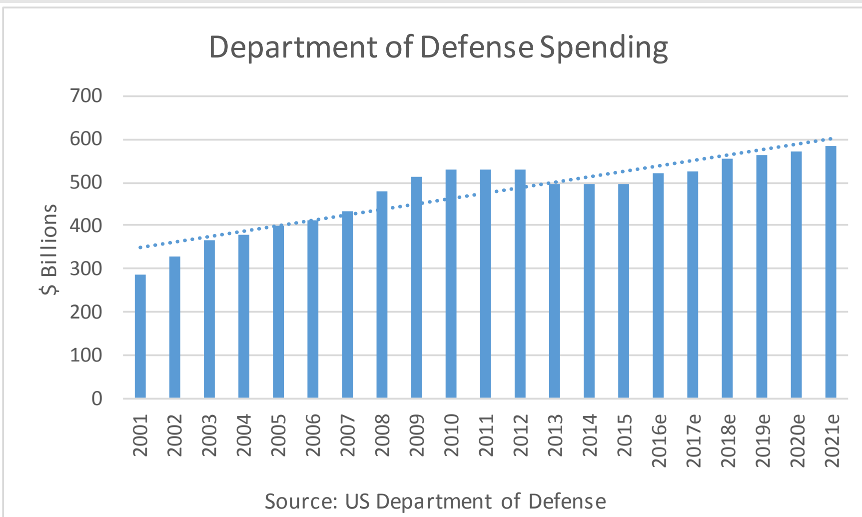
AIRI's Complex Machining segment also manufactures complete landing gear assemblies and landing gear components for the US Air Force F-16 Fighting Falcon and the US Navy's F-18 Hornet aircraft. The company specializes in deep hole gun-drilling (a process that produces deep, straight holes in a variety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

Aerostructures and Electronics accounted for 34% of total revenue in 2015. This segment provides specialty welding services and metal fabrications, electromechanical systems and assemblies, and wire harness and cable assemblies to the defense and commercial aerospace industry.

Turbine Engine Components accounted for 13% of total revenue in 2015. This segment provides complex machining and welding services with a focus on aircraft jet engines and ground turbines.

Defense Spending Overview

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

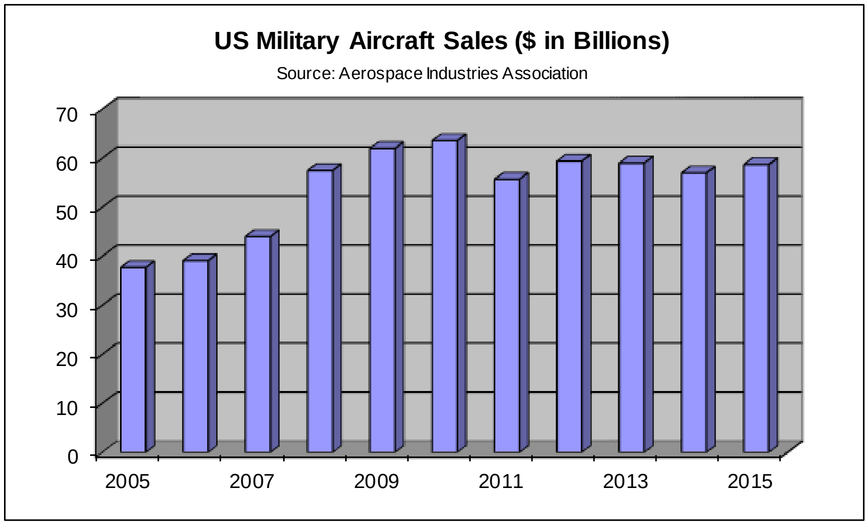


Changes in defense spending are likely to directly impact AIRI's revenues. US defense spending increased through much of the post-9/11 decade and peaked in 2012 at over $530 billion. However, budget cuts reduced defense spending by 7% to $495.5 billion in 2013 and spending for 2014 and 2015 remained flat. Defense spending is projected to increase through 2021 (see chart at bottom right on previous page).

Although DoD spending was flat in 2015, Air Industries' revenues grew by 25% due to the acquisitions of Woodbine (April 2014), Eur-Pac (June 2014), ECC (September 2014), AMK (October 2014), Sterling (March 2015), and Compac (September 2015). Excluding acquisitions, sales from existing operations increased by 8% to $62.9 million.

Military Aircraft Market and Forecast

Over 90% of Air Industries' revenue is derived from sales to the US military aircraft market. The latest report from the Aerospace Industries Association (AIA) shows US military aircraft sales of $58.7 billion in 2015, up 3% from 2014 but down 8% from the peak in 2010 (see chart at right). The AIA said the large drop in US military aircraft sales since 2010 was due to budget cuts caused in large part by the Budget Control Act of 2011 which resulted in reductions in military spending and a drop in overseas contingency operations funding.



