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AIR INDUSTRIES GROUP, INC.  
Form 10-K/A  
October 16, 2009

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

FORM 10-K/A  
(Amendment No. 2)

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

For the fiscal year ended December 31, 2007

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-29245

AIR INDUSTRIES GROUP, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
State or other jurisdiction of incorporation or organization

20-4458244  
(I.R.S. Employer Identification No.)

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

11706  
(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
----- None	----- N/A

Securities registered pursuant to section 12(g) of the Act:

Common Stock, \$0.001 par value  
(Title of class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (ss. 229.405 of this chapter) is not contained herein, and

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will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. As of June 30, 2007, the aggregate market value of the common stock of the registrant held by non-affiliates (excluding shares held by directors, officers and others holding more than 5% of the outstanding shares of the class) was \$15,837,736, based upon a closing sale price of \$0.27 as reported by Bloomberg Finance.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. As of March 31, 2008, the registrant had outstanding 69,262,227 shares of common stock.

### DOCUMENTS INCORPORATED BY REFERENCE

None

### Explanatory Note

Air Industries Group, Inc. is filing this amendment to its Annual Report on Form 10-K for the fiscal year ended December 31, 2007 originally filed with the Securities and Exchange Commission on April 14, 2008, as amended on April 17, 2008 (the "Form 10-K"), to amend Item 8. Financial Statements and Supplementary Data to restate its statement of operations for that fiscal year to account for the "beneficial conversion feature" upon the issuance of its Series B Convertible Preferred Stock in April and May of 2007 in response to a letter from the Staff of the Securities and Exchange Commission dated August 29, 2008, and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation to reflect the adjustment relating to that restatement. Additionally, during the preparation of the Company's December 31, 2008 consolidated financial statements, the Company discovered that certain expenses which should have been included in cost of goods sold were classified as a reduction of accounts payable and accrued expenses and therefore both cost of goods sold and accounts payable and accrued expenses has been understated by a like amount. The aggregate effect is to reduce the net income of the Company for the year ended December 31, 2007 and to reduce stockholders' equity of the Company at December 31, 2007. As a result of the restatement, Air Industries Group, Inc. had a net loss attributable to common stockholders of \$(1,782,017), or \$(0.03 per share), for the year ended December 31, 2007 instead of net income attributable to common stockholders of \$233,858 or \$0.00 per share, as previously reported in the Form 10-K. In addition, in connection with the filing of this amendment and pursuant to the rules of the Securities and Exchange Commission, we are including with this amendment certain currently dated

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certifications. Accordingly, Item 15 of Part IV has also been amended to reflect the filing of these currently dated certifications.

Except as described above, no other changes have been made to the Form 10-K. All capitalized or other defined terms used in the Form 10-K have the same meaning in this amendment. This amendment continues to speak as of the date of the filing of the Form 10-K and we have not updated the disclosures contained therein to reflect any events that occurred subsequent to that date. The filing of this Form 10-K/A is not a representation that any statements contained in items of Form 10-K other than Part II, Items 7 and 8 are true or complete as of any date subsequent to the date of the filing of the Form 10-K.

### PART II

#### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

The following discussion of our results of operations constitutes management's review of the factors that affected our financial and operating performance for the years ended December 31, 2007 and 2006. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report.

#### General

AIM has evolved from being an individual parts manufacturer to being a manufacturer of subassemblies (i.e. being an assembly constructor) and being an engineering integrator. AIM currently produces over 2,400 individual products (SKU's) that are assembled by a skilled labor force.

Sigma Metals distributes aluminum, stainless, and titanium raw materials for the aerospace industry to customers in the United States, Europe and Asia. These materials are sold to Major Aerospace Manufacturers and their lower tier supply chain companies, and are incorporated into products produced by Sikorsky, Lockheed Martin, Boeing and Northrop Grumman and others.

Welding Metallurgy is a supplier of welded assemblies and performs tube bending, sheet metal fabrication and precision assembly. Welding Metallurgy also manufactures components for various subsectors of the commercial and military aerospace industry. Its customers include Sikorsky, Lockheed Martin, Boeing and Northrop Grumman.

Sales of parts and services to one customer accounted for 46% of AIRI's revenue in 2007, and are subject to General Ordering Agreements which were recently renegotiated and extended through 2012.

#### Results of Operations

We completed the acquisition of Sigma Metals on April 16, 2007, and the acquisition of Welding Metallurgy on August 26, 2007; consequently, the results of Sigma and Welding Metallurgy from April 17, 2007, and August 27, 2007, respectively, are included in our financial statements for the year ended December 31, 2007, and reflected in the discussion below.

Year ended December 31, 2007 compared with year ended December 31, 2006

#### Segment Data

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We follow SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS No. 131), which establishes standards for reporting information about operating segments in annual and interim financial statements, and requires that companies report financial and descriptive information about their reportable segments based on a management approach. SFAS No. 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. As a result of the acquisition of Sigma in April 2007 and Welding Metallurgy in August 2007, we have three reportable segments: Air Industries Machining, Sigma Metals and Welding Metallurgy. Air Industries Machining is primarily engaged in processing, cutting, milling, machining and hardening metals into assemblies that are widely used in the aerospace industry. Sigma Metals is a supplier of sheet metal, plate, forgings and bar stock to converters who supply parts to major domestic and international aerospace customers. Welding Metallurgy is a fabricator of parts primarily used in the defense industry. Welding specializes in complex welding applications and in tubular structures.

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

We are in the process of integrating Sigma Metals and Welding Metallurgy into our fully integrated Enterprise Resource Program for operational and financial control. This process is expected to be completed by the end of the second quarter of 2008 and will enable our management to have more accurate and current information when making decisions concerning sales, product pricing and the reasonableness of related costs.

As a result of the acquisitions of Sigma Metals and Welding Metallurgy our customer base has become more diversified and less dependent on one major customer whose pre-acquisition percentage of revenue was in excess of 70% and is now on a post-acquisition basis approximately 46%.

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The following table sets forth, for the periods indicated, certain components of our statements of operations

	Year Ended December 31,	
	2007	2006
Air Industries Machining	Restated	
Revenue	\$ 34,088,056	\$ 33,044,996
Gross Profit	7,687,817	5,042,054
Pre Tax Income	2,739,500	1,563,036
Assets	31,304,053	24,576,329
Sigma Metals		
Revenue	9,890,659	--
Gross Profit	2,781,253	--
Pre Tax Income	303,996	--
Assets	11,463,079	--
Welding Metallurgy		
Revenue	2,089,930	--

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	Gross Profit	1,588,347	--
	Pre Tax Income	1,026,715	--
	Assets	8,425,658	--
 Corporate			
	Revenue	--	--
	Gross Profit	--	--
	Pre Tax Income	(3,503,866)	(1,409,636)
	Assets	22,962,665	8,333,815
 Consolidated			
	Revenue	46,068,645	33,044,996
	Gross Profit	12,057,417	5,042,054
	Pre Tax Income	566,344	153,400
	Provision for Taxes	365,319	489,969
	Net Income	201,025	(336,569)
	Elimination of Assets	(23,865,005)	(8,017,962)
	Assets	50,290,040	24,892,182

In the paragraphs below, the numbers for 2007 reflect the consolidated results of our operations for 2007.

Net sales were \$46,068,645 for the year ended December 31, 2007, or Fiscal 2007, an increase of \$13,023,649, or 39%, from net sales of \$33,044,996 for the year ended December 31, 2006, or Fiscal 2006. This increase was attributable to the consolidation of \$11,980,589 of net sales from Sigma and Welding Metallurgy from April 16, 2007 and August 27, 2007, respectively, augmented by an increase in net sales at AIM of \$1,043,060. The increase in net sales at AIM reflects a slight increase in price being paid by our largest customer and an increase in overall unit volume.

Gross profit was \$12,057,417 in Fiscal 2007 (26.2% of net sales), compared to gross profit of \$5,042,054 in Fiscal 2006 (15.3% of net sales). The increase in gross profit is primarily attributable to the revenues of Sigma Metals (\$9,890,659) and Welding Metallurgy (\$2,089,930). The increase in gross profit as a percentage of sales reflects the continuation of the shift in our production to higher margin military products.

Selling and marketing expenses were \$1,476,111 in Fiscal 2007, an increase of \$875,100 (145.6%) from selling and marketing expenses of \$601,011 in Fiscal 2006. This increase was attributable to inclusion of selling expenses of Sigma Metals (\$963,705) and Welding Metallurgy (\$15,284), partially offset by reductions in field engineering and out bound freight expenses.

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General and administrative expenses were \$8,418,508 in Fiscal 2007, an increase of \$4,628,921 (122%) from general and administrative expenses of \$3,789,587 in Fiscal 2006. The increase was primarily due to inclusion of general and administrative expenses of Sigma Metals (\$1,405,910) and Welding Metallurgy (\$336,976). This increase also reflects (i) a reclassification of the cost of certain management personnel to better reflect their functions, (ii) professional fees attributable to our reporting requirements as a public company (\$365,678) and (iii) preparations for compliance with Sarbanes-Oxley (\$340,000). Fiscal 2007 also reflects an increase in non-cash compensation charges resulting from the grant of options to management under our Stock Incentive Plan (\$406,210). In addition, we incurred additional bad debt expense in 2007 as compared to 2006 (\$200,000) based upon managements' assessment of the collectability of certain outstanding receivables.

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Interest and financing costs was \$1,578,337 in Fiscal 2007, an increase of \$538,229 (52%) from interest and financing costs of \$1,040,108 in Fiscal 2006. This increase is attributable to borrowings relating to the acquisition of Sigma Metals and Welding Metallurgy in Fiscal 2007, higher interest rates and borrowings for operations at Sigma and Welding Metallurgy.

Other income and other expense was \$56,113 in Fiscal 2007 a decrease of \$245,081 (130%) and primarily reflects the 2006 present value gain realized as a result of the sale and lease-back transaction for our real estate.

Income Before Provision for Income Taxes was \$566,344 in Fiscal 2007, an increase of \$412,944 (269%) from income before income taxes of \$153,400 in Fiscal 2006. The increase in income during Fiscal 2007 resulted primarily from the impact on AIRI's business of the acquisitions of Sigma and Welding Metallurgy offset in part by expenses incurred by us to comply with our reporting obligations as a public entity.

Provision for Income Taxes decreased to \$365,319 for Fiscal 2007, as compared to \$489,969 for Fiscal 2006, primarily reflecting the taxes payable as a result of our net income for the reasons discussed above.

### Impact of Inflation

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

### Liquidity and Capital Resources

Since the PNC Loan Facility requires that all cash at our operating subsidiaries be swept on a daily basis to our loan accounts, at December 31, 2007 and December 31, 2006, we had no cash or cash equivalents. At December 31, 2007, we had working capital of \$5,272,485 as compared to working capital of \$4,911,354 as of December 31, 2006. This increase reflects the proceeds of the placement of our series B convertible preferred stock, offset by the cash used to acquire Sigma and Welding Metallurgy (\$4,060,796 and \$ 3,500,000 respectively) and our negative cash flows from operations during the year ended December 31, 2007. It should be noted that included in current liabilities is an aggregate of \$16,488,000 payable to our bank lenders. Under the terms of our loan agreements these amounts are not payable until April 30, 2010 and August 24, 2010, respectively, but have been included in current liabilities due to the right of the banks to demand immediate repayment as a result of the subjective nature of the acceleration clause upon the occurrence of certain events, which management believes are not likely to occur, combined with the existence of a lockbox arrangement. We believe that our cash requirements for operations in the next twelve months will be met by revenues from operations, cash reserves, and amounts available under the PNC Loan Facility.

As of December 31, 2007, our outstanding debt consisted of \$16,489,046 under our loan facility made up of \$15,960,716 classified as short-term and \$528,330 classified as long-term. Notes payable to the former shareholders of our subsidiaries AIM, Sigma and Welding of \$3,938,832 are classified as \$1,435,796 short-term and \$2,503,036 as long-term. Capital lease obligations of \$1,478,791 are classified as \$290,285 short-term with the remaining balance of \$1,188,506 classified as long-term. Additionally at December 31, 2007 there was a standby letter of credit outstanding in the amount of \$127,500. In addition, reflecting the sale leaseback of AIM's corporate campus, we now pay approximately \$45,000 per month as rent, plus \$15,662 to fund real estate tax escrow accounts and other reserves held by the landlord.

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We used \$5,948,396 in operations during the year ended December 31, 2007. The use of cash in operations reflects an increase in inventory of \$3,323,195, an increase in our deposits with vendors of \$724,607, a decrease in prepaid expenses of \$47,643, and a decrease in our accounts payable and accrued expenses of \$2,431,218. The increase in our inventory and decrease in our accounts payable noted above are associated with our pre-existing operations and do not reflect the changes resulting from the acquisitions of Sigma and Welding Metallurgy. The increase in the inventory in our pre-existing operations is primarily related to the need to support the increase in contractual business space for follow-on contracts in 2008 as well substantial activity in new business products. The additional increase in inventory reflected on our balance sheet results primarily from the acquisition of our metals and welding operations. The increase in deposits with vendors and decrease in accounts payable are due to advanced payment requirements imposed by certain suppliers of our pre-existing operations. As a result of efforts to reduce amounts due these suppliers, we anticipate that they may not require prepayments in the immediate future.

In addition to the foregoing uses of cash, during 2007 AIM had capitalized development costs in the amount of \$1,533,215 in connection with engineering and tooling outlays related to its successful efforts to win certain long-term contracts. Included in these projects are contracts for Goodrich Landing Gear related to the A380, Boeing, Latacoere and Sikorsky.

In connection with the acquisition of Air Industries Machining Corp., we paid the sellers \$2,040,103 in cash and incurred notes payable obligations to the sellers in the aggregate principal amount of \$1,627,262, of which \$665,262, plus accrued interest of \$54,511 were in the form of convertible promissory notes which were converted by the holders into 1,799,432 shares of common stock at a conversion price of \$0.40 per share on January 26, 2007. The remaining principal amount, \$625,300, is payable in equal quarterly installments of \$48,100 of principal, plus interest through March 2011.

In connection with the acquisition of Sigma Metals, we paid the sellers \$4,060,796 in cash and incurred notes payable obligations to the former shareholders of Sigma Metals in the aggregate principal amount of \$1,497,411. The remaining principal balance as of December 31, 2007 is \$1,216,488, and is payable in equal monthly installments of \$43,446 of principal plus interest, through 2010, except that in April 2008 \$247,090 was prepaid on the notes due the former shareholders.