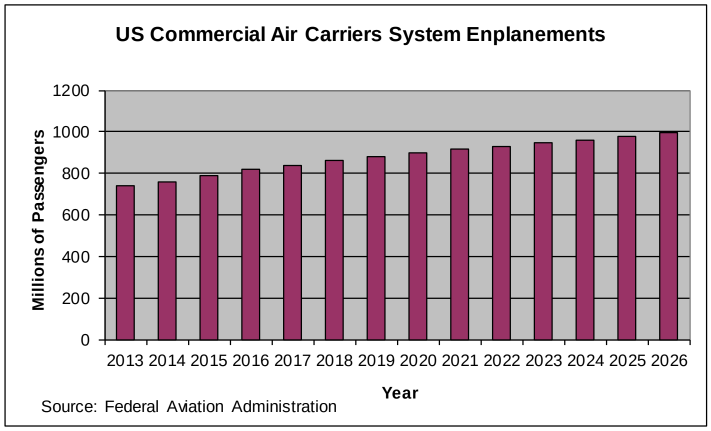
The four largest components of the DoD's spending budget are in operation and maintenance (largest component), military personnel, procurement, and research, development, test & evaluation (RDT&E). As over 90% of AIRI's military sales are for the repair and maintenance of existing aircraft, the category with the greatest impact on AIRI's sales is operation and maintenance spending. The latest (February 2016) DoD budget for operation and maintenance (O&M) spending is for a 1% increase in 2016 followed by a 4% increase in 2017.

Commercial Aircraft Market and Forecast

In 2000, commercial aircraft parts accounted for approximately 60% of AIRI's total revenue. AIRI'S customers began shifting to defense after September 11, 2001 resulting in approximately 90% of AIRI'S total revenue coming from defense and less than 10% from the commercial aircraft market in 2015. Although the company's product lines primarily serve the defense market, they also serve the commercial markets. With defense budgets being under pressure over the last three years, prime contractors began to shift their focus to the commercial sector. AIRI's customers (such as Boeing and United Technologies' Sikorsky and Goodrich divisions) typically build to both military and commercial specifications.

According to the Federal Aviation Administration's (FAA) Aerospace Forecast 2016-2026, the number of passengers flying US commercial air carriers is projected to increase steadily throughout its forecast horizon. The FAA is forecasting US carrier passenger growth over the next ten years to average 2.2% per year (see chart at top right on next page). Driving this growth will be a rise in economic activity. The FAA cited economic forecasts from IHS Global Insight, Inc. for US GDP growth to average 2.4% annually from 2016 to 2025.

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



Competition

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

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

Air Industries' competitors include Monitor Aerospace, a division of Stellex Aerospace, Hydromil, a division of Triumph Aerospace Group (TTM revenues of $3.8B), Heroux-Devtek (TTM revenues of $312M), and Ellanef Manufacturing, a division of Magellan Corporation.

Strategy

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

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

2014 and 2015 revenue contribution from these acquisitions can be seen in the table at right along with AIRI's organic sales and our projections for 2016 and 2017. Sterling Engineering and Compac did not contribute to AIRI's 2014 results as they were acquired in 2015.

Sales (in thousands $)

	2014A	2015A	2016E	2017E
Woodbine	1,047	753	700	728
Eur-Pac	2,756	4,802	7,600	7,904
ECC	281	605	563	586
Compac	-	467	1,302	1,354
AMK	1,838	4,057	4,596	4,780
Sterling	-	6,894	6,560	6,822
Organic	58,409	62,864	59,726	63,126
Total sales	$ 64,331	$ 80,442	$ 81,047	$ 85,300

Source: Company reports and Taglich Brothers' estimates

The aerospace and defense industries have consolidated since the 1990s. The consolidation of the prime contractors has caused a similar consolidation of their suppliers. Major contractors seek to streamline supply chains by buying both larger quantities and more complete sub-assemblies from fewer suppliers. Air Industries' acquisitions are part of the company's strategy to grow in this market. AIRI is now producing more complete sub-assemblies sought after by major contractors and sales have grown at an average annual growth rate of 11% over the past four years due primarily to strategic acquisitions.

Economic Outlook

In July 2016, the International Monetary Fund (IMF) lowered its global economic growth forecast to 3.1% in 2016 and 3.4% in 2017, down from an earlier (April 2016) growth forecast of 3.2% for 2016 and 3.5% for 2017. The reduced growth estimate primarily reflects increased political uncertainty taking a toll on confidence and investment in the aftermath of the June 23, 2016 vote in the United Kingdom to leave the European Union.

The IMF lowered its economic growth estimate for the US to 2.2% in 2016, down from an earlier (April 2016) growth forecast of 2.4%, but kept it unchanged at 2.5% in 2017. The IMF said that 1Q16 growth was weaker than expected, triggering the downward revision to the 2016 forecast, but indicators of economic activity (such as labor and financial market indicators) point to a pick-up in 2Q16 and for the remainder of the year. The IMF projects the impact from the UK leaving the European Union to be muted for the US, as lower long-term interest rates and a more gradual path of monetary policy normalization are expected to broadly offset larger corporate spreads (difference between corporate and treasury bond yields), a stronger US dollar, and some decline in confidence.

The second estimate of US GDP growth (released on August 26, 2016) showed the US economy grew at an annual rate of 1.1% in 2Q16, up from 0.8% growth in 1Q16. The 2Q16 US GDP growth estimate primarily reflects a rise in consumer spending. Partly offsetting this contribution to GDP growth was a decline in inventory investment, housing investment, government spending, and business investment.

2Q and 1H 2016 Financial Results

2Q16 **-** Total revenue increased 2% to $19.4 million. The net loss was $334,000 or ($0.04) per share versus a net loss of $601,000 or ($0.08) per share in 2Q15. We projected (on 12/15/15) 2Q16 revenue of $22.5 million and EPS of $0.06.

The increase in total sales was primarily due to Complex Machining segment gains offset in part by decreased sales from the company's Aerostructures & Electronics and Turbine Engine Components segments.

Complex machining sales increased 8% to $10.3 million due to an increase in orders and deliveries at Nassau Tool Works. Aerostructures and Electronics sales decreased 4% to $6 million due to the absence of a large contract ($2 million) that was awarded in 2015. This decrease in sales was partly offset by increased sales due to the August 2016 acquisition of Compac Development Corporation. Turbine Engine Component sales decreased 7% to $3 million due to the end of a specific project at Sterling Engine Corporation which was partly offset by gains at AMK Technical Services from new customers and contracts.

Gross margins increased to 21.5% from 20.4% primarily due to increased margins from the Complex Machining segment stemming from increased factory overhead coverage. Operating (SG&A) expenses increased to $4.2 million from $3.8 million primarily due to an increase in headcount. The increase in revenue and gross margins was more than offset by the increase in operating expenses resulted in an operating loss of $27,000 compared to operating income of $72,000 in 2Q15.

1H16 - Total revenue decreased 4% to $34.5 million. The net loss was $1.8 million or ($0.23) per share versus a net loss of $497,000 or ($0.07) per share in 1H15.

The decrease in total sales was primarily due to decreased sales at the company's Complex Machining and Aerostructures & Electronics segments offset in part by increased sales at the company's Turbine Engine Components segment.

Complex Machining segment sales decreased 4% to $17.8 million and Aerostructures & Electronics segment sales decreased 7% to $11.2 million. Turbine Engine Component segment sales increased to $5.6 million from $5.2 million.

Gross margins decreased to 20.2% from 23% primarily due to decreased factory overhead coverage at the company's Aerostructures & Electronics and Turbine Engine Components segments. Operating (SG&A) expenses increased to $8.6 million from $7.7 million primarily due to an increase in headcount. The operating loss was $1.6 million versus operating income of $538,000 due to decreased revenue, lower gross margins, and higher operating expenses.

Income Statement
(in thousands $)

	6mos16	6mos15
Complex Machining	17,768	18,595
Aerostructures & Electronics	11,201	12,059
Turbine Engine Components	5,578	5,214
Total sales	34,547	35,868
Cost of sales	27,571	27,602
Gross profit	6,976	8,266
Operating expenses	8,594	7,728
Operating income	(1,618)	538
Interest and financing costs	(877)	(890)
Other (expense) income	31	62
Income before taxes	(2,464)	(290)
Income tax (benefit)	(782)	207
Net income / (loss)	(1,682)	(497)
Preferred stock dividends	(82)	-
Net income/(loss) to common	(1,764)	(497)
EPS	(0.23)	(0.07)
Shares Outstanding	7,586	7,398
Margin Analysis		
Gross margin	20.2%	23.0%
Operating margin	(4.7)%	1.5%
Tax rate	31.7%	(71.4)%
Year / Year Growth		
Total Revenues	(3.7)%	
Net Income	NMF	
EPS	NMF	

Source: Company filings

Liquidity

As of June 30, 2016, the company had $759,000 cash and a current ratio of 1.1X versus 1.3X for the aerospace and defense industry. Total debt was approximately $40.8 million for a debt/equity ratio of 1.2X versus 1.0X for the aerospace and defense industry. We project the company should need to raise an additional $6.5 million (from convertible preferred stock) in order to pay down its existing debt obligations and meets its operational needs through 2017.

Cash provided by operations in the first six months of 2016 was $111,000 consisting of $572,000 cash earnings and a $461,000 increase in working capital. The change in working capital was primarily due to an increase in inventory partly offset by a decrease in accounts receivable and an increase in accounts payable. Cash provided by investing was $48,000 consisting of $1.7 million proceeds from the sale of fixed assets partly offset by $1.2 million of capital expenditures and $394,000 of capitalized engineering costs. Cash provided by financing was $71,000 and consisted primarily of proceeds from the issuance of preferred stock and notes payable, offset in part by debt payments and financing expenses. Cash increased by $230,000 to $759,000 at June 30, 2016.

Air Industries has a revolving credit line and term loan with PNC bank. The revolver matures April 30, 2018 and the term loans mature June 30, 2021. The credit line provides for maximum borrowings of $33 million (June 30, 2016 outstanding balance was $26.9 million) and term loans of $7.4 million. Air Industries pays an annual interest rate of an alternate base rate plus 1.75% for domestic rate loans and LIBOR plus 4.5% for LIBOR based loans. As of June 30, 2016, Air Industries was not in compliance with the minimum EBITDA requirement covenant of its loan facility. In September 2016, Air Industries received a waiver for its noncompliance from PNC.

The outstanding term loans have been aggregated into a single term loan in the principal amount of $7.4 million to be repaid in sixty consecutive monthly instalments of principal in the amount of $123,333 together with accrued interest.

Excess advances of $12.5 million have been recognized under an amended credit agreement and are to be repaid with an initial principal payment in the amount of $1.5 million (paid in May 2016) and payments of $100,000 in principal each Monday commencing June 6, 2016.