In connection with the acquisition of Welding Metallurgy, we paid the sellers \$3,500,000 in cash and incurred a notes payable obligation to the former shareholders of Welding Metallurgy in the aggregate principal amount of \$2,000,000, which bears no interest until August 24, 2008, and bears interest thereafter at 7% per annum. To reflect the fact that this note does not bear interest for the first year, we have discounted the value of the note in our balance sheet to \$1,860,000, and will expense the imputed interest on a monthly basis and accrete up the value of the note to its face value of \$2,000,000. The balance of this note at December 31, 2007 was \$1,906,667. The indebtedness evidenced by this note is subordinate to our indebtedness to PNC and SCCF and is payable in one installment in the principal amount of \$500,000 due on August 24, 2008 and twelve consecutive quarterly installments of principal in the amount of \$125,000, plus accrued interest, commencing on November 30, 2008 and continuing through August 31, 2011. Under the stock purchase agreement, we are obligated to pay the sellers an additional \$190,377 as an adjustment to the purchase price. We have agreed to pay this adjustment to the purchase price in four equal monthly installments of \$49,400 (which amount includes interest of 7% per annum from November 1, 2007) commencing on March 31, 2008 and on the last day of each calendar month thereafter through June 30, 2008.

The terms of the PNC Loan Facility are described in the notes to our

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consolidated financial statements included in this report. Under the PNC Loan Facility, as of December 31, 2007, we had revolving loan balances of \$11,332,940, a term loan balance of \$244,906, and an equipment loan balance of \$411,200 as compared to balances of \$5,027,043; \$362,034 and \$411,200 as of December 31, 2006. In addition, as of December 31, 2007 we had capital lease obligations to other parties totaling \$1,478,791.

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To finance the acquisition of Sigma Metals and to provide us with additional working capital and funds for future acquisitions, we completed a private placement of our series B convertible preferred stock in which we raised gross proceeds of \$8,023,000. A first closing, in which we received gross proceeds of \$4,955,000 occurred simultaneously with the acquisition of Sigma Metals and was entirely devoted to the acquisition. A second closing occurred on May 3, 2007, in which we received gross proceeds of \$3,068,000. The holders of the series B preferred stock are entitled to a cumulative annual dividend of 7% per annum, which we have the right to pay in additional shares of series B preferred stock, except under certain circumstances. In October 2007 and January 2008, we issued an aggregate of 26,798 and 16,456 shares of series B preferred stock in payment of accrued dividends. The shares of series B preferred stock issued in the offering and in payment of accrued dividends are convertible into approximately 30,439,944 shares of our common stock. On April 1, 2008, our Board declared a dividend on our series B convertible preferred stock, payable in 19,825 additional shares of series B convertible preferred stock.

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

In connection with the acquisition of Welding Metallurgy, the terms of the PNC Loan Facility were amended and modified to include Welding Metallurgy as a borrower and Air Industries Group and Welding Metallurgy as guarantors of amounts due under the PNC Loan Facility. In connection with that amendment, Welding Metallurgy pledged all of its assets and properties to PNC to secure its obligations under the PNC Loan Facility. The maximum revolving advance amount was increased by an additional \$3,000,000 to \$14,000,000.

Additionally, in connection with the Welding Metallurgy acquisition, Steel City Capital Funding LLC, or SCCF provided a Term Loan of \$4,500,000. The Term Loan is payable on August 24, 2010. Borrowings under the SCCF Loan Agreement bear interest, payable monthly, generally at a rate of 6% over the base commercial lending rate of PNC Bank as publicly announced to be in effect from time to time. Under the terms of our loan agreements these amounts are not payable until August 24, 2010, but have been included in current liabilities due to the right of the banks to demand immediate repayment as a result of the subjective nature of the acceleration clause upon the occurrence of certain events, which management believes are not likely to occur, combined with the existence of a lockbox arrangement. In addition, to secure the obligations due SCCF, we pledged to SCCF the capital stock of Air Industries Machining Corp, Sigma Metals, and Welding Metallurgy, and each of those entities granted to SCCF a security interest on all of their assets.

During the year ended December 31, 2007, borrowings under the PNC Loan Facility increased by \$6,305,477. These funds were used to reduce a trade



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payable (\$2,431,218), for production engineering (\$1,533,215), to purchase raw materials inventory (\$1,186,256) and to pay taxes (\$509,165).

As of December 31, 2007, two customers accounted for approximately 22% and 11% of our accounts receivable. In addition, these customers accounted for approximately 46% and 11% of net sales, respectively, for the year ended December 31, 2007. In the event either of such customers is unable or unwilling to pay amounts due or in the event our relationships with such customers are severed or negatively affected, our results of operations will be materially adversely affected and we may not have the resources to meet our capital obligations.

### Agreement for the Acquisition of the Blair Companies

On November 15, 2007, we entered into a Stock Purchase Agreement (the "Blair Purchase Agreement") with the shareholders of Blair Industries, Inc., a New York corporation, Blair Accumulators, Inc., a New York corporation, H.S.M. Machine Works, Inc., a New York corporation, and H.S.M. Machine Works, Inc., a North Carolina corporation (collectively, the "Blair Companies") to acquire all of outstanding capital stock of the Blair Companies.

Founded in 1951, the Blair Companies produce structural landing gear components; complex airframe machined parts, as well as hydraulic components. In 1979 the Blair Companies expanded their operations to include hydraulic actuators, mechanical assemblies, a wide variety of kits, and complete landing gear assemblies. Currently, they also design and manufacture fully dressed landing gear and other structural and hydraulic components primarily for commercial and military aircraft. The Blair Companies operate out of one facility in Medford, Long Island, New York, and another facility in Leland, North Carolina. For over 10 years, Blair has been a certified supplier for Goodrich Landing Gear, the world's largest provider of landing gear to the aerospace industry's prime contractors, and maintains similar standing with France-based Messier-Dowty, the world's second largest provider of landing gear.

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We believe the acquisition of the Blair Companies will facilitate and accelerate our transition from basic contract manufacturing to becoming a provider of comprehensive integration services, particularly for fully dressed landing gear and provide us with expanded capabilities and a high-end customer base for landing gear and other critical flight safety components and assemblies.

The purchase price for the Blair Companies is \$16,358,000, subject to adjustment based upon the Net Asset Value (as defined in the Blair Purchase Agreement) of the Blair Companies as of the date of closing. The purchase price is payable in a combination of cash, promissory notes and shares of our preferred stock having a liquidation value of \$1,000,000. However, we are engaged in discussions with the shareholders of the Blair Companies to eliminate the preferred stock as part of the purchase price and with respect to certain other terms. The promissory notes will have a term of five years commencing on the date of closing, accrue interest at rates of four percent (4%) per annum, as to promissory notes in the initial principal amount of \$1,358,000, and eight percent (8%) per annum, as to principal notes in the initial principal amount of \$5,000,000, and contain other customary terms and conditions.

The closing is subject to certain conditions including, but limited to, our ability to secure not less than \$12 million in debt or equity financing. We have agreed to pay the shareholders of the Blair Companies a break-up fee of \$150,000 under certain circumstances.

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Concurrent with the closing, we will enter into employment agreements with one of the shareholders and a key employee of the Blair Companies. The employment agreements provide for annual base salaries aggregating initially to \$400,000, together with certain bonuses based upon performance and customary increases. The employment agreements will contain customary terms and provisions relating to severance, benefits and vacation. One of the employment agreements will have an initial term of five (5) years and the other employment agreement will have an initial term of three (3) years.

We cannot assure you that (i) we will be successful in negotiating an amendment to the Blair Purchase Agreement on terms favorable to us, if at all, (ii) we will be able to obtain the financing to complete the acquisition on terms favorable to us, if at all, or (iii) even if we are able to amend the Blair Purchase Agreement and obtain a commitment for financing, we will be able to complete the acquisition. See Item 1A ("Risk Factors") under the risks captioned "Our indebtedness may affect operations," "We may issue shares of our capital stock to complete an acquisition, which would reduce the equity interest of our stockholders" and "We may issue our debt securities to complete an acquisition, and if we are unable to generate sufficient cash flow from operations to satisfy the debt service associated with that indebtedness, our inability to do so may force us to sell assets and restrict our ability to obtain additional financing or place onerous restrictions on our operations."

### Restatement of Quarterly Operating Results (unaudited)

We have made certain adjustments, described below, to our balance sheet as of December 31, 2007 and our results of operations previously reported in our Form 10-K for the year ended December 31, 2007 and Form 10-QSBs for the first three fiscal quarters of 2007. These adjustments were the result of:

- o our determination to capitalize certain amounts related to development expenditures made in the first three quarters of 2007 previously expensed and the completion of the allocation of the purchase price we paid for Sigma Metals and Welding Metallurgy among certain intangible assets of those companies that initially had been allocated to goodwill. These adjustments were previously included on our Form 10K filed on April 14, 2008, for the year-ended December 31, 2007. These adjustments have been audited by McGladrey & Pullen, LLP and are indicated in the tables below as adjustment (1) and (2).
- o our determination to make certain adjustments to our statement of operations to account for the "beneficial conversion feature" upon the issuance of our Series B Preferred Stock issued in the second quarter of 2007, following our receipt of a letter from the Staff of the Securities and Exchange Commission dated August 29, 2008, requesting information with respect to the accounting treatment of the Series B Preferred Stock. This adjustment was previously included on our Form 10Q filed on November 19, 2008 under the caption, restated statement of operations for the nine months ended September 30, 2007. This adjustment reduces the Net Income Available to Common Shareholders by \$1,589,000. This adjustment has been audited by McGladrey & Pullen, LLP and is indicated in the tables below as adjustment (3).
- o our discovery that certain expenses in the amount of \$673,229 which should have been included in cost of goods sold were classified as a reduction of accounts payable and accrued expenses, resulting in the understatement of cost of goods sold and accounts payable and accrued expenses by a like amount. Additionally the results of this adjustment created an income tax benefit in the amount of \$246,354. The aggregate effect of which is to reduce our net income for the year ended December 31, 2007 and to reduce our stockholders' equity at December 31, 2007 by \$426,875. This adjustment

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has been audited by Rotenberg Meril Solomon Bertiger & Guttilla PC and are indicated in the tables below as adjustment (4).

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### Balance Sheet Restated Items

	2007 as filed	adjustments	Note	2007 restated
	-----	-----	----	-----
Accounts Payable and Accrued expenses	\$ 6,549,122	\$ 673,229	(4)	\$ 7,222,351
Income Taxes Payable	390,615	(246,354)	(4)	144,261
Accumulated Deficit	\$ (458,373)	\$ (426,875)	(4)	\$ (885,248)

	2007 As Filed	Adjustments	Note	2007 Adjusted
	-----	-----	----	-----
Net Income	\$ 46,068,645	\$ --		\$ 46,068,645
Cost of Sales	33,337,999	673,229	(4)	34,011,228
Gross Profit	12,730,646	673,229		12,057,417
Cost and expenses	9,894,619	--		9,894,619
Operating Income	2,836,027	673,229		2,162,798
Interest and amortization costs	1,578,377	--		1,578,377
Other (Income) Expenses	18,077	--		18,077
Income before income taxes	1,239,573	(673,229)		566,344
Income tax provision	611,673	(246,354)	(4)	365,319
Net (Loss) Income	627,900	(426,875)		201,025
Less: Dividend attributable to preferred stockholders	394,042	--		394,042
Less: Beneficial conversion Feature	--	1,589,000	(3)	1,589,000
Net (loss) income attributable to common stockholders	\$ 233,858	\$ (1,548,158)		\$ (1,782,016)
Loss per common share:	--	--		--
Net loss per common share (Basic)	\$ 0.00	--		\$ (0.03)
Net loss per common share (Diluted)	\$ 0.00	--		\$ (0.03)
Weighted average shares outstanding (Basic)	65,402,711	--		65,402,711
Weighted average shares outstanding (Diluted)	67,861,015	--		65,402,711

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	Q1 2007 as filed	Adjustments	Notes	Q1 2007 Adjusted	Q2 2007 as filed
Net Income	\$ 7,488,130	\$ --		\$ 7,488,130	\$ 10,989,536
Cost of Sales	6,239,484	(418,014)	(1)	--	8,616,698
	--	(88,169)	(4)	5,733,301	--
Gross Profit	1,248,646	506,183		1,754,829	2,372,838
Cost and expenses	1,126,792	--		1,126,792	2,330,498
Operating Income	121,854	506,183		628,037	42,340
Interest and amortization costs	130,954	--		130,954	280,869
Other (Income) Expenses	(2,377)	--		(2,377)	(1,224)
Income before income taxes	(6,723)	506,183		499,460	(237,305)
Income tax provision	64,764	194,430	(1)	--	78,138
	--	41,046	(4)	300,240	--
Net (Loss) Income	(71,487)	270,707		199,220	(315,443)
Less: Dividend attributable to preferred stockholders	--	--		--	110,964
Less: Beneficial conversion Feature	--	--		--	--
Net (loss) income attributable to common stockholders	(71,487)	270,707		199,220	(426,407)
Loss per common share:					
Net loss per common share (Basic)	\$ (0.00)			\$ 0.00	\$ (0.01)
Net loss per common share (Diluted)	\$ (0.00)			\$ 0.00	\$ (0.01)
Weighted average shares outstanding (Basic)	58,833,681			58,833,681	65,667,564
Weighted average shares outstanding (Diluted)	58,833,681			60,202,835	65,667,564

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	Q3 2007 as filed	Adjustments	Notes	Q3 2007 Adjusted	Q4 2007 as filed
Net Income	\$ 12,845,821	\$ --		\$ 12,845,821	\$ 14,745,158
Cost of Sales	9,254,338	(456,336)	(1)	--	10,536,063
	--	38,222	(4)	8,836,224	--
Gross Profit	3,591,483	418,114		4,009,597	4,209,065
Cost and expenses	2,617,134	112,921	(1) (2)	2,730,055	3,651,393
Operating Income	974,349	305,193		1,279,542	557,702
Interest and amortization costs	478,920	--		478,920	687,634
Other (Income) Expenses	26,074	--		26,074	(4,396)

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Income before income taxes	469,355	305,193		774,548	(125,536)
Income tax provision	46,761	159,757	(1) (2)	188,737	(108,217)
	--	(17,781)	(4)	--	--
Net (Loss) Income	422,594	163,217		585,811	(17,319)
Less: Dividend attributable to preferred stockholders	136,578	--		136,578	146,500
Less: Beneficial conversion Feature	--	--		--	--
Net (loss) income attributable to common stockholders	\$ 286,016	\$ 163,217		449,233	(163,819)
Loss per common share:					
Net loss per common share (Basic)	\$ 0.00			\$ 0.01	\$ (0.00)
Net loss per common share (Diluted)	\$ 0.00			\$ 0.01	\$ (0.00)
Weighted average shares outstanding (Basic)	67,838,959			67,838,959	69,122,227
Weighted average shares outstanding (Diluted)	70,734,615			70,734,615	70,738,078

(1) The adjustments to Cost of Sales relates to our determination to capitalize certain engineering costs initially expensed.