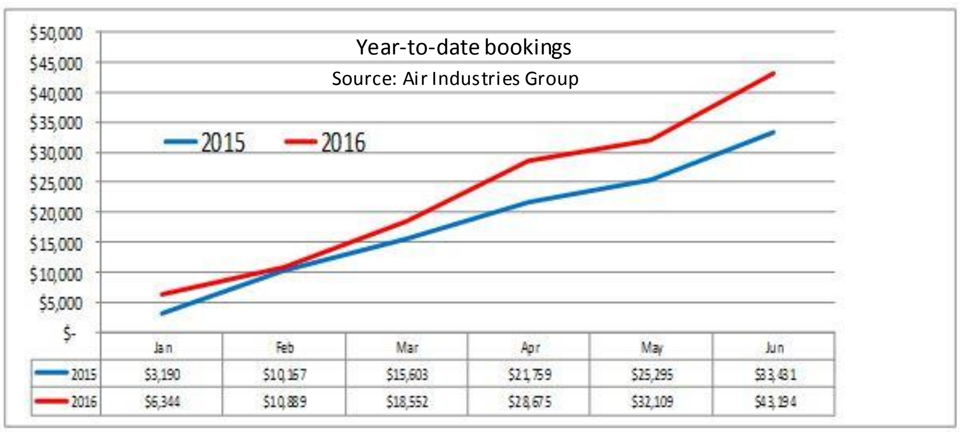
In August 2016, AIRI issued and sold a total of $4.2 million (inclusive of the notes issued to Michael Taglich and Robert Taglich discussed below) of 12% subordinated convertible notes due December 31, 2017 with warrants to purchase up to 172,763 shares of common stock.

The notes are convertible into shares of AIRI common stock at a conversion price of $4.92 per share and are automatically convertible into shares of the company's series A convertible preferred stock at a price of $10.00 per share. The automatic conversion is contingent upon the filing of a certificate of amendment to the company's articles of incorporation increasing the number of shares of series A preferred stock so that a sufficient number of shares are available for issuance upon conversion of the notes.

In August 2016, the Company issued to Michael Taglich, President of Taglich Brothers, Inc. and Chairman of Air Industries Group, a note in the principal amount of $1.5 million with warrants to purchase 61,817 shares of common stock, upon surrender for cancellation $1.5 million of previously issued promissory notes. The company issued to Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, a note in the principal amount of $4,000 with warrants to purchase 178 shares of common stock in consideration of the forgiveness of $4,000 interest accrued on notes previously exchanged for series A preferred stock.

Projections

Although AIRI's sales were down 4% in 1H16, a robust firm backlog (approximately $95 million to be shipped over the next 18 months) and strong 1H16 bookings (up approximately 30%, see chart at right) suggest a return to growth starting in 4Q16.



The chart at lower right provides a breakdown of Air Industries' organic sales and the effect of acquisitions. 2016 sales will have a full year's contribution from Compac and Sterling and benefit from the recent (September 2016) $3.1 million contract at Eur-Pac. 2017 sales should benefit from an anticipated 4% increase in O&M spending and a continued ramp in revenue from a $38 million commercial contract that was awarded in 2013 for nacelle thrust struts (structural members that attach aircraft engines to aircraft engine housings).

Sales (in thousands $)

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Woodbine	1,047	753	700	728
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Organic	58,409	62,864	59,726	63,126
Total sales	$ 64,331	$ 80,442	$ 81,047	$ 85,300

Source: Company reports and Taglich Brothers' estimates

The following table provides a segmented breakdown of Air Industries' 2014 and 2015 actual sales and gross margins and our projections for 2016 and 2017. Woodbine, Eur-Pac ECC and Compac are classified under AIRI's Aerostructures & Electronics segment while AMK and Sterling are classified under AIRI's Turbine Engine Components segment.

Sales ($ in thousands)	2014A	2015A	1Q16A	2Q16A	3Q16E	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E
Complex Machining	44,220	42,356	7,467	10,301	11,000	13,500	42,268	11,550	11,800	12,050	12,300	47,700
Aerostructures & Electronics	18,273	27,134	5,160	6,041	6,000	9,550	26,751	6,100	6,200	6,300	6,400	25,000
Turbine Engine Components	1,838	10,952	2,557	3,021	2,900	3,550	12,028	3,000	3,100	3,200	3,300	12,600
Total	64,331	80,442	15,184	19,363	19,900	26,600	81,047	20,650	21,100	21,550	22,000	85,300
Gross Profit ($ in thousands)												
Complex Machining	8,691	10,412	1,858	2,564	2,739	3,362	10,523	2,876	2,938	3,000	3,063	11,877
Aerostructures & Electronics	4,812	6,553	948	1,446	1,440	2,579	6,413	1,464	1,488	1,512	1,536	6,000
Turbine Engine Components	595	316	15	145	131	533	823	150	208	269	330	957
Total	14,098	17,281	2,821	4,155	4,310	6,473	17,758	4,490	4,634	4,781	4,929	18,834
Gross Margin												
Complex Machining	19.7%	24.6%	24.9%	24.9%	24.9%	24.9%	24.9%	24.9%	24.9%	24.9%	24.9%	24.9%
Aerostructures & Electronics	26.3%	24.2%	18.4%	23.9%	24.0%	27.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%
Turbine Engine Components	32.4%	2.9%	0.6%	4.8%	4.5%	15.0%	6.8%	5.0%	6.7%	8.4%	10.0%	7.6%
Total	21.9%	21.5%	18.6%	21.5%	21.7%	24.3%	21.9%	21.7%	22.0%	22.2%	22.4%	22.1%

Source: Company filings and Taglich Brothers' estimates

Our gross margin projection for 2016 has been lowered to 21.9% from 24.2% to reflect year-to-date results. We project margins rising to 22.1% in 2017 as increased sales from the higher margin Complex Machining segment make up a greater percentage of total sales (56% in 2017 versus 52% in 2016).

_2016_ – We project revenue of $81 million and a net loss of $1.4 million or ($0.17) per share, down from $90.6 million revenue and $1.8 million or $0.24 per share net income previously to primarily reflect year-to-date results that were not reflected in our prior report.

Increased sales and gross profits should be offset by increased SG&A expenses, keeping operating margins at 0.8% in 2016. We project 2016 interest expense of $1.9 million and a tax rate of 21.6%.

We project $4 million cash from operations consisting primarily of cash earnings. Cash from operations, proceeds from the issuance of stock and debt, and the sale of fixed assets, will fall short of covering capital expenditures and debt repayments resulting in a $234,000 decrease in cash to $295,000 at year-end 2016.

_2017_ – We project revenue of $85.3 million and a net loss of $932,000 or ($0.10) per share. Sales will be driven by an anticipated 4% increase in O&M spending and an additional $1 million from a $38 million commercial contract.

Increased sales and gross profits should be offset by increased SG&A expenses, increasing operating margins to 1.7% in 2016 from 0.8%. We project interest expense to decrease to $1.7 million in 2017 from $1.9 million in 2016 due to lower debt levels as the company continues to pay down debt. We project a tax rate of 40%.

We project $2 million cash from operations from cash earnings of $3.9 million and a $2 million increase in working capital. The increase in working capital should come primarily from an increase in inventory. Cash from operations will fall short of covering debt repayments and capital expenditures necessitating an additional $6.5 million raise of capital from the issuance of preferred stock. These items should result in a $25,000 decrease in cash to $270,000 at year-end 2017.

Risks

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

Reliance on government spending - Approximately 90% of AIRI's sales are to the US military. In 2015, AIRI's Complex Machining segment experienced a reduction in sales as a result of a slowing of orders from reduced military spending. Further reductions in defense spending, or delays in passage of defense budgets, could adversely impact AIRI's financial results.

Reliance on a small number of customers – Air Industries derives most of its revenues from a small number of customers. In 2015, two customers accounted for 36% of net sales. The loss of one or more of the company's largest customers will likely have a materially adverse impact on AIRI's financial results.

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

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

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

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

Material weakness in disclosure controls and procedures – As of June 30, 2016, AIRI's disclosure controls and procedures were not effective due to a material weakness related to the inability of AIRI's internal accounting personnel to identify, analyze, record and disclose the tax and financial reporting implications of certain complex accounting matters, and inventory accounting. In an effort to eliminate such weakness, the company has hired Marianne Giglio as CAO and entered into an agreement with Chord Advisors, LLC to assist AIRI's accounting staff.

Liquidity risk - Shares of Air Industries Group have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. There are 6.8 million shares in the float and the average daily volume is approximately 8,600 shares.

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

Consolidated Balance Sheets
(in thousands $)

	2013A	2014A	2015A	2Q16A	2016E	2017E
Cash and cash equivalents	561	1,418	529	759	295	270
Accounts receivable	8,584	11,916	13,662	11,333	13,765	14,487
Inventory	26,222	28,391	36,923	40,532	36,998	38,855
Deferred tax asset	1,051	1,421	1,725	2,394	2,633	2,939
Prepaid expenses and other current assets	510	875	1,583	1,405	1,405	1,405
Assets held for sale	-	-	1,700	-	-	-
Deposits - vendors	-	-	-	-	-	-
Total current assets	36,928	44,021	56,122	56,423	55,096	57,957
Property and equipment, net	6,523	9,557	15,299	17,029	15,221	13,747
Capitalized engineering costs	752	712	1,027	1,222	1,222	1,222
Deferred financing costs	605	825	1,094	1,159	1,159	1,159
Intangible assets	4,726	4,513	3,852	3,213	2,573	1,293
Deferred tax asset	185	858	338	487	725	991
Goodwill	453	5,434	10,518	10,518	10,518	10,518
Total assets	**50,172**	**65,920**	**88,250**	**90,051**	**86,514**	**86,887**
Notes payable and capitalized lease obligations	14,969	19,508	40,893	35,572	32,274	27,074
Accounts payable and accrued expenses	6,855	6,948	12,053	12,805	12,077	12,684
Lease impairment	71	56	-	-	-	-
Deferred gain on sale	38	38	38	38	38	38
Deferred revenue	251	158	958	1,245	1,245	1,245
Dividends payable	717	1,066	-	-	-	-
Income taxes payable	1,496	71	14	22	22	22
Total current liabilities	24,397	27,845	53,956	49,682	45,656	41,063
Long-term debt	2,527	8,213	3,912	5,261	4,858	3,256
Lease impairment	56	4	-	-	-	-
Deferred gain on sale	447	409	371	352	352	352
Deferred rent	1,132	1,177	1,206	1,212	1,212	1,212
Total liabilities	**28,559**	**37,648**	**59,445**	**56,507**	**52,078**	**45,883**
Preferred stock	**-**	**-**	**-**	**1**	**1**	**2**
Total stockholders' equity*	**21,613**	**28,272**	**28,805**	**33,544**	**34,435**	**41,004**
Total liabilities & stockholders' equity	**50,172**	**65,920**	**88,250**	**90,051**	**86,514**	**86,887**

* includes $1.75 million of additional paid-in capital for preferred stock issued for notes payable