(2) The adjustments to costs and expenses relate to the amortization of amounts attributable to intangibles that have been specifically identified among the assets of Sigma and Welding Metallurgy that initially had been included in goodwill.

As of June 30, 2007 and September 30, 2007, \$3,720,000 and \$2,434,225 was reclassified from goodwill to intangibles, respectively, related to the completion of the allocation of purchase prices. There was no impact on cash flow for any of the periods.

(3) The beneficial conversion feature adjustment arises as the conversion price of the convertible preferred stock is less than the fair value of the common shares into which it is convertible.

(4) The adjustment to Cost of Sales relates to certain expenses which should have been included in cost of goods sold were classified as a reduction of accounts payable and accrued expenses.

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#### Critical Accounting Policies

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

#### Inventory Valuation

We value inventory at the lower of cost on a first-in-first-out basis or market.

AIM purchases inventory only when it has signed non-cancellable contracts

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with its customers for orders of its finished goods. Welding Metallurgy generally produces pursuant to customer orders and maintains relatively low inventory levels. AIM occasionally produces finished goods in excess of purchase order quantities in anticipation of future purchase order demands but historically this excess has been used in fulfilling future purchase orders. Sigma routinely acquires inventory without corresponding purchase orders. We periodically evaluate inventory items that are not secured by purchase orders and establish reserves for obsolescence accordingly. We also reserve an allowance for excess quantities, slow-moving goods, and obsolete items.

### Capitalized Pre Production Costs

We have contractual agreements with certain customers to produce parts, which the customers design. The production of these parts require pre-production engineering and programming of our machines. We account for these pre-production costs pursuant to Emerging Issues Task Force Issue No. 99-5, "Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements" (EITF 99-5). The pre-production costs associated with a particular contract are capitalized and beginning with the first shipment of product pursuant to such contract, amortized over a period determined as follows: (i) if deliverables are scheduled for a period of three years or less, on a straight line basis over the anticipated length of the contract and (ii) if deliverables are scheduled for more than three years, on a straight line basis over three years. If we were to be reimbursed for a portion of the pre-production expenses associated with a particular contract only the unreimbursed portion would be capitalized under EITF 99-5. We also may progress bill on certain engineering being expended. These 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 our customer purchase orders 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." We generally recognize 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 advance payments until earned, at which time revenue is recognized. Air Industries utilizes a return merchandise authorization procedure for determining whether to accept returned products. Customer requests to return products are reviewed by the contracts department and if the request is approved credit is issued upon receipt of the product. Revenues are recorded net of returns and allowances.

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### Income Taxes

Income taxes are calculated using an asset and liability approach as prescribed by SFAS No. 109, Accounting for Income Taxes. The provision for income taxes includes federal and state taxes currently payable and deferred taxes, due to temporary differences between financial statement and tax bases of assets and liabilities. In addition, future tax benefits are recognized to the extent that realization of such benefits is more likely than not. Valuation allowances are established when management determines that it is more likely than not that some portion or all of the deferred asset will not be realized. The effect of a change in tax rates is recognized as income or expense in the period of change.

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### Stock-Based Compensation

In December 2004, the FASB issued SFAS 123(R) which is a revision of SFAS No.123 and supersedes Accounting Principles Board Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant. We recorded an expense of \$437,202 and \$167,126 for the years ended December 31, 2007 and 2006, respectively, in accordance with the measurement requirements under SFAS No. 123(R)

### Goodwill

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. We apply SFAS No. 142, Goodwill and Other Intangible Assets and accordingly do not amortize goodwill but test it for impairment. The Company performs impairment testing for goodwill annually, or more frequently when indicators of impairment exist, using a two-step approach. 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.

The fair values of the reporting units were determined using a combination of valuation techniques consistent with the income approach. For purposes of the income approach, discounted cash flows were calculated by taking the net present value of estimated cash flows using a combination of historical results, estimated future cash flows and an appropriate price to earnings multiple. We use our internal forecasts to estimate future cash flows and actual results may differ from forecasted results. However, these differences have not been material and we believe that this methodology provides a reasonable means to determine fair values. Cash flows were discounted using a discount rate based on expected equity return rates, which ranged from 12.61% to 14.73% for 2007. Our evaluations for the year ended December 31, 2007 indicated there was no impairment of our Goodwill.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Our primary exposure to market risk consists of changes in interest rates on borrowings under the loan facility. An increase in interest rates would adversely affect our operating results and the cash flow available after debt service to fund operations. We manage exposure to interest rate fluctuations by optimizing the use of fixed and variable rate debt. Except with respect to the interest rates under the loan facility, we do not have debts or hold instruments that are sensitive to changes in interest rates, foreign currency exchange rates or commodity prices.

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### Item 8. Financial Statements and Supplementary Data.

The financial information required by this item is set forth beginning on page F-1 and is incorporated herein by reference.

### PART IV

### Item 15. Exhibits, Financial Statement Schedules.

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Documents filed as part of this Report:

1. Financial Statements

Our consolidated financial statements required by this Item are submitted in a separate section beginning on page F-1 of this Report

2. Financial Statement Schedules:

None

3. Exhibits

Exhibit No.	Description
-----	-----
2.1	Debtor's Amended Plan of Reorganization (incorporated by reference to Exhibit 2.1 of Registrant's Form 8-K, filed January 14, 2005).
2.2	Merger Agreement, dated as of November 14, 2005, among Gales Industries Incorporated, two of its stockholders, Gales Industries Merger Sub, Inc., and Ashlin Development Corporation (incorporated herein by reference to Exhibit 10.1 of Registrant's Form 8-K report filed November 21, 2005).
3.1	Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K report, filed February 15, 2006).
3.2	Certificate of Amendment to Certificate of Incorporation changing our corporate name (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K report, filed July 2, 2007).
3.3	Certificate of Amendment to Certificate of Incorporation increasing the number of shares of our authorized capital stock (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K report, filed April 7, 2008).
3.4	By-Laws of the Registrant (incorporated by reference to Exhibit 3.2 of the Registrant's Form 8-K report, filed February 15, 2006).
4.2	Form of Convertible Promissory Note, dated November 30, 2005, in the amount of \$332,631, from Gales Industries Incorporated (and assumed by the Registrant) to each of Peter Rettaliata and Dario Peragallo (incorporated by reference to Exhibit 4.2 of the Registrant's Form 8-K report, filed December 6, 2005).
4.3	Form of Warrant issued by the Registrant to GunnAllen Financial, Inc. after completion of the Offering (incorporated by reference to Exhibit 4.3 of the Registrant's Form 8-K report, filed December 6, 2005).
4.4	Form of Warrant issued by Original Gales to Atlas Private Equity, LLC (and assumed by the Registrant) (Incorporated by reference to Exhibit 4.4 of the Registrants Form 10-KSB, filed April 17, 2006).
4.5	Form of Warrant issued by Gales Industries Incorporated (and



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assumed by the Registrant) to investors in the \$45,000 Bridge Financing in or about August 2005 (incorporated by reference to Exhibit 4.5 of the Registrant's Form 8-K report, filed December 6, 2005).

- 4.6 Form of Warrant issued by Gales Industries Incorporated (and assumed by the Registrant) to investors in the \$105,000 Bridge Financing in or about September, 2005 (incorporated by reference to Exhibit 4.6 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.7 Form of Warrant issued and to be issued to Porter, LeVay & Rose, Inc. (incorporated herein by reference to the exhibit of the same number to Registrant's Amendment No. 1 on Form SB-2/A, filed June 16, 2006).

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- 4.8 Certificate of Designation (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.1 Asset Purchase Agreement between the Registrant and TeeZee, Inc. dated October 15, 2004 (incorporated by reference of the Registrant's Report on Form 8-K, filed on January 14, 2005).
- 10.2 Stock Purchase Agreement, dated as of July 25, 2005, by and among Gales Industries Incorporated, Air Industries Machining, Corp., Luis Peragallo, Jorge Peragallo, Peter Rettaliata and Dario Peragallo (incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.3 Secured Subordinated Promissory Note, dated November 30, 2005, in the amount of \$962,000, from Gales Industries Incorporated (and assumed by the Registrant) to Luis Peragallo (incorporated by reference to Exhibit 10.3 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.4 Security Agreement, dated as of November 30, 2005, by and between Gales Industries Incorporated (and assumed by the Registrant) and Luis Peragallo (incorporated by reference to Exhibit 10.4 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.5 Contract of Sale, dated as of November 7, 2005, by and between DPPR Realty Corp. and Gales Industries Incorporated for the purchase of the property known as 1480 North Clinton Avenue, Bay Shore, NY (incorporated by reference to Exhibit 10.5 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.6 Contract of Sale, dated as of November 7, 2005, by and between KPK Realty Corp. and Gales Industries Incorporated for the purchase of the property known as 1460 North Fifth Avenue and 1479 North Clinton Avenue, Bay Shore, NY (incorporated by reference to Exhibit 10.6 of the Registrant's Form 8-K Report, filed December 6, 2005).
- 10.7 Employment Agreement, dated as of September 26, 2005, by and between Gales Industries Incorporated (and assumed by the Registrant) and Michael A. Gales (incorporated by reference to

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- Exhibit 10.7 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.8 Employment Agreement, dated as of September 26, 2005, by and between Louis A. Giusto and Gales Industries Incorporated (and assumed by the Registrant) (incorporated by reference to Exhibit 10.8 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.9 Employment Agreement, dated as of September 26, 2005, by and among Gales Industries Incorporated (and assumed by the Registrant), Air Industries Machining, Corp. and Peter D. Rettaliata (incorporated by reference to Exhibit 10.9 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.10 Employment Agreement, dated as of September 26, 2005, by and among Gales Industries Incorporated (and assumed by the Registrant), Air Industries Machining, Corp. and Dario Peragallo (incorporated by reference to Exhibit 10.10 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.11 Form of Placement Agency Agreement, dated as of September 26, 2005, between GunnAllen Financial Inc. and Gales Industries Incorporated (including Amendments No.1 and No.2 thereto, dated October 25, 2005 and November 10, 2005, respectively). (Incorporated by reference to Exhibit 10.11 of Registrant's registration statement on Form SB-2, No. 333-131709, filed on February 9, 2006).
- 10.12 Registrant's 1998 Stock Option Plan (incorporated by reference to Exhibit 10.18 of the Registrant's annual report on Form 10-KSB, filed April 12, 2002).
- 10.13 2005 Stock Incentive Plan (incorporated by reference to Exhibit 10.14 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.14 Stock Option Agreement, dated as of September 26, 2005, by Gales Industries Incorporated (and assumed by the Registrant) with Michael A. Gales (incorporated by reference to Exhibit 10.15 of the Registrant's Form 8-K report, filed December 6, 2005).
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- 10.15 Stock Option Agreement, dated as of September 26, 2005, by Gales Industries Incorporated (and assumed by the Registrant) with Louis A. Giusto (incorporated by reference to Exhibit 10.16 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.16 Stock Option Agreement, dated as of September 26, 2005, by Gales Industries Incorporated (and assumed by the Registrant) with Peter Rettaliata (incorporated by reference to Exhibit 10.17 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.17 Stock Option Agreement, dated as of September 26, 2005, by Gales Industries Incorporated (and assumed by the Registrant) with Dario Peragallo (incorporated by reference to Exhibit 10.18 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.18 Revolving Credit, Term Loan, Equipment Line and Security

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- Agreement, dated as of November 30, 2005, by and between Air Industries Machining, Corp., PNC Bank, National Association, as Lender, and PNC Bank, National Association, as Agent (incorporated by reference to Exhibit 10.19 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.19 Mortgage and Security Agreement, dated as of November 30, 2005, by and between Air Industries Machining, Corp. and PNC Bank (incorporated by reference to Exhibit 10.20 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.20 Long Term Agreement, dated as of August 18, 2000, between Air Industries Machining, Corp. and Sikorsky Aircraft Corporation (incorporated by reference to Exhibit 10.21 of the Registrant's Form 8-K report, filed December 6, 2005).
- 10.21 Long Term Agreement, dated as of September 7, 2000, between Air Industries Machining, Corp. and Sikorsky Aircraft Corporation (incorporated by reference to Exhibit 10.22 of the Registrant's Current Report on Form 8-K filed on December 6, 2005).
- 10.22 Stock Purchase Agreement, dated January 2, 2007, between Gales Industries Incorporated, Sigma Metals, Inc. ("Sigma Metals"), and George Elkins, Carole Tate and Joseph Coonan, the shareholders of Sigma Metals (incorporated by reference to Exhibit 10.01 of the Registrant's Form 8-K report, filed January 2, 2007).
- 10.23 Form of Subscription Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.24 Form of Promissory Note (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.25 Agreement dated March 30, 2007 between Gales Industries Incorporated and James A. Brown (incorporated by reference to Exhibit 10.11 of Registrant's Annual Report on Form 10-KSB for the year ended December 31, 2006).
- 10.26 Restricted Stock Agreement dated March 30, 2007 between Gales Industries Incorporated and James A. Brown (incorporated by reference to Exhibit 10.12 of Registrant's Annual Report on Form 10-KSB for the year ended December 31, 2006).
- 10.27 Stock Purchase Agreement, dated March 9, 2007, between Gales Industries Incorporated and John Gantt and Lugenia Gantt, the shareholders of Welding Metallurgy, Inc. (incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K report, filed March 14, 2007).
- 10.28 Amendment No. 1 dated August 2, 2007 to the Stock Purchase Agreement, dated March 9, 2007, between Gales Industries Incorporated and John Gantt and Lugenia Gantt, the shareholders of Welding Metallurgy, Inc. (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K/A report, filed August 3, 2007).
- 10.29 Separation Agreement and General Release dated March 16, 2007 between the Registrant and Michael A. Gales (incorporated by reference from the Registrant's Form 8-K filed on March 20,

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2007).

- 10.30 7% Promissory Note of Registrant in the principal amount of \$2,000,000 in favor of John and Lugenia Gantt (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.31 Escrow Agreement dated as of August 24, 2007 by and among the Registrant, John and Lugenia Gantt and Eaton & Van Winkle LLP, as escrow agent (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.32 Registration Rights Agreement dated as of August 24, 2007 by and among the Registrant and John and Lugenia Gantt (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).