Source: Company filings and Taglich Brothers' estimates

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

	2013A	2014A	2015A	2016E	2017E
Net sales	62,833	64,331	80,442	81,047	85,300
Cost of sales	47,598	50,233	63,161	63,289	66,466
Gross profit	15,235	14,098	17,281	17,758	18,834
Operating expenses	10,622	12,363	16,655	17,094	17,400
Operating income	4,613	1,735	626	664	1,434
Interest and financing costs	(1,340)	(1,295)	(1,858)	(1,852)	(1,687)
Other (expense) income	296	(141)	114	81	100
Income before taxes	3,569	299	(1,118)	(1,107)	(153)
Income tax (benefit)	(170)	(368)	(286)	(239)	(61)
Net Income / (Loss)	3,739	667	(832)	(868)	(92)
Preferred stock dividends	(82)	-	-	(502)	(840)
Net Income/(Loss) to common	3,657	667	(832)	(1,370)	(932)
EPS	0.63	0.10	(0.11)	(0.17)	(0.10)
Shares Outstanding	5,933	6,916	7,478	7,864	9,247
Margin Analysis					
Gross margin	24.2%	21.9%	21.5%	21.9%	22.1%
Operating margin	7.3%	2.7%	0.8%	0.8%	1.7%
Net margin	6.0%	1.0%	(1.0)%	(1.1)%	-0.1%
Tax rate	(4.8)%	(123.1)%	25.6%	21.6%	40.0%
Year / Year Growth					
Total Revenues	(2.2)%	2.4%	25.0%	0.8%	5.2%
Net Income	46.7%	(82.2)%	(224.7)%	NMF	NMF
EPS	17.7%	(84.7)%	(215.4)%	NMF	NMF

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statements 2015A -2017E
(in thousands $)

	3/15A	6/15A	9/15A	12/15A	2015A	3/16A	6/16A	9/16E	12/16E	2016E	3/17E	6/17E	9/17E	12/17E	2017E
Net sales	16,811	19,057	21,076	23,498	80,442	15,184	19,363	19,900	26,600	81,047	20,650	21,100	21,550	22,000	85,300
Cost of sales	12,442	15,160	16,898	18,661	63,161	12,363	15,208	15,591	20,128	63,289	16,160	16,466	16,769	17,071	66,466
Gross profit	4,369	3,897	4,178	4,837	17,281	2,821	4,155	4,310	6,473	17,758	4,490	4,634	4,781	4,929	18,834
Operating expenses	3,903	3,825	4,152	4,775	16,655	4,412	4,182	4,150	4,350	17,094	4,350	4,350	4,350	4,350	17,400
Operating income	466	72	26	62	626	(1,591)	(27)	160	2,123	664	140	284	431	579	1,434
Interest and financing costs	(346)	(544)	(451)	(517)	(1,858)	(505)	(372)	(499)	(476)	(1,852)	(454)	(432)	(411)	(390)	(1,687)
Other (expense) income	8	54	36	16	114	10	21	25	25	81	25	25	25	25	100
Income before taxes	128	(418)	(389)	(439)	(1,118)	(2,086)	(378)	(314)	1,672	(1,107)	(289)	(123)	45	214	(153)
Income tax (benefit)	24	183	(726)	233	(286)	(656)	(126)	(126)	669	(239)	(115)	(49)	18	86	(61)
Net Income / (Loss)	104	(601)	337	(672)	(832)	(1,430)	(252)	(189)	1,003	(868)	(173)	(74)	27	128	(92)
Preferred stock dividends	-	-	-	-	-	-	(82)	(210)	(210)	(502)	(210)	(210)	(210)	(210)	(840)
Net Income/(Loss) to common	104	(601)	337	(672)	(832)	(1,430)	(334)	(399)	793	(1,370)	(383)	(284)	(183)	(82)	(932)
EPS	0.01	(0.08)	0.04	(0.09)	(0.11)	(0.19)	(0.04)	(0.05)	0.10	(0.17)	(0.04)	(0.03)	(0.02)	(0.01)	(0.10)
Shares Outstanding	7,521	7,557	7,686	7,478	7,478	7,585	7,588	7,957	8,325	7,864	8,694	9,063	9,431	9,800	9,247
Margin Analysis															
Gross margin	26.0%	20.4%	19.8%	20.6%	21.5%	18.6%	21.5%	21.7%	24.3%	21.9%	21.7%	22.0%	22.2%	22.4%	22.1%
Operating margin	2.8%	0.4%	0.1%	0.3%	0.8%	(10.5)%	(0.1)%	0.8%	8.0%	0.8%	0.7%	1.3%	2.0%	2.6%	1.7%
Net margin	0.6%	(3.2)%	1.6%	(2.9)%	(1.0)%	(9.4)%	(1.3)%	(0.9)%	3.8%	(1.1)%	-0.8%	(0.4)%	0.1%	0.6%	-0.1%
Tax rate	18.8%	(43.8)%	186.6%	(53.1)%	25.6%	31.4%	33.3%	40.0%	40.0%	21.6%	40.0%	40.0%	40.0%	40.0%	40.0%
Year / Year Growth															
Total Revenues	8.8%	42.6%	39.1%	15.4%	25.0%	(9.7)%	1.6%	(5.6)%	13.2%	0.8%	36.0%	9.0%	8.3%	(17.3)%	5.2%
Net Income	(69.5)%	(197.6)%	(11.3)%	0.3%	(224.7)%	NMF	(58.1)%	(156.0)%	(249.3)%	NMF	NMF	(70.6)%	(114.4)%	(87.2)%	NMF
EPS	(75.2)%	(185.2)%	(14.7)%	(7.2)%	(215.4)%	NMF	(44.7)%	(214.3)%	(206.0)%	NMF	NMF	(28.8)%	(61.3)%	(108.7)%	NMF