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- 10.33 Fourth Amendment to the Revolving Credit, Term Loan and Security Agreement dated as of November 30, 2005 with the financial institutions named therein (the "Lenders") and PNC Bank N.A., as agent for the Lenders, as amended, dated as of August 24, 2007 (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.34 Loan and Security Agreement dated as of August 24, 2007 among Air Industries Machining, Corp., Sigma Metals, Inc., Welding Metallurgy, Inc. and Steel City Capital Funding LLC incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.35 Pledge Agreement dated as of August 24, 2007 by and among Air Industries Machining, Corp. and Sigma Metals, Inc., as pledgors, and Steel City Capital Funding LLC., as pledge incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.36 Pledge Agreement dated as of August 24, 2007 by and among Air Industries Machining, Corp. and Sigma Metals, Inc., as pledgors, and John and Lugenia Gantt, as pledges (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.37 Pledge Agreement dated as of August 24, 2007 by and between Air Industries Group, Inc., as pledgor, and Steel City Capital Funding LLC, as pledge (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.38 Guarantor Surety ship Agreement dated as of August 24, 2007 between the Registrant and Steel City Capital Funding LLC (incorporated by reference from the Registrant's Form 8-K filed on August 26, 2007).
- 10.39 Stock Purchase Agreement, dated as of November 15, 2007, by and among Air Industries Group, Inc. and the shareholders of Blair Industries, Inc., Blair Accumulators, Inc., H.S.M. Machine Works, Inc., and H.S.M. Machine Works, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on November 15, 2007).

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- 10.40 Letter of Clarification between the Company and Michael A. Gales dated May 11, 2007 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-QSB for the fiscal quarter ended March 31, 2007).
  - 10.41 Sublease agreement dated as of January 1, 2008 between Huttig Building Products, Inc. and the Registrant\*.
  - 14.1 Code of Ethics (incorporated by reference to Exhibit 14.1 to the Registrant's Registration Statement on Form SB-2 (Registration No. 333-144561) filed with the SEC on July 13, 2007 and declared effective on July 27, 2007).
  - 21.1 Subsidiaries\*
  - 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
  - 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
  - 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
  - 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- \* Filed as part of the Registrant's Annual Report on Form 10-K as filed on April 14, 2008
- \*\* Filed as part of the Registrant's Annual Report on Form 10-K/A as filed on April 17, 2008

AIR INDUSTRIES GROUP, INC.  
CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2007 and 2006

AIR INDUSTRIES GROUP, INC.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders  
Air Industries Group, Inc. (formerly Gales Industries Incorporated)

We have audited, before the effects of the adjustments for the correction of the error listed as (4) of Note 19, the consolidated balance sheet of Air Industries Group, Inc. (formerly Gales Industries Incorporated) and subsidiaries as of December 31, 2007, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended (the 2007 financial statements before the effects of the adjustments listed as (4) in Note 19 are not presented herein). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, except for the error listed as (4) in Note 19, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Air Industries Group, Inc. (formerly Gales Industries Incorporated) and subsidiaries as of December 31, 2007, and the results of their operations and their cash flows for year then ended, in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assertion about the effectiveness of Air Industries Group, Inc. (formerly Gales Industries Incorporated) and subsidiaries' internal control over financial reporting as of December 31, 2007 included in the accompanying Management's Annual Report on Internal Control over Financial Reporting and, accordingly, we do not express an opinion thereon.

As described and listed as (3) of Note 19 to the financial statements, the 2007 financial statements have been restated for an error in recording a beneficial conversion on the issuance of Preferred Stock.

We were not engaged to audit, review or apply any procedures to the adjustment for the correction of the error listed as (4) of Note 19 and accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and properly applied. Those adjustments were audited by Rotenberg Meril Solomon Bertiger & Guttilla P.C.

/s/ McGladrey & Pullen, LLP

New York, New York  
April 14, 2008, except for item listed as (3) of Note 19 for which the date is  
November 19, 2008

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REPORT OF INDEPENDENT REGISTERED ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Air Industries Group, Inc.

We have audited the adjustments described in Note 19 Item (4) that were applied to restate the December 31, 2007 consolidated financial statements to correct certain expenses which should have been included in cost of goods sold that were classified as reductions of accounts payable and accrued expenses. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2007 consolidated financial statements of Air Industries Group, Inc. and Subsidiaries other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the December 31, 2007 consolidated financial statements taken as a whole.

/s/ ROTENBERG MERIL SOLOMON BERTIGER & GUTTILLA, P.C.

ROTENBERG MERIL SOLOMON BERTIGER & GUTTILLA, P.C.  
Saddle Brook, New Jersey  
October 5, 2009

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AIR INDUSTRIES GROUP INC  
Consolidated Balance Sheet At December 31,

ASSETS	2007	2006
	-----	-----
Current Assets	(Restated)	
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$302,016 and \$176,458	\$ 7,674,647	\$ 3,508
Inventory	21,820,514	15,257
Prepaid Expenses and Other Current Assets	230,209	232
Deposits - Customers	905,063	180
	-----	-----
Total Current Assets	30,630,433	19,179
Property and Equipment, net	4,786,143	3,565
Capitalized Engineering Costs - net of Accumulated Amortization of \$11,294	1,521,921	
Deferred Financing Costs	575,502	369
Intangible Assets, net of accumulated amortization of \$ 277,251	5,876,974	
Goodwill	6,372,372	1,265
Deposits - Landlord	103,226	448
Other Assets	423,469	63
	-----	-----
TOTAL ASSETS	\$ 50,290,040	\$ 24,892
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Notes Payable - Revolver	\$ 11,332,940	\$ 5,027

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Accounts Payable and Accrued Expenses	7,222,351	7,648
Notes Payable - Current Portion	4,627,776	127
Notes Payable - Sellers - Current Portion	1,435,796	192
Capital Lease Obligations - Current Portion	290,285	407
Due to Sellers	--	53
Dividends Payable	266,503	120
Deferred Gain on Sale - Current Portion	38,036	38
Income Taxes Payable	144,261	653
	-----	-----
Total current liabilities	25,357,948	14,268
Long term liabilities		
Notes Payable - Net of Current Portion	528,330	645
Notes Payable - Sellers - Net of Current Portion	2,503,036	1,290
Capital Lease Obligations - Net of Current Portion	1,188,506	552
Deferred Tax Liability	1,878,677	512
Deferred Gain on Sale - Net of Current Portion	675,082	713
Deferred Rent	229,604	39
	-----	-----
Total liabilities	32,361,183	18,022
Commitments and contingencies		
Stockholders' Equity		
Preferred Stock Par Value \$.001-Authorized 8,003,716 shares Designated as Series "A" Convertible Preferred -\$.001 par Value, 1,000 Shares Authorized 0 Shares issued and outstanding as of December 31, 2007 and December 31, 2006, respectively. Designated as Series "B" Convertible Preferred -\$.001 Par Value, 2,000,000 shares authorized, 829, 098 and 0 shares issued and outstanding as as December 31, 2007 and December 31, 2006, respectively.		
Liquidation Value, \$ 18,060,000	829	
Common Stock - \$.001 Par, 120,055,746 Shares Authorized, 69,122,189 and 57,269,301 Shares Issued and Outstanding as of December 31, 2007 and 2006, respectively	69,122	57
Additional Paid-In Capital	18,744,154	7,898
Accumulated Deficit	(885,248)	(1,086)
	-----	-----
Total Stockholders' Equity	17,928,857	6,869
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 50,290,040	\$ 24,892
	=====	=====

See Notes to Consolidated Financial Statements.

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AIR INDUSTRIES GROUP INC  
Consolidated Statement of Operations for the Years Ended December 31,

	2007	2006
	-----	-----
	(Restated)	
Net sales	\$46,068,645	\$33,044,996
Cost of Sales	34,011,228	28,002,942



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Gross profit	12,057,417	5,042,054
Operating costs and expenses:		
Selling and marketing	1,476,111	601,011
General and administrative	8,418,508	3,789,587
Income from operations	2,162,798	651,456
Interest and financing costs	1,578,377	1,040,108
Gain on Sale of Life Insurance Policy	--	(53,047)
Gain on Sale of Real Estate	(38,036)	(300,037)
Other Income	(25,014)	(435,627)
Other Expenses	81,127	246,659
Income before provision for income taxes	566,344	153,400
Provision for income taxes	365,319	489,969
Net Income (Loss)	201,025	(336,569)
Dividend attributable to preferred stockholders	394,042	420,003
Beneficial Conversion Feature	1,589,000	--
Net Loss attributable to common stockholders	\$ (1,782,017)	\$ (756,572)
Income (Loss) per share (basic)	\$ (0.03)	\$ (0.02)
Income (Loss) per share (diluted)	\$ (0.03)	\$ (0.02)
Weighted average shares outstanding (basic)	65,402,711	32,208,029
Weighted average shares outstanding (diluted)	65,402,711	32,208,029

See Notes to Consolidated Financial Statements.

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AIR INDUSTRIES GROUP INC  
Consolidated Statement of Stockholders' Equity For the Years  
Ended December 31, 2006 and 2007

Series A  
Preferred Stock

Series B  
Preferred Stock

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	Shares	Amount	Shares	Amount
	-----	-----	-----	-----
Balance, January 1, 2006	900	\$ 1	--	
Non-Cash Stock Option Compensation	--	--	--	
Preferred Stock Dividend	--	--	--	
Non-Cash Warrant Compensation	--	--	--	
Conversion of Preferred Shares to Common Shares in connection with filing the registration statement	(900)	(1)	--	
Conversion of Preferred Dividend to Common Shares in connection with filing the registration statement	--	--	--	
Net Loss	--	--	--	
-----				
Balance, December 31, 2006				
Conversion of warrants	--	--	--	
Conversion of Seller's Notes	--	--	--	
Issuance of Restricted Shares	--	--	--	
Preferred Series B Stock Issuance	--	--	802,300	8
Transaction costs paid for Series B Issuance	--	--	--	
Issuance of Stock for Acquisition of Sigma	--	--	--	
Exercise of Stock Options	--	--	--	
Issuance of Stock for Acquisition of Welding Met	--	--	--	
Non-cash stock option expense	--	--	--	
Non-cash Warrants Expense	--	--	--	
Preferred Dividend Paid In Stock	--	--	26,798	
Dividend on Series B preferred stock	--	--	--	
Net Income	--	--	--	
-----				
Balance, December 31, 2007 (Restated)	--	\$ --	829,098	\$ 8
=====				

	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity
	-----	-----	-----
Balance, January 1, 2006	\$ 7,844,614	\$ (749,704)	\$ 7,109,634
Non-Cash Stock Option Compensation	167,126	--	167,126
Preferred Stock Dividend	(480,003)	--	(480,003)
Non-Cash Warrant Compensation	49,510	--	49,510
Conversion of Preferred Shares to Common Shares in connection with filing the registration statement	(40,909)	--	--
Conversion of Preferred Dividend to Common Shares in connection with filing the			

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registration statement	358,364	--	360,000
Net Loss	--	(336,569)	(336,569)
	-----	-----	-----
Balance, December 31, 2006	7,898,702	(1,086,273)	6,869,698
Conversion of warrants	(312)	--	--
Conversion of Seller's Notes	717,974	--	719,773
Issuance of Restricted Shares	51,800	--	52,000
Preferred Series B Stock Issuance	8,022,198	--	8,023,000
Transaction costs paid for Series B Issuance	(698,840)	--	(698,840)
Issuance of Stock for Acquisition of Sigma	1,949,585	--	1,957,001
Exercise of Stock Options	(91)	--	--
Issuance of Stock for Acquisition of Welding Met	564,464	--	566,500
Non-cash stock option expense	354,210	--	354,210
Non-cash Warrants Expense	30,991	--	30,991
Preferred Dividend Paid			
In Stock	(27)	--	--
Dividend on Series B preferred stock	(146,500)	--	(146,500)
Net Income	--	201,025	201,025
	-----	-----	-----
Balance, December 31, 2007 (Restated)	\$ 18,744,154	\$ (885,248)	\$ 17,928,858
	=====	=====	=====

See Notes to Consolidated Financial Statements.

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AIR INDUSTRIES GROUP INC  
Consolidated Statement of Cash Flows For the Years Ended December 31,

	2007
	-----
	(Restated)
CASH FLOWS FROM OPERATING ACTIVITIES	
Net Income (loss)	\$ 201,025
Adjustments to Reconcile Net Income (Loss) to Net Cash used in Operating Activities, net of effect of acquisitions:	
Depreciation and amortization of property and equipment	850,428
Amortization of Intangible Assets	277,251
Amortization of Capitalized Engineering Costs	11,294
Bad Debt Expense	356,240
Non-Cash Compensation Expense	406,210
Warrants issued for Services	30,991
Non-Cash Interest Expense	63,271
Amortization of Deferred Financing costs	161,046
Gain on Sale of Officers Life Insurance	--
Gain on Sale of Real Estate	(38,033)
Deferred Taxes	389,060
Changes in Assets and Liabilities	
(Increase) Decrease in Operating Assets:	
Accounts Receivable	(1,569,686)
Inventory	(3,323,195)
Prepaid Expenses and Other Current Assets	47,643

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Deposits	(724,607)
Cash Surrender Value - Officers Life Insurance	--
Other Assets	(337,184)
Increase (Decrease) in Operating Liabilities	
Accounts payable and accrued expenses	(2,431,218)
Income Taxes payable	(509,165)
Deferred Rent	190,233
Advance Payments - Customers	--
	-----
NET CASH USED IN OPERATING ACTIVITIES	(5,948,396)
	-----
CASH FLOWS FROM INVESTING ACTIVITIES	
Cash paid for deposit on Leasehold improvements	(24,040)
Cash paid for acquisitions, including transaction costs of \$486,200, net of cash acquired of \$94,448	(7,952,548)
Cash paid for Capitalized Engineering costs	(1,533,215)
Cash Received for sale of real estate	--
Purchase of property and equipment	(205,296)
	-----
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(9,715,099)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from Private Placement	8,023,000
Repayment of notes payable to Sellers	(527,017)
Payments for Issuance costs on Private Placement	(698,840)
Principal payments on capital lease obligations	(154,026)
Proceeds from notes payable	4,500,000
Net Proceeds from Revolver	6,305,477
Principal Payments on Notes Payable	(1,417,599)
Cash Paid for Deferred Financing Costs	(367,500)
Proceed from Sale of Officer's life insurance	--
Repayment of Mortgage Notes Payable	--
	-----
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	15,663,495
	-----
Net decrease in cash and cash equivalents	--
Cash and cash equivalents at beginning of year	--
	-----
Cash and cash equivalents at end of year	--
	=====
Supplemental cash flow information	
Cash paid during the year for interest	\$ 1,002,920
	=====
Supplemental cash flow information	
Cash paid during the year for Income taxes	\$ 678,729
	=====
Supplemental schedule of non cash investing and financing activities	
Property and Equipment acquired under capital leases	\$ 673,000
	=====
Non-cash Dividends on Preferred Stock	\$ 146,500
	=====
Conversion of Preferred Stock to Common Stock	
Conversion of Preferred Dividends to Common stock	
Conversion of Preferred Dividends to Preferred Stock	\$ 247,542
	=====
Notes Payable-Seller and accrued interest converted to common Stock	\$ 719,773
	=====

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Conversion of Warrants to common stock	\$ 312
	=====
Purchase of all capital stock of Sigma Metals, Inc and assumption of liabilities in the acquisition as follows:	
Fair Value of Assets acquired	\$ 5,590,165
Goodwill	1,549,931
Intangibles	3,720,000
Cash paid (includes transaction costs of \$280,500)	(4,341,296)
Notes payable issued to Sellers	(1,497,411)
Common Stock issued	(1,957,001)
	-----
Liabilities Assumed	\$ 3,064,388
	=====
Purchase of all capital stock of Welding Metallurgy, Inc and assumption of liabilities in the acquisition as follows:	
Fair Value of Assets acquired	\$ 1,587,686
Goodwill	3,556,478
Intangibles	2,434,225
Cash paid (includes transaction costs of \$205,700)	(3,705,700)
Accrued Purchase Price	(190,377)
Notes payable issued to Sellers (net of accredited value of \$140,000)	(1,860,000)
Common Stock issued	(566,500)
	-----
Liabilities Assumed	\$ 1,255,812
	=====

See Notes to Consolidated Financial Statements.