Source: Company filings and Taglich Brothers' estimates

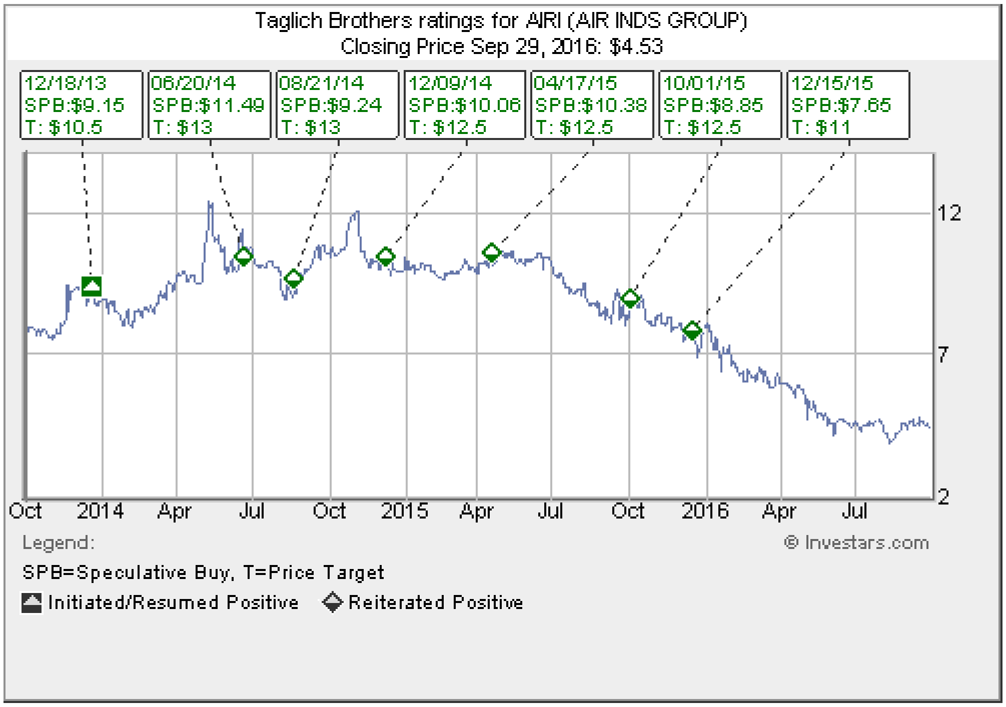
Statement of Cash Flows for the Periods Ended
(in thousands $)

	2013A	2014A	2015A	6mo16A	2016E	2017E
Net income (loss)	3,739	667	(832)	(1,682)	(868)	(92)
Depreciation	1,709	2,364	3,090	1,851	3,078	2,774
Amortization of intangible assets	1,163	1,163	1,262	640	1,280	1,280
Amortization of capitalized engineering costs	430	375	341	198	400	400
Bad debt expense	394	299	176	29	60	60
Stock compensation expense	38	42	100	83	160	160
Amortization of deferred financing costs	69	49	204	285	570	570
Negative goodwill from acquisition	(361)	-	-	-	-	-
Gain on sale of real estate	(38)	(38)	(38)	(14)	(14)	-
Deferred income taxes	(1,236)	(1,043)	(215)	(818)	(823)	(1,208)
Adjustments to lease impairment	-	-	-	-	-	-
Cash earnings (loss)	5,907	3,878	4,088	572	3,843	3,944
Changes in assets and liabilities						
Accounts receivable	2,871	(2,417)	91	2,300	(103)	(722)
Inventory	440	(1,802)	(8,412)	(3,840)	(75)	(1,857)
Prepaid expenses and other current assets	35	(244)	(748)	178	178	-
Deposits and other assets	154	(164)	(18)	(151)	(151)	-
Accounts payable and accrued expenses	(892)	(577)	3,593	754	24	606
Deferred rent	75	45	29	6	6	-
Income taxes payable	48	(1,425)	(57)	5	8	-
Deferred revenue	251	(93)	540	287	287	-
(Increase) decrease in working capital	2,982	(6,677)	(4,982)	(461)	175	(1,973)
Net Cash Provided by Operations	**8,889**	**(2,799)**	**(894)**	**111**	**4,018**	**1,971**
Cash paid for acquisitions, net	(450)	(8,757)	(6,340)	-	-	-
Capitalized engineering costs	(380)	(335)	(656)	(394)	(394)	(394)
Purchase of property and equipment	(288)	(571)	(1,564)	(1,229)	(1,300)	(1,300)
Proceeds from sale of fixed assets	-	-	-	1,671	1,671	-
Deposit for new property and equipment	-	-	-	-	-	-
Net Cash Used in Investing	**(1,118)**	**(9,663)**	**(8,560)**	**48**	**(23)**	**(1,694)**
Proceeds from sales of common stock	997	9,530	-	-	-	-
Costs to raise capital	-	(968)	-	-	-	-
Proceeds from capital lease refinance	-	-	500	-	-	-
Notes payable - sellers	(644)	(691)	(41)	-	-	-
Capital lease obligations	(996)	(143)	(717)	(604)	(1,611)	(1,602)
Notes payable - jr. subordinated debt	-	-	-	-	-	-
Notes payable - revolver	(3,637)	3,142	11,933	(2,668)	(5,268)	(5,200)
Proceeds from notes payable - term loan	-	7,328	3,500	-	-	-
Payments of notes payable - term loan	(1,800)	(913)	(2,030)	(2,445)	(7,388)	-
Proceeds from note payable	-	-	350	1,400	1,400	-
Proceeds from convertible notes payable	-	-	-	-	4,250	-
Deferred financing costs	(102)	(151)	(402)	(199)	(199)	-
Payments related to lease impairment	(85)	(67)	(60)	-	-	-
Expense for issuance of preferred stock	-	-	-	(663)	(663)	-
Proceeds from issuance of preferred stock*	-	-	-	5,250	5,250	6,500
Dividends paid	(1,433)	(3,748)	(4,468)	-	-	-
Net Cash Provided by (Used in) Financing	**(7,700)**	**13,319**	**8,565**	**71**	**(4,229)**	**(302)**
Net Change in Cash	**71**	**857**	**(889)**	**230**	**(234)**	**(25)**
Cash - Beginning of Period	**577**	**561**	**1,418**	**529**	**529**	**295**
Cash - End of Period	**648**	**1,418**	**529**	**759**	**295**	**270**