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AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. FORMATION AND BASIS OF PRESENTATION

Merger and Acquisition

Ashlin Development Corp. (the "Company" or "Ashlin"), a Florida corporation, entered into a Merger Agreement on November 14, 2005 with Gales Industries Incorporated, a privately-held Delaware corporation ("Original Gales"). As a result of the transaction, the former stockholders of Original Gales became the controlling stockholders of Ashlin. Additionally, since Ashlin had no substantial assets prior to the merger, the transaction was treated for accounting purposes as a reverse acquisition of a public shell. Accordingly, for financial statement presentation purposes, Original Gales is the surviving entity.

Prior to the closing of the merger, Original Gales acquired all of the outstanding capital stock of Air Industries Machining Corporation ("AIM"). Because of the change in ownership, management and control that occurred in connection with the acquisition of AIM by Original Gales, in accordance with Statement of Financial Accounting Standards ("SFAS") 141, Business Combinations, the transaction was accounted for as a purchase. Accordingly, the purchase price was allocated to assets acquired and liabilities assumed based on SFAS No. 141.

Original Gales was formed in October 2004 and, since prior to the acquisition it did not have any business operations or activity other than the transactions contemplated with the merger and succeeded substantially all of the business operations of AIM, AIM is the "Predecessor" to Original Gales.

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On February 15, 2006, Ashlin changed its name to Gales Industries Incorporated and its state of domicile from Florida to Delaware. On June 26, 2007, the name of the Company was changed from Gales Industries Incorporated to Air Industries Group, Inc.

The financial statements presented are those of Original Gales, now known as Air Industries Group, Inc. ("AIRI") and its wholly owned subsidiaries; AIM, Sigma Metals ("Sigma") and Welding Metallurgy ("WeldingMet"). Sigma and Welding are included from the dates of acquisition to the current year end.

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### Note 2. ACQUISITIONS

On April 16, 2007, the Company purchased all of the outstanding capital stock of Sigma for approximately \$7.5 million. We paid \$4,060,796 of the purchase price in cash and issued to the former shareholders of Sigma our 7 % promissory notes due April 1, 2010 in the aggregate principal amount of \$1,497,411 and 7,416,082 shares of our common stock having a value of \$1,957,000. The remaining principal balance of the promissory notes, \$1,216,488 as of December 31, 2007, is repayable in equal monthly installments of \$43,446 principal, plus accrued interest at the rate of 7% per annum, through April, 1, 2010. In connection with the acquisition of Sigma Metals we entered into Employment Agreements, discussed below, with three members of the management of Sigma.

The acquisition has been accounted for in accordance with the provisions of SFAS No. 141, "Business Combinations." The total purchase price was allocated to the net tangible assets based on the estimated fair values. The allocation of the purchase price was based upon valuation data as of April 17, 2007. The final valuation has been completed. For tax reporting purposes the Company will amortize goodwill. The allocation of the purchase price is as follows:

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### AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Purchase of all capital stock of Sigma Metals, Inc and assumption of liabilities in the acquisition as follows:	
Fair Value of Assets acquired	\$ 5,590,164
Goodwill	1,549,931
Intangibles	3,720,000
Cash paid (includes transaction costs of \$280,500)	(4,341,296)
Notes payable issued to Sellers	(1,497,411)
Common Stock issued	(1,957,000)
	-----
Liabilities Assumed	\$ 3,064,388
	=====

On August 24, 2007, we purchased, through a wholly-owned indirect subsidiary, WMS Merger Corp, all of the issued and outstanding capital stock of Welding Metallurgy, Inc pursuant to that certain Stock Purchase Agreement, dated as of March 9, 2007, with the shareholders of Welding, as amended by Amendment No.1 thereto dated as of August 2, 2007 (the "Welding Stock Purchase Agreement").

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In consideration for the shares of Welding, the Company paid the former shareholders of Welding \$3,500,000 in cash, and issued to them our promissory note in the principal amount of \$2,000,000 due August 31, 2011 and 2,035,529 shares of our common stock, having a value of \$566,500. The promissory note bears no interest until August 24, 2008, and thereafter bears interest at the rate of 7% per annum. To reflect the fact that this note does not bear interest for the first year, the Company has discounted the value of the note in its balance sheet to \$1,860,000, and will expense the imputed interest on a monthly basis and accrete up the value of the note to its face value of \$2,000,000. Under the stock purchase agreement, we are obligated to pay the sellers an additional \$190,377 as an adjustment to the purchase price. We have agreed to pay this adjustment to the purchase price in four equal monthly installments of \$49,400 (which includes interest of 7% per annum from November 1, 2007) commencing on March 31, 2008 and on the last day of each calendar month thereafter through June 30, 2008. The cash portion of the purchase price was provided by the proceeds of a term loan of \$4,500,000 under a Loan and Security Agreement dated as of August 24, 2007 by and among our wholly-owned subsidiaries, Air Industries Machining, Corp., or AIM, Sigma and Welding, and Steel City Capital Funding LLC (the SCCF Loan Agreement"). To secure payment of the indebtedness under the promissory note, AIM and Sigma Metals pledged to the former shareholders of Welding Metallurgy, and granted them a security interest in, all of the outstanding shares of Welding, subject to the prior rights of Steel City Capital Funding LLC.

Since the purchase price paid by the Company was in excess of the fair market value of the assets acquired, the excess has been recorded as goodwill.

The acquisition has been accounted for in accordance with the provisions of SFAS No. 141, "Business Combinations." The total purchase price was allocated to the net tangible assets based on the estimated fair values. The allocation of the purchase price was based upon valuation data as of August 27, 2007. The final valuation has been completed. For tax reporting purposes, the Company will amortize goodwill. The allocation of the purchase price is as follows:

Purchase of all capital stock of Welding Metallurgy, Inc and assumption of liabilities in the acquisition as follows:

Fair Value of Assets acquired	\$ 1,587,686
Goodwill	3,556,478
Intangibles	2,434,225
Cash paid (includes transaction costs of \$205,700)	(3,705,700)
Accrued Purchase Price	(190,377)
Notes payable issued to Sellers (net of discount of \$140,000)	(1,860,000)
Common Stock issued	(566,500)
	-----
Liabilities Assumed	\$ 1,255,812
	=====

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### AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The components of the intangibles acquired for Sigma and Welding are comprised of the following:

2007	Estimated Useful Lives
----	-----
(Restated)	

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Trade Names	\$ 2,480,000	20 Years
Customer Relationships	2,900,000	11 to 14 Years
Technical know-how	660,000	10 Years
Professional Certification Certificates	114,225	0.25 to 2 years
	-----	
Total	6,154,225	
	-----	
Less: Accumulated Amortization	(277,251)	
	-----	
Intangibles, Net	\$ 5,876,974	
	=====	

The expense for the amortization of the intangibles for the year ended December 31, 2007 amounted to \$277,251.

The table set forth below indicates the amortization of intangibles over the next five years:

Year	Amount
----	-----
2008	\$489,496
2009	\$450,894
2010	\$436,299
2011	\$436,299
2012	\$436,299

In the case of both Sigma and Welding, the fair value of the net assets acquired was less than the amounts paid for the stock of the acquired entity. This excess has been recognized as goodwill.

The following unaudited pro forma information assumes the acquisitions of Sigma and Welding occurred as of the beginning of each year. The pro forma results are not necessarily indicative of what actually would have occurred had the acquisitions been in effect for the period presented.

	(Restated) (pro forma) 2007 ----	(pro forma) (pro forma) 2006 ----
	(unaudited)	(unaudited)
Net sales	\$54,412,000	\$55,481,000
	-----	-----
Gross Profit	\$15,737,000	\$13,433,000
	-----	-----
Net income	\$ 2,554,000	\$ 1,971,000
	-----	-----
Net income attributable to common stockholders	\$ 570,958	\$ 1,550,997
	=====	=====
Earnings per share, basic	\$ 0.01	\$ 0.05
	=====	=====
Earnings per share, diluted	\$ 0.01	\$ 0.04
	=====	=====
Weighted average shares outstanding (Basic)	68,889,275	41,659,640
	=====	=====
Weighted average shares outstanding (Diluted)	71,347,588	46,382,620
	=====	=====



AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principal Business Activity

The Company is primarily engaged in manufacturing aircraft structural parts, assemblies and the distribution of metals principally for prime defense contractors in the aerospace industry in the United States. The Company's customer base consists mainly of publicly traded companies in the aerospace industry.

Principles of Consolidation

The accompanying consolidated financial statements include accounts of the Company and Merger Sub and Merger Sub's wholly owned subsidiaries, AIM, Sigma Metals and Welding Metallurgy. Significant inter-company accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid instruments with an original maturity of three months or less. All cash is applied on a daily basis to amounts outstanding under the revolving portion of the Loan Facility.

Accounts Receivable

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

Inventory Valuation

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

AIM purchases inventory only when it has signed non-cancellable contracts with its customers for orders of its finished goods. Welding Metallurgy generally produces pursuant to customer orders and maintains relatively low inventory levels. AIM occasionally produces finished goods in excess of purchase order quantities in anticipation of future purchase order demands but historically this excess has been used in fulfilling future purchase orders. Sigma routinely acquires inventory without corresponding purchase orders. The Company periodically evaluates inventory items that are not secured by purchase orders and establishes reserves for obsolescence accordingly. The Company also reserves for excess quantities, slow-moving goods, and obsolete items.

Capitalized Engineering Cost

The Company has contractual agreements with certain customers to produce parts, which the customers design. The production of these parts require pre-production engineering and programming of our machines. The Company accounts

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for these pre-production costs pursuant to Emerging Issues Task Force Issue No. 99-5, "Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements" (EITF 99-5). The pre-production costs associated with a particular contract are capitalized and beginning with the first shipment of product pursuant to such contract, amortized over a period determined as follows: (i) if deliverables are scheduled for a period of three years or less, on a straight line basis over the anticipated length of the contract and (ii) if deliverables are scheduled for more than three years, on a straight line basis over three years. If the Company were to be reimbursed for a portion of the pre-production expenses associated with a particular contract only the unreimbursed portion would be capitalized under EITF 99-5. The Company also may progress bill on certain engineering being expended. These 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 provide for liquidated damages in the event that a stop-work order is issued prior to the final delivery of the product.

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### AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Property and Equipment

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

#### Impairment of Long Lived Assets

The Company reviews long-lived assets for impairment if events or whenever circumstances indicate that the carrying value of such assets may not be fully recoverable. Impairment is evaluated based on the sum of undiscounted estimated future cash flows expected to result from use of an asset compared to its carrying value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If impairment is recognized, the carrying value of the impaired asset is reduced to its fair value, based on discounted estimated future cash flows.

#### Deferred Financing Cost

Costs connected with obtaining and executing debt arrangements are capitalized and amortized on the straight-line basis over the term of the related debt.

#### Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." The Company recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable. Payments received in advance from customers for products delivered are recorded as customer advance payments until earned, at which time revenue is recognized. The

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Terms and Conditions contained in our customer Purchase orders provide for liquidated damages in the event that a stop work order is issued prior to the final delivery. The Company utilizes an 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 credit is issued upon receipt of the product. Net sales represent gross sales less returns and allowances. Shipping costs are included in cost of sales.

### Use of Estimates

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

### Credit Risk

Financial instruments involving potential credit risk include accounts receivable. Of the accounts receivable balance outstanding as of December 31, 2007 approximately 22% and 11% are attributable to two customers, respectively. Of the account receivable balance at December 31, 2006, approximately 34% and 17% are attributable to these customers, respectively.

Two customers accounted for approximately 46% and 11% of net sales for the years ended December 31, 2007. One of these customers accounted for approximately 61% of net sales for the year ended December 31, 2006.

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## AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Fair Value of Financial Instruments

The Company has estimated the fair value of financial instruments using available market information and other valuation methodologies in accordance with SFAS No. 107, "Disclosures about Fair Value of Financial Instruments." Management of the Company believes that the fair value of financial instruments, consisting of cash, accounts receivable, accounts payable and accrued liabilities, approximates carrying value due to the immediate or short-term maturity associated with these instruments and that the notes payable approximate fair value in that they carry market-based interest rates.

### Income Taxes

Income taxes are calculated using an asset and liability approach as prescribed by SFAS No. 109, "Accounting for Income Taxes". The provision for income taxes includes federal and state taxes currently payable and deferred taxes, due to temporary differences between financial statement and tax bases of assets and liabilities. In addition, future tax benefits are recognized to the extent that realization of such benefits is more likely than not. Valuation allowances are established when management determines that it is more likely than not that some portion or the entire deferred asset will not be realized. The effect of a change in tax rates is recognized as income or expense in the period of change.

In June 2006, the FASB issued Financial Accounting Standards Board

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("FASB") Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes--An Interpretation of FASB Statement No. 109," regarding accounting for, and disclosure of, uncertain tax positions. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes," and 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 interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company will recognize interest and penalties, if any, related to taxes not properly paid in prior periods in tax expense. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 effective as of January 1, 2007.

### Earnings per share

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

The Company did not include 3,025,578 warrants and 4,060,000 options to purchase the Company's common stock for the year ended December 31, 2007 and 5,271,257 warrants and 4,850,000 options to purchase the Company's common stock for the year ended December 31, 2006 in the calculation of diluted earnings per share because the effects of their inclusion would have been anti-dilutive. The shares of Series B Preferred Stock that are convertible into 30,039,783 shares of common stock at December 31, 2007 are not included in the calculation of diluted earnings per shares because the effect of the inclusion would have been anti-dilutive.

### Stock-Based Compensation

In December 2004, the FASB issued SFAS 123(R) which is a revision of SFAS No. 123 and supersedes Accounting Principles Board Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values at the date of grant. The Company recorded in the accompanying statement of operations an expense of \$437,202 and \$167,126 for the years ended December 31, 2007 and 2006, respectively, in accordance with the measurement requirements under SFAS No. 123(R). The Company adopted SFAS No. 123(R), effective as of January 1, 2005.

### Goodwill and Intangibles

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. The Company applies SFAS No. 142, "Goodwill and Other Intangible Assets" and accordingly does not amortize goodwill but tests it for impairment. The Company performs impairment testing for goodwill annually, or more frequently when indicators of impairment exist, using a two-step approach. 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.

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## AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The fair values of the reporting units were determined using a combination of valuation techniques consistent with the income approach. For purposes of the income approach, discounted cash flows were calculated by taking the net present value of estimated cash flows using a combination of historical results, estimated future cash flows and an appropriate price to earnings multiple. We use our internal forecasts to estimate future cash flows and actual results may differ from forecasted results. However, these differences have not been material and we believe that this methodology provides a reasonable means to determine fair values. Cash flows were discounted using a discount rate based on expected equity return rates, which ranged from 12.61% to 14.73% for 2007. Our evaluations for the year ended December 31, 2007 indicated there was no impairment of our Goodwill.

### Recently Issued Accounting Standards

In September 2006, FASB issued SFAS 157 "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Management is currently evaluating the effect of this pronouncement on its financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"), which establishes principles and requirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) requires contingent consideration to be recognized at its fair value on the acquisition date and, for certain arrangements, changes in fair value to be recognized in earnings until settled. SFAS 141(R) also requires acquisition-related transaction and restructuring costs to be expensed rather than treated as part of the cost of the acquisition. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities" ("SFAS No. 159"). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new guidance is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the potential impact of the adoption of SFAS No. 159 on its financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements an Amendment of ARB No. 51" ("SFAS 160"),

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which establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 also provides guidance when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent's owners and the interests of the non controlling owners of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company is currently evaluating the impact this statement will have on its financial position and results of operations.

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AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 INVENTORY

The components of inventory consisted of the following:

	2007 ----	2006 ----
	(Restated)	
Raw Materials	\$ 9,050,196	\$ 2,234,175
Work In Progress	7,755,367	7,546,178
Finished Goods	5,014,951	5,477,288
	-----	-----
Total Inventory	\$21,820,514	\$15,257,641
	=====	=====

Note 5 PROPERTY AND EQUIPMENT

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

	2007 ----	2006 ----	Estimated Useful Life -----
	(Restated)		
Machinery and Equipment	\$ 3,105,545	\$ 2,117,441	5 - 8 years
Capital Lease Machinery and Equipment	1,669,718	1,164,671	5 - 8 years
Tools and Instruments	827,351	555,164	3 - 7 years
Automotive Equipment	30,227	30,227	5 years
Furniture and fixtures	146,455	274,837	5 - 8 years
Leasehold Improvements	312,727	3,583	Term of Lease
Computer Software	131,168		4 years
	-----	-----	
Total property and equipment	6,223,191	4,145,923	
Less: Accumulated Depreciation and Amortization	(1,437,048)	(580,607)	
	-----	-----	
Property and equipment, net	\$ 4,786,143	\$ 3,565,316	

=====

Depreciation and amortization expense for the years ended December 31, 2007 and 2006, amounted to \$850,428 and \$597,009 respectively.

Note 6 SALE-LEASEBACK TRANSACTION

On October 24, 2006, the Company consummated an agreement, whereby the Company sold the buildings and real property located at its corporate headquarters in Bay Shore, New York (the "Property") for a purchase price of \$6,200,000. As a result, the Company had a gain on the sale of approximately \$1,051,188 of which we recognized \$300,037 during the year ended December 31, 2006. The remaining \$751,151 will be recognized ratably over the remaining term of the twenty year lease, and is included in the caption Deferred Gain on Sale of Real Estate in the accompanying Balance Sheet.

Simultaneous with the closing of the sale of the Property, the Company entered into a 20-year triple-net lease (the "Lease") with the Purchaser for the property. Base annual rent is approximately \$540,000 for the first five years, \$621,000 for the sixth year, and thereafter increases 3% per year. The Lease grants AIM an option to renew the Lease for an additional period of five years. The Company deposited with the Purchaser \$127,500 as security for the performance of its obligations under the Lease, which it subsequently replaced with a \$127,500 letter of credit. In addition, the Company deposited with the landlord \$393,000 (Deposits) as security for the completion of certain repairs and upgrades to the Property. As of December 31, 2007, the Company has completed certain of the improvements and has reclassified the amounts to the appropriate fixed asset accounts. The Company still has deposits of \$103,226 deposited with the landlord. This amount is included in the caption Deposits - Landlord on the accompanying Balance Sheet. Pursuant to the terms of the Lease, the Company is required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance. These costs will be offset against the funds that are deposited with the landlord. The lease also contains customary representations, warranties, obligations, conditions and indemnification provisions and grants the Purchaser customary remedies upon a breach of the lease by the Company, including the right to terminate the Lease and hold the Company liable for any deficiency in future rent. (See Note 12).

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AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. NOTES PAYABLE - BANKS AND CREDIT FACILITY

On November 30, 2005 the Company executed a credit facility with PNC Bank N.A. (the "Loan Facility"), secured by substantially all of its assets.

The Loan Facility provided for maximum borrowings of \$14,000,000 consisting of (i) a \$9,000,000 revolving loan, (ii) a \$3,500,000 term loan, and (iii) a \$1,500,000 equipment financing loan. In connection with the Loan Facility the Company paid a finder's fee of \$196,500, consisting of \$125,000 in cash and 325,000 shares of Common Stock, which is included in deferred financing costs. The shares issued to the finder were valued at \$0.22 per share and were contributed by one of the Company's senior executives and accounted for as a capital contribution.

On January 10, 2007, the Company and PNC further amended the terms of the

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Loan Facility to revise the formula to determine the amounts of revolving advances permitted to be borrowed under the Loan Facility. The cost of this amendment was \$42,500 and is being amortized over the remaining term of the Credit Facility. The amount that the Company is permitted to borrow as a revolving advance under the Loan Facility is based on a percentage of the Company's eligible receivables, which now includes government receivables that have not been assigned by the Company.

To refinance the debt of Sigma Metals, on April 19, 2007, the Company entered into a Third Amendment to the Loan Facility. The amendment modified the terms of the loan facility to add Sigma Metals as a borrower, but required Sigma Metals to pledge all of its assets and properties to PNC Bank to secure its obligations under the Loan Facility. In addition, the termination date of the Loan Facility was extended to April 30, 2010 and the maximum revolving advance amount was increased from \$9,000,000 to \$11,000,000.

In connection with the acquisition of Welding Metallurgy, the Company entered into the Fourth Amendment to the Loan Facility, dated as of August 24, 2007, which adds Welding Metallurgy as a borrower under the Facility and the Company as a guarantor of the obligations there under. Additionally, amendment four increased the maximum revolving advance amount from \$11,000,000 to \$14,000,000.

The revolving loans bear interest, at the option of the Company, that is based on (i) the higher of (A) PNC's base commercial lending rate as published from time to time ("PNC Rate") plus 0.25% or (B) the Federal Funds rate plus 0.5%, or (ii) the Eurodollar Rate for the Interest Period selected by the Company plus 2.5%. The revolving loans had an interest rate of 7.75% per annum on December 31, 2007 and an outstanding balance of \$11,332,940. The revolving loans and equipment loans are payable in full on November 30, 2009.

The term loan is for a period of 4 years and bears interest, at the option of the Company, at the (i) PNC Rate plus 0.50% per annum or (ii) the Eurodollar Rate for the interest period selected by the Company plus 2.75%. In October 2006 the Term Note was reduced by \$2,800,000 and the remaining balance of \$383,330 became an Amended and Restated Term Note providing for principal payments of \$10,648 per month and the Maturity Date was amended to become the first business day of October 2009. At December 31, 2007 the balance of the term loan was \$244,906.

In connection with the Welding Metallurgy acquisition, Steel City Capital Funding LLC ("SCCF") provided a Term Loan of \$4,500,000, which is payable on August 24, 2010. Borrowings under the SCCF Loan Agreement bear interest, payable monthly, generally at a rate of 6% over the base commercial lending rate of PNC Bank as publicly announced to be in effect from time to time. Under the terms of the Loan Facility and the SCCF Loan Agreement, the amounts are not due to be repaid until August 2010, but have been included in current liabilities due to the right of the banks to demand immediate repayment pursuant to a subjective acceleration clause, which management believes are not likely to occur, combined with the existence of a lockbox arrangement. To secure payment of the indebtedness under the SCCF Loan Agreement, AIR pledged all of the outstanding shares of AIM and Sigma, which, in turn, pledged all of the outstanding shares of Welding Metallurgy.

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AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In addition to the foregoing, the Loan Facility was further amended to



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allow the Company to borrow or to obtain the issuance, renewal, extension and increase of standby letters of credit, up to an aggregate availability of \$500,000, for its account until November 30, 2009. At December 31, 2007 the Company had an outstanding letter of credit in the amount of \$127,500.

The equipment loans bear interest, at the option of the Company, that is based on (i) the PNC Rate plus 0.50% per annum or (ii) the Eurodollar Rate for the interest period selected plus 2.75% per annum. The equipment loan had an interest rate of 7.75% per annum at December 31, 2007. Such equipment financing is limited to an aggregate of \$750,000 in any fiscal year and amortized in equal installments of sixty months following the close of each "borrowing period", the first of which ended December 31, 2007. Each subsequent "borrowing period" ends on each December 31 thereafter. All equipment loans are due and payable on November 30, 2009. As of December 31, 2007, the equipment financing loan had a balance of \$411,200.

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

The terms of the Loan Facility require that, among other things, the Company maintain certain financial ratios and levels of working capital. As of December 31, 2007 the Company has met these terms. The Loan Facility also is secured by all assets of the Company and 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 such, the revolving loan has been classified as a current liability.

Interest expense related to these credit facilities amounted to \$821,492 and \$686,917 for the years ended December 31, 2007 and 2006, respectively.

As of December 31, 2007, future minimum principal payments are as follows:

Year	Amount
----	-----
2008	\$ 4,627,776
2009	528,330
	-----
	5,156,106
Less: current portion	(4,627,776)
	-----
Total Long Term Portion	\$ 528,330
	=====

The Company incurred an aggregate of \$859,564 in finders' fees and legal costs in connection with the Loan Facility which is being amortized over the 48 month term of the Loan Facility. During the years ended December 31, 2007 and 2006, the Company amortized \$161,046 and \$117,159, respectively, of these costs.

On December 28, 2007, the Company and PNC entered into an amendment to the Loan Facility modifying certain financial covenants.

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### Note 8. CASH SURRENDER VALUE - OFFICER'S LIFE INSURANCE

During the year ended December 31, 2006, the Company sold its key-man life insurance policies. Proceeds from the sale of the insurance policy were \$86,000 which was offset by the cash surrender value of \$33,263. The resulting gain of \$53,047 was recognized as Other Non-Operating Income in the accompanying Statement of Operations for the year ended December 31, 2006.

### Note 9. 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 \$1,478,791 and \$959,817 as of December 31, 2007 and 2006, respectively.

As of December 31, 2007, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

Year	Amount
----	-----
2008	\$ 409,861
2009	413,798
2010	409,861
2011	409,861
2012	145,310
	-----
Total future minimum lease payments	1,788,691
Less: imputed interest	(309,900)
Less: current portion	(290,285)
	-----
Total Long Term Portion	\$ 1,188,506
	=====

### Note 10. NOTES PAYABLE - SELLERS

On November 30, 2005, in connection with the acquisition of AIM, the Company issued notes payable for an aggregate of \$1,627,262 to three former AIM shareholders, two of whom have become part of the Company's senior management and are also stockholders of the Company. On January 26, 2007, the two senior management members converted \$665,262 principal amount of their notes, plus accrued interest of \$54,511, into an aggregate of 1,799,432 shares of common stock at a conversion price of \$0.40 per share.

The remaining principal amount of the note of \$625,300 matures on September 30, 2010, is subordinated to all of the Company's senior debt and is payable in twenty consecutive calendar quarters of equal installments of principal plus accrued interest commencing on December 31, 2005. The interest rate on this note is equal to Prime Rate plus 0.5% per annum (8.75% at December 31, 2007). Interest on outstanding balances at September 30, 2010, in the event of nonpayment, shall accrue at a floating rate equal to the Prime Rate plus 7% per annum as of December 31, 2007.

In connection with the acquisition of Sigma, the Company incurred notes payable obligations to the former shareholders of Sigma in the aggregate principal amount of \$1,497,411. The remaining principal balance, at December 31, 2007, of \$1,216,488, is payable in equal monthly installments of \$43,446 of principal plus interest at 7% per annum through 2010, except that in April 2008 \$247,090 was prepaid on the notes due the former shareholders.

These notes are subordinated to all of the Company's senior debt.

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In connection with the acquisition of Welding, the Company incurred a note payable to the former shareholders of Welding in the aggregate principal amount of \$2,000,000, which bears no interest until August 24, 2008, and bears interest thereafter at 7% per annum.