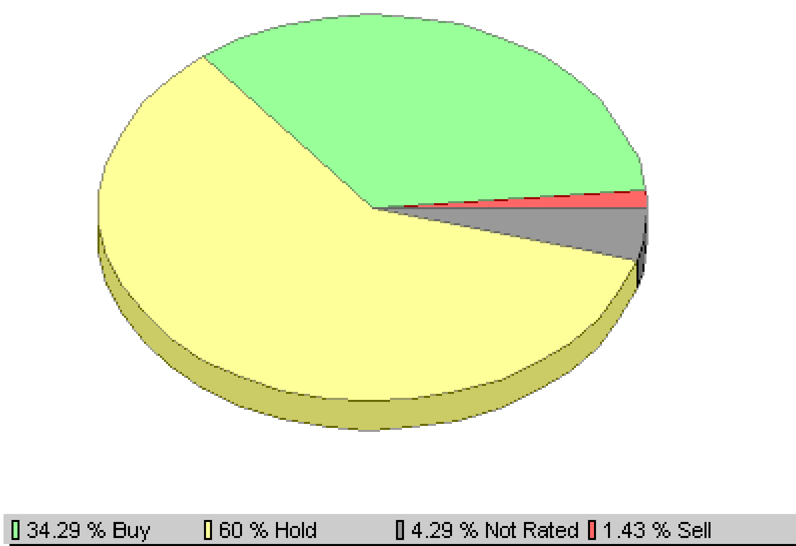
* excludes $1.75 million of additional paid-in capital for preferred stock issued for notes payable -non-cash item

Source: Company filings and Taglich Brothers' estimates

Price Chart



Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	2	7
Hold		
Sell		
Not Rated		

Important Disclosures

As of the date of this report, Taglich Brothers, Inc. and/or its affiliates, own more than 1% of AIRI common stock. Michael Taglich, President of Taglich Brothers, Inc. and Chairman of Air Industries Group, owns or has a controlling interest in 391,223 shares of AIRI common stock, 267,179 shares of convertible preferred stock, 14,500 stock options (right to purchase), and 188,532 warrants. In September 2015, April 2016, May 2016, and August 2016, Michael Taglich loaned the company monies in which he was issued promissory notes from the company. Robert Taglich, Managing Director of Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 408,639 shares of AIRI common stock, 94,436 shares of convertible preferred stock, 14,500 stock options (right to purchase), and 134,451 warrants. In April 2016 and May 2016, Robert Taglich loaned the company monies in which he was issued promissory notes from the company. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 56,042 shares of AIRI common stock and 14,000 warrants. Robert Schroeder, Vice President of Investment Banking at Taglich Brothers, Inc. and a Director of Air Industries Group, owns or has a controlling interest in 51,679 shares of AIRI common stock, 15,250 stock options (right to purchase), and 27,585 warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 13,054 shares of AIRI common stock. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 10,500 AIRI warrants. Taglich Brothers, Inc. owns 17,990 shares of AIRI common stock. Taglich Brothers, Inc. had an investment banking relationship with the company mentioned in this report. In April and May of 2007, Taglich Brothers Inc. served as the placement agent in the sale of convertible preferred stock for the company. In June 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes for the company. In September and October of 2008, Taglich Brothers, Inc. served as the placement agent in the sale of junior subordinated notes and convertible preferred stock for the company. In October 2013 and May 2014, Taglich Brothers, Inc. served as the placement agent in the sale of common stock for the company. In May and June 2016, Taglich Brothers, Inc. served as the placement agent in the sale of convertible preferred stock for the company. In August 2016, Taglich Brothers, Inc. served as the placement agent in the sale of convertible notes for the company.

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

General Disclosures

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

Analyst Certification

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

Public companies mentioned in this report:

Boeing (NYSE: BA)
Heroux-Devtek, Inc. (OTC: HERXF)
Lockheed Martin (NYSE: LMT)
Northrop Grumman (NYSE: NOC)
Triumph Group, Inc. (NYSE: TGI)

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.