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### AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

To reflect the fact that this note does not bear interest for the first year, at December 31, 2007 the Company has discounted the value of the note in its balance sheet to \$1,906,667. The Company will expense the imputed interest on a monthly basis and accrete up the value of the note to its face value of \$2,000,000. This note was originally recorded at the discounted value of \$1,860,000 and resulted in a non cash interest charge. The indebtedness evidenced by this note is subordinate to the Company's indebtedness to PNC and SCCF and is payable in one installment in the principal amount of \$500,000 due on August 24, 2008 and twelve consecutive quarterly installments of principal in the amount of \$125,000, plus accrued interest commencing on November 30, 2008 and continuing through August 31, 2011. This note is subordinated to all of the Company's senior debt and accrues interest at 7% per annum. Additionally the Company will pay an additional \$190,377 to the former owners as a working capital adjustment under the stock purchase agreement. This will be paid in four monthly installments of \$47,494 plus accrued interest at 7% per annum, commencing on March 31, 2008.

As of December 31, 2007, the aggregate future minimum note payments, with remaining terms of greater than one year are as follows:

Year	Amount
----	-----
2008	\$ 1,529,130
2009	1,213,752
2010	866,184
2011	423,100
	-----
Sellers Notes Payable	4,032,166
Less: Unaccreted Interest	(93,334)
Less: Current portion	(1,435,796)
	-----
Long-term portion	\$ 2,503,036
	=====

Interest expense on these notes amounted to \$107,111 and \$132,193 for the years ended December 31, 2007 and 2006 respectively.

#### Note 11. EMPLOYEE BENEFITS PLANS

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

The Employees of the Company are members of the United Service Workers Union TUJAT Local 355 (the "Union"), which provided medical benefit plans at

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defined rates which are contributed in their entirety by the Company. The company paid \$1,712,115 and \$2,275,295 in union benefits during the years ended December 31, 2007 and 2006 respectively.

### Note 12. COMMITMENTS AND CONTINGENCIES

The Company leases its facilities under various operating lease agreements, which contain renewal options and escalation provisions. Rent expense was \$842,795 and \$111,775 for the years ended December 31, 2007 and 2006, respectively. The Company is responsible for paying all operating costs under the term of the lease. As of December 31, 2007, the aggregate future minimum lease payments are as follows:

Year	Annual Rent
----	-----
2008	\$1,054,572
2009	1,069,968
2010	1,086,176
2011	1,126,206
2012	1,219,606
Thereafter	12,940,984
Total	<u>\$18,497,512</u>
	=====

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### AIR INDUSTRIES GROUP, INC. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### Litigation

We were a defendant in an action by our former investor relations firm filed on September 18, 2007 in the Supreme Court of the State of New York, New York County captioned Porter, Levay & Rose, Inc. against Air Industries Group, Inc. et al. (Index No. 003104/07). This case has been settled for \$65,000.

#### Customer Audits

The Company's government contracts and those of many of its customers are subject to the procurement rules and regulations of the United States government, including the Federal Acquisition Regulations ("FAR"). Many of the contract terms are dictated by these rules and regulations. During and after the fulfillment of a government contract, the Company may be audited in respect of the direct and allocated indirect costs attributed thereto. These audits may result in adjustments to its contract costs. Additionally, the Company may be subject to U.S. government inquiries and investigations because of its participation in government procurement. Any inquiry or investigation can result

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in fines or limitations on the Company's ability to continue to bid for government contracts and fulfill existing contracts.

The Company believes that it is in compliance with all federal, state and local laws and regulations governing its operations and has obtained all material licenses and permits required for the operation of its business.

### Governmental Regulation

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

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

### Employment Contracts

In September 2005, the Company entered into employment agreements (the "Agreements") with four senior executives that became effective November 30, 2005. The Agreements are for a period of approximately eight years. The Agreements provide for annual base compensation aggregating \$940,000. The Board, at its sole discretion, determines whether a bonus is issued, provided that in the case of two executives, the amount of the bonus shall be predicated on their performance and the achievement by the Company of its operating targets set forth in its annual budget, and in the case of these two executives, provided further, in no event shall the amount of their bonuses be less than 50% of their salary at that time. For the years ended December 31, 2007 and 2006 no bonuses were paid. Each senior executive's agreement also call for grants of stock options to purchase the Company's common stock aggregating 4,850,000 shares of which 3,410,000 have been granted as of December 31, 2007.

The Company and one of its four senior executives mentioned above entered into a Separation Agreement and General Release (the "Separation Agreement") effective March 16, 2007, whereby the executive resigned from his positions with the Company. Pursuant to the Separation Agreement, the Employment Agreement between the executive and the Company terminated effective March 16, 2007. In lieu of the compensation payable to the executive pursuant to his Employment Agreement, from March 16, 2007, to November 30, 2010, the executive will be paid \$100,000 per annum; from December 1, 2010 to May 31, 2011, he will be paid \$50,000. In addition, if the Company achieves certain agreed-upon levels of performance he may receive up to an additional \$50,000. Upon the execution of his employment agreement mentioned above the Company granted this executive

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options to purchase 1,250,000 shares of Common Stock, subject to an agreed upon vesting schedule and exercisable over a ten-year period commencing on the date of grant. Pursuant to the Separation Agreement, all unvested options held by this executive vested as of March 16, 2007, and the right to exercise all of his options terminated as of March 16, 2008.

On April 17, 2007, the Company entered into employment agreements (the "Agreements") with three senior executives at Sigma Metals. The Agreements are for a period of approximately five years.

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AIR INDUSTRIES GROUP, INC.  
NOTES ON CONSOLIDATED FINANCIAL STATEMENTS

The Agreements provide for annual base compensation aggregating \$600,000. Additionally, each of these Agreements provide for performance based bonus compensation of up to 15% of the Executive's base salary and options to purchase up to 100,000 shares per year, should Sigma achieve specified levels of growth in its year over year earnings, as defined in the agreements. Sigma did not achieve the requisite level of growth in earnings in 2007 and, accordingly, no accrual was made for performance bonuses under these Agreements.

Note 13. INCOME TAXES:

The provision for income taxes at December 31, 2007 and 2006 consists of the following:

	2007 (Restated)	2006
	-----	-----
Current		
Federal	\$ 233,248	\$ 504,585
State	7,391	148,841
	-----	-----
Total Current Provision	240,639	653,426
Deferred		
Federal	(150,623)	(127,595)
State	104,238	(35,862)
	-----	-----
Total Deferred Taxes	(46,385)	(163,457)
Valuation Allowance	171,065	--
	-----	-----
Net deferred taxes after valuation allowance	124,680	(163,457)
	-----	-----
Net Provision for Income Taxes	\$ 365,319	\$ 489,969
	=====	=====

The components of deferred tax assets as of December 31, 2007 and 2006, are as follows:

	2007 ----	2006 ----
	(Restated)	
Bad debts	\$ 120,014	\$ 76,080
Inventory - 263A Adjustment	340,617	338,092
Non-cash compensation - warrants	43,108	40,121
Non-cash compensation - options	240,685	124,354

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Deferred Rent	79,591	16,977
Deferred gain on sale of real estate	247,202	323,859
Federal tax benefit of State Tax	--	(64,790)
	-----	-----
Total deferred tax asset	1,071,217	854,693
Valuation allowance	(1,071,217)	(854,693)
	-----	-----
Net deferred tax asset	\$ --	\$ --
	=====	=====

The components of the deferred tax liability as of December 31, 2007 and 2006 are as follows:

	2007	2006
	----	----
	(Restated)	
Property and equipment	\$ 772,895	\$ 512,937
Amortization - Sigma Transaction	91,658	--
Amortization - Welding Transaction	1,014,124	--
	-----	-----
Total deferred tax liability	\$1,878,677	\$ 512,937
	=====	=====

The difference between income taxes computed at the statutory federal rate and the provision for income taxes for the years ended December 31, 2007 and 2006 relates to the following:

	2007	2006
	----	----
	(Restated)	
Tax benefit at federal statutory rate	34.00%	34.00%
State income taxes, net of federal income tax benefit	1.12%	6.02%
Permanent differences	1.37%	6.66%
Other	-0.38%	--
True-up from prior year	-1.81%	-84.37%
Change in valuation allowance	30.21%	357.10%
	-----	-----
Total effective tax rate	64.50%	319.41%
	=====	=====

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AIR INDUSTRIES GROUP, INC.  
NOTES ON CONSOLIDATED FINANCIAL STATEMENTS

Realization of deferred tax assets is dependent on future earnings. Due to the uncertainty of realization of the net deferred tax assets, the Company has provided a valuation allowance. In assessing the realizability of it, management considers whether it is more likely than not that some or all of the deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making the assessment.

Note 14 STOCK-BASED COMPENSATION ARRANGEMENTS

During 2005, the Company's Board of Directors approved a stock option plan and reserved 10,000,000 shares of its Common Stock for issuance under the plan.

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The stock option plan permits the Company to grant non-qualified and incentive stock options to employees, directors, and consultants. Awards granted under the Company's plans vest over one and five years.

	Number of Shares -----	Weighted Average Exercise Price -----	Weighted Remaining Contractual Term -----	Agg Int V --
Outstanding at January 1, 2006	2,370,000	\$0.38	--	
Outstanding at December 31, 2006	2,370,000	0.38	9	\$
Options granted	3,923,900	0.35	--	
Options exercised	(250,000)	--	--	
Options cancelled	(66,667)	--	--	
Reserved for grant based on future market price	1,440,000	N/A	--	
Outstanding at December 31, 2007	7,417,233	\$0.35	6	\$
Options vested and exercisable At December 31, 2007	2,786,665	\$0.44	6	\$

The Company accounts for its stock option plans under the measurement provisions of Statement of Financial Accounting Standards No. 123(R) (revised 2004), Share-Based Payment ("SFAS 123(R)"). The weighted average fair values of options granted for December 31, 2007 and 2006 are \$0.35 and \$0.38. During the year ended December 31, 2007, 250,000 stock options were exercised.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model using weighted average assumptions for grants in the years ended December 31, 2007 and 2006 as follows:

	2007 -----	2006 -----
Risk Free Interest Rates	3.55% - 4.77%	4.77%
Expected Dividend Yields	0%	0%
Expected Terms to Exercise	1 - 8 Years	9 Years
Expected Volatility	78.07% - 177.30%	180%

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

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AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2007 and 2006, 2,786,665 and 1,580,000 options are vested and exercisable, respectively. The weighted average exercise price of exercisable options at December 31, 2007 and 2006 was \$0.44 and \$0.32 per share, respectively. A summary of the status of the Company's stock options as of



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December 31, 2007, and changes during the year then ended is presented below.

The Company recorded expenses of \$437,202 and \$167,126 in its consolidated statement of operations, which reflects the value of granted stock options over the vesting period in accordance with SFAS No. 123R, for the years ended December 31, 2007 and 2006, respectively.

The following table summarizes information about stock options at December 31, 2007:

Exercise Price	Options Outstanding		Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable
\$0.22 - \$0.29	3,897,233	6.87	\$0.26	706,665
\$0.43 - \$0.48	1,580,000	7.74	0.46	1,580,000
\$0.67	500,000	0.21	0.67	500,000
Based on Future Market Price	1,440,000	--	N/A	--
	7,417,233	4.94	\$0.35	2,786,665

A summary of the status of the Company's non-vested options as of December 31, 2007 and changes during the year ended December 31, 2007 is presented below:

	Number of Options	Weighted Average Exercise Price Per Option	Weighted Average Remaining Contractual Term (in years)
Non-vested Options at January 1, 2007	3,270,000	\$0.45	9
Options granted and priced	4,463,900	\$0.32	--
Options vested	(2,786,665)	\$0.44	--
Options forfeited, expired or exercised	(316,667)	\$0.22	--
Non-vested Options at December 31, 2007	4,630,568	\$0.26	8

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### AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2007, there was \$480,826 of unrecognized compensation cost related to non vested stock option awards, which is to be recognized over the remaining weighted average vesting period of five years.

On February 13, 2007, the Company granted each of the four non-management members of the Board an option to purchase 100,000 shares of common stock. The

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options vested as to 33,333 shares upon grant, as to a total of 66,666 on March 1, 2008 and will vest as to all 100,000 shares on March 1, 2009 and are exercisable at a price of \$0.27 per share until March 1, 2014. Options to purchase 66,667 shares granted to Stephen M. Nagler lapsed upon his failure to stand for re-election in June 2007. On August 29, 2007, the Company granted David Buonanno, a non-management director, an option to purchase 100,000 shares of common stock, which was immediately exercisable as to 33,333 shares. The option will become exercisable as to a total of 66,666 shares on June 26, 2008, and as to all 100,000 shares on June 26, 2009. The exercise price of the option is \$0.28 per share. The option expires on August 1, 2014.

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

The Company issued to a placement agent in the Private offering of the Company's Series B Convertible Preferred Stock described in Note 14, warrants to purchase 2,900,578 shares of Common Stock at a per share exercise price of \$0.305 in addition to other consideration. These warrants have a term of five-years and a cashless exercise feature. These warrants were valued at \$32,000 using the Black-Scholes model and the value of such warrants was deducted from the additional paid in capital resulting from the offering.

The following table summarizes the Company's outstanding warrants as of December 31, 2007 and changes during the year then ended:

	Weighted Number of Shares	Weighted Average Exercise Price	Average Remaining Contractual Life (Years)
Outstanding at January 1, 2006	5,229,589	\$0.21	4.1
Granted	41,668	0.97	4.8
	-----	-----	-----
Outstanding at December 31, 2006	5,271,257	\$0.22	4.9
Granted	3,025,578	0.30	4.3
Cancelled	(41,668)	0.97	3.7
Exercised	(409,091)	--	--
	-----	-----	-----
Outstanding at December 31, 2007	7,846,076	0.25	3.4
	=====		

The following tables summarizes the Company's outstanding restricted shares as of December 31, 2007:

	Weighted Number of Shares	Exercise Grant Date Price
Outstanding at January 1, 2007	--	--
Granted	200,000	\$ 0.26
Vested	(200,000)	0.26
	-----	-----
Outstanding at December 31, 2007	--	--

AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15. EQUITY TRANSACTIONS AND ASSET ACQUISITIONS

Sigma Metals, Inc

On April 16, 2007, the Company purchased all of the outstanding capital stock of Sigma Metals for approximately \$7.5 million. The Company paid \$4,060,796 of the purchase price in cash and issued to the former shareholders of Sigma Metals 7% promissory notes due April 1, 2010 in the aggregate principal amount of \$1,497,411 and 7,416,082 shares of the Company's common stock having a value of \$1,957,000. The remaining principal balance of the promissory notes, \$1,216,488 as of December 31, 2007, is repayable in equal monthly installments of \$43,446 principal, plus accrued interest at the rate of 7% per annum, through April, 1, 2010, except that in April 2008 \$247,090 was prepaid to the former shareholders.

To finance the acquisition of Sigma and provide us with additional working capital, the Company completed a private placement of our Series B Convertible Preferred Stock, par value \$0.001 per share ("Series B Preferred Stock") in which the Company raised gross proceeds of \$8,023,000. A first closing, in which we received gross proceeds of \$4,955,000 occurred simultaneously with the acquisition of Sigma and was entirely devoted to the acquisition. A second closing occurred on May 3, 2007, in which the Company received gross proceeds of \$3,068,000. The Company recorded a beneficial conversion feature of \$1,589,000, as the conversion price of the convertible preferred stock is less than the fair value of the common shares into which it is convertible. The holders of the Series B Preferred Stock are entitled to a cumulative annual dividend of 7% per annum which the Company has the right to pay in additional shares of Series B Preferred Stock, except under certain circumstances. In October 2007 and January 2008, an aggregate of 26,798 shares and 16,456 shares of Series B Preferred Stock were issued in payment of accrued dividends on the Series Preferred Stock of \$247,542 and \$146,500 respectively. The shares of Series B Preferred Stock issued in the offering and in payment of accrued dividends are convertible into approximately 30,439,944 shares of the Company's common stock. The series B convertible preferred stock is convertible into shares of the Company's common stock at a conversion price per share of \$0.276, subject to adjustment for certain anti-dilution events.

Welding Metallurgy, Inc.

On August 24, 2007, the Company purchased, through a wholly-owned indirect subsidiary, all of the outstanding capital stock of Welding Metallurgy, Inc. pursuant to that certain Stock Purchase Agreement, dated as of March 9, 2007, as amended, with the shareholders of Welding Metallurgy (the "Welding Metallurgy Stock Purchase Agreement"). In consideration for the shares of Welding Metallurgy, the Company paid the former shareholders of Welding Metallurgy \$3,500,000 in cash, and issued to them a promissory note in the principal amount of \$2,000,000 due August 31, 2011 and 2,035,529 shares of common stock, having a value of \$566,500. The promissory note bears no interest until August 24, 2008, and thereafter bears interest at the rate of 7% per annum. To reflect the fact that this note does not bear interest for the first year, the Company has discounted the value of the note in its balance sheet to \$1,860,000, and will expense the imputed interest on a monthly basis and accrete up the value of the note to its face value of \$2,000,000. The cash portion of the purchase price was

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provided by the proceeds of a term loan of \$4,500,000 under a Loan and Security Agreement dated as of August 24, 2007 by and among the Company's wholly-owned subsidiaries, Air Industries Machining, Corp., Sigma Metals and Welding Metallurgy, and Steel City Capital Funding LLC (the "SCCF Loan Agreement"). To secure payment of the indebtedness under the promissory note, AIM and Sigma Metals pledged to the former shareholders of Welding Metallurgy, and granted them a security interest in, all of the outstanding shares of Welding Metallurgy, subject to the prior rights of Steel City Capital Funding LLC.

The Company has agreed to register for resale under the Securities Act the shares of its common stock issued to the former shareholders of Welding Metallurgy, at their request, in connection with certain registration statements the Company may file in the future. One half of the shares of the common stock issued to the former shareholders of Welding Metallurgy have been deposited in escrow to secure their indemnity obligations under the Stock Purchase Agreement until February 24, 2009.

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### AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Note 16 RELATED PARTY TRANSACTIONS

Stephen M. Nagler, a director of the Company until June 26, 2007, is a partner in Eaton & Van Winkle LLP, the Company's legal counsel. The Company paid Eaton & Van Winkle LLP \$443,991 in 2007 and \$500,000 in 2006 for legal fees and disbursements.

#### Note 17 SUBSEQUENT EVENTS

The operations of Sigma Metals and Welding Metallurgy have been relocated to a new 81,035 square foot facility located in Hauppauge, New York. This space is occupied under a sublease which provides for an annual base rent of approximately \$514,572 for the first year of the sublease, with increases of approximately 3% per year for the remainder of the following eight years.

Sigma Metals operations had previously been conducted at a facility in Deer Park, Long Island under a lease which expired on January 31, 2008. Welding Metallurgy's operations had previously been conducted at a facility located in West Babylon, New York under a lease which expired at the end of February 2008.

In February 2008, the Company and PNC entered into an amendment to the Loan Facility increasing the inventory sublimit used in the borrowing base calculation to \$10,250,000.

On April 1, 2008, the Company declared a dividend on its series B convertible preferred stock, payable in 19,825 shares of series B convertible preferred stock.

At a Special Meeting of Stockholders on April 3, 2008, the stockholders approved an amendment to the certificate of incorporation increasing to 250,000,000 the number of shares of common stock we are authorized to issue and authorized the Board of Directors to effect, at its discretion at any time not later than December 31, 2008, if at all, a reverse stock split of common stock at a ratio within the range from one-for-ten to one-for-thirty, with the ratio and timing to be selected and implemented by our Board. The reverse stock split is part of a plan intended to enable the Company to obtain a listing for common stock on a national securities exchange. If the reverse stock split is effected, the number of authorized shares of common stock would be reduced to 125,000,000

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shares.

On April 11, 2008, the Company granted each of its four non-management directors an option to purchase 100,000 shares of common stock at an exercise price per share of \$0.225 exercisable immediately for five years. In addition, the terms of the options previously granted to Messrs. Rettaliata, Giusto and Peragallo were modified to provide that the options scheduled to vest from 2008 through 2012, 1,440,000 options in the aggregate, will be exercisable at a per share price of \$0.225.

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AIR INDUSTRIES GROUP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 SEGMENT REPORTING

Financial information about the Company's operating segments for the year ended December 31, 2007 and 2006 as required under Statement of Financial Accounting Standard 131 is as follows:

	Year Ended December 31,	
	2007	2006
	-----	-----
Air Industries Machining	(Restated)	
Revenue	\$ 34,088,056	\$ 33,044,996
Gross Profit	7,687,817	5,042,054
Pre Tax Income	2,739,500	1,563,036
Assets	31,304,053	24,576,329
Sigma Metals		
Revenue	9,890,659	--
Gross Profit	2,781,253	--
Pre Tax Income	303,996	--
Assets	11,463,079	--
Welding Metallurgy		
Revenue	2,089,930	--
Gross Profit	1,588,347	--
Pre Tax Income	1,026,715	--
Assets	8,425,658	--
Corporate		
Revenue	--	--
Gross Profit	--	--
Pre Tax Income	(3,503,866)	(1,409,636)
Assets	22,962,665	8,333,815
Consolidated		
Revenue	46,068,645	33,044,996
Gross Profit	12,057,417	5,042,054
Pre Tax Income	566,344	153,400
Provision for Taxes	365,319	489,969
Net Income	201,025	(336,569)
Elimination of Assets	(23,865,005)	(8,017,962)
Assets	50,290,040	24,892,182

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## AIR INDUSTRIES GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 19 RESTATEMENT AND ADJUSTED UNAUDITED QUARTERLY DATA

We have made certain adjustments, described below, to our balance sheet as of December 31, 2007 and our results of operations previously reported in our Form 10-K for the year ended December 31, 2007 and Form 10-QSBs for the first three fiscal quarters of 2007. These adjustments were the result of:

- o our determination to capitalize certain amounts related to development expenditures made in the first three quarters of 2007 previously expensed and the completion of the allocation of the purchase price we paid for Sigma Metals and Welding Metallurgy among certain intangible assets of those companies that initially had been allocated to goodwill. These adjustments were previously included on our Form 10K filed on April 14, 2008, for the year-ended December 31, 2007. These adjustments have been audited by McGladrey & Pullen, LLP and are indicated in the tables below as adjustment (1) and (2).
- o our determination to make certain adjustments to our statement of operations to account for the "beneficial conversion feature" upon the issuance of our Series B Preferred Stock issued in the second quarter of 2007, following our receipt of a letter from the Staff of the Securities and Exchange Commission dated August 29, 2008, requesting information with respect to the accounting treatment of the Series B Preferred Stock. This adjustment was previously included on our Form 10Q filed on November 19, 2008 under the caption, restated statement of operations for the nine months ended September 30, 2007. This adjustment reduces the Net Income Available to Common Shareholders by \$1,589,000. This adjustment has been audited by McGladrey & Pullen, LLP and is indicated in the tables below as adjustment (3).
- o our discovery that certain expenses in the amount of \$673,229 which should have been included in cost of goods sold were classified as a reduction of accounts payable and accrued expenses, resulting in the understatement of cost of goods sold and accounts payable and accrued expenses by a like amount. Additionally the results of this adjustment created an income tax benefit in the amount of \$246,354. The aggregate effect of which is to reduce our net income for the year ended December 31, 2007 and to reduce our stockholders' equity at December 31, 2007 by \$426,875. This adjustment has been audited by Rotenberg Meril Solomon Bertiger & Guttilla PC and are indicated in the tables below as adjustment (4).

#### Balance Sheet Restated Items

	2007 as filed -----	adjustments -----	Note ----	2007 restated -----
Accounts Payable and Accrued expenses	\$ 6,549,122	\$ 673,229	(4)	\$ 7,222,351
Income Taxes Payable	390,615	(246,354)	(4)	144,261
Accumulated Deficit	\$ (458,373)	\$ (426,875)	(4)	\$ (885,248)

2007

2007

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	As Filed	Adjustments	Note	Adjusted
Net Income	\$ 46,068,645	\$ --		\$ 46,068,645
Cost of Sales	33,337,999	673,229	(4)	34,011,228
Gross Profit	12,730,646	673,229		12,057,417
Cost and expenses	9,894,619	--		9,894,619
Operating Income	2,836,027	673,229		2,162,798
Interest and amortization costs	1,578,377	--		1,578,377
Other (Income) Expenses	18,077	--		18,077
Income before income taxes	1,239,573	(673,229)		566,344
Income tax provision	611,673	(246,354)	(4)	365,319
Net (Loss) Income	627,900	(426,875)		201,025
Less: Dividend attributable to preferred stockholders	394,042	--		394,042
Less: Beneficial conversion Feature	--	1,589,000	(3)	1,589,000
Net (loss) income attributable to common stockholders	\$ 233,858	\$ (1,548,158)		\$ (1,782,016)
Loss per common share:	--	--		--
Net loss per common share (Basic)	\$ 0.00	--		\$ (0.03)
Net loss per common share (Diluted)	\$ 0.00	--		\$ (0.03)
Weighted average shares outstanding (Basic)	65,402,711	--		65,402,711
Weighted average shares outstanding (Diluted)	67,861,015	--		65,402,711

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	Q1 2007 as filed	Adjustments	Notes	Q1 2007 Adjusted	Q2 2007 as filed
Net Income	\$ 7,488,130	\$ --		\$ 7,488,130	\$ 10,989,536
Cost of Sales	6,239,484	(418,014)	(1)	--	8,616,698
	--	(88,169)	(4)	5,733,301	--
Gross Profit	1,248,646	506,183		1,754,829	2,372,838
Cost and expenses	1,126,792	--		1,126,792	2,330,498
Operating Income	121,854	506,183		628,037	42,340
Interest and amortization costs	130,954	--		130,954	280,869
Other (Income) Expenses	(2,377)	--		(2,377)	(1,224)
Income before income taxes	(6,723)	506,183		499,460	(237,305)
Income tax provision	64,764	194,430	(1)	--	78,138
	--	41,046	(4)	300,240	--

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Net (Loss) Income	(71,487)	270,707	199,220	(315,443)
Less: Dividend attributable to preferred stockholders	--	--	--	110,964
Less: Beneficial conversion Feature	--	--	--	--
Net (loss) income attributable to common stockholders	(71,487)	270,707	199,220	(426,407)
Loss per common share:				
Net loss per common share (Basic)	\$ (0.00)		\$ 0.00	\$ (0.01)
Net loss per common share (Diluted)	\$ (0.00)		\$ 0.00	\$ (0.01)
Weighted average shares outstanding (Basic)	58,833,681		58,833,681	65,667,564
Weighted average shares outstanding (Diluted)	58,833,681		60,202,835	65,667,564

	Q3 2007 as filed	Adjustments	Notes	Q3 2007 Adjusted	Q4 2007 as filed
Net Income	\$ 12,845,821	\$ --		\$ 12,845,821	\$ 14,745,158
Cost of Sales	9,254,338	(456,336)	(1)	--	10,536,063
	--	38,222	(4)	8,836,224	--
Gross Profit	3,591,483	418,114		4,009,597	4,209,065
Cost and expenses	2,617,134	112,921	(1) (2)	2,730,055	3,651,393
Operating Income	974,349	305,193		1,279,542	557,702
Interest and amortization costs	478,920	--		478,920	687,634
Other (Income) Expenses	26,074	--		26,074	(4,396)
Income before income taxes	469,355	305,193		774,548	(125,536)
Income tax provision	46,761	159,757	(1) (2)	188,737	(108,217)
	--	(17,781)	(4)	--	--
Net (Loss) Income	422,594	163,217		585,811	(17,319)
Less: Dividend attributable to preferred stockholders	136,578	--		136,578	146,500
Less: Beneficial conversion Feature	--	--		--	--
Net (loss) income attributable to common stockholders	\$ 286,016	\$ 163,217		449,233	(163,819)
Loss per common share:					
Net loss per common share (Basic)	\$ 0.00			\$ 0.01	\$ (0.00)
Net loss per common share (Diluted)	\$ 0.00			\$ 0.01	\$ (0.00)
Weighted average shares outstanding (Basic)	67,838,959			67,838,959	69,122,227



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Weighted average shares outstanding (Diluted)	70,734,615	70,734,615	70,738,078
--	------------	------------	------------

(1) The adjustments to Cost of Sales relates to our determination to capitalize certain engineering costs initially expensed.

(2) The adjustments to costs and expenses relate to the amortization of amounts attributable to intangibles that have been specifically identified among the assets of Sigma and Welding Metallurgy that initially had been included in goodwill.

As of June 30, 2007 and September 30, 2007, \$3,720,000 and \$2,434,225 was reclassified from goodwill to intangibles, respectively, related to the completion of the allocation of purchase prices. There was no impact on cash flow for any of the periods.

(3) The beneficial conversion feature adjustment arises as the conversion price of the convertible preferred stock is less than the fair value of the common shares into which it is convertible.

(4) The adjustment to Cost of Sales relates to certain expenses which should have been included in cost of goods sold were classified as a reduction of accounts payable and accrued expenses.

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SIGNATURES

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

AIR INDUSTRIES GROUP, INC.

Dated: October 9, 2009

By: /s/ Peter D. Rettaliata

-----  
Peter D. Rettaliata  
President and CEO  
(principal executive officer)

By: /s/ Scott Glassman

-----  
Scott Glassman  
Chief Accounting Officer  
(principal financial and accounting officer)