

AIR INDUSTRIES GROUP  
Form 10-K  
April 04, 2016

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

FORM 10-K

Annual Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended: December 31, 2015

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

Commission File No. 001-35927

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

Nevada  
(State or other jurisdiction of incorporation or  
organization)

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

360 Motor Parkway, Suite 100, Hauppauge, New York 11788  
(Address of Principal Executive Offices)

(631) 881-4920  
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

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

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

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

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

As of June 30, 2015, the aggregate market value of our common stock held by non-affiliates was \$68,233,558, based on 6,722,518 shares of outstanding common stock held by non-affiliates, and a price of \$10.15 per share, which was the last reported sale price of our common stock on the NYSE MKT on that date.

There were a total of 7,560,040 shares of the registrant’s common stock outstanding as of March 1, 2016.

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## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement relating to its 2016 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. Such Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

AIR INDUSTRIES GROUP  
FORM 10-K  
For the Fiscal Year Ended December 31, 2015

|                 |   | Page |
|-----------------|---|------|
| <b>PART I</b>   |   |      |
| <u>Item 1.</u>  | <u>Business</u>   | 1    |
| <u>Item 1A.</u> | <u>Risk Factors</u>   | 6    |
| <u>Item 2.</u>  | <u>Properties</u>   | 12   |
| <u>Item 3.</u>  | <u>Legal Proceedings</u>  | 13   |
| <u>Item 4.</u>  | <u>Mine Safety Disclosures</u>  | 13   |
| <b>PART II</b>  |   |      |
| <u>Item 5.</u>  | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 14   |
| <u>Item 6.</u>  | <u>Selected Financial Data</u>  | 15   |
| <u>Item 7.</u>  | <u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>                         | 15   |
| <u>Item 8.</u>  | <u>Financial Statements and Supplementary Data</u>  | 29   |
| <u>Item 9.</u>  | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 29   |
| <u>Item 9A.</u> | <u>Controls and Procedures</u>  | 29   |
| <u>Item 9B.</u> | <u>Other Information</u>  | 30   |
| <b>PART IV</b>  |   |      |
| <u>Item 15.</u> | <u>Exhibits and Financial Statements Schedule</u>   | 32   |
|                 | <u>Consolidated Financial Statements</u>  | F-1  |

(i)

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## We are an Emerging Growth Company

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

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

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

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

## Cautionary Note Regarding Forward-Looking Statements

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

Forward-looking statements are predictive in nature and can be identified by the fact that they do not relate strictly to historical or current facts and generally include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions. Although we believe that these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital, capital expenditures, distribution channels, profitability, new products, adequacy of funds from operations, and general economic conditions, these statements and other projections contained herein expressing opinions about future outcomes and non-historical information, are subject to uncertainties and, therefore, there is no assurance that the outcomes expressed in these statements will be achieved.

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

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

(ii)



## PART I

## ITEM 1. BUSINESS

## Introduction

As used in this report, unless otherwise stated or the context requires otherwise, the "Company" and terms such as "we," "us" "our," and "AIRI" refer to Air Industries Group, a Nevada corporation, and its directly and indirectly wholly-owned subsidiaries.

We are an aerospace and defense company. We manufacture and design structural parts and assemblies that focus on flight safety, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants, jet engines and other components. We also provide sheet metal fabrication of aerostructures, tube bending and welding services. Our products are currently deployed on a wide range of high profile military and commercial aircraft including Sikorsky's UH-60 Black Hawk and CH-47 Chinook helicopters, Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2 Hawkeye, Boeing's 777, Airbus' 380 commercial airliners and the US Navy F-18 and USAF F-16 fighter aircraft. Our Turbine Engine sector makes components for jet engines that are used on the USAF F-15, the Airbus A-330 and A-380, and the Boeing 777, in addition to a number of ground turbine applications.

We became a public company in 2005 when our net sales were approximately \$30 million. At that time we had been manufacturing components and subassemblies for the defense and commercial aerospace industry for over 45 years and had established long term relationships with leading defense and aerospace manufacturers. On August 30, 2013, we reincorporated as a Nevada corporation and changed our name to Air industries Group. Since becoming public we have completed a series of acquisitions of defense related businesses. Since January 1, 2014, we have made the following acquisitions:

- In April 2014, we acquired Woodbine Products, Inc. ("WPI"). WPI was founded in 1954 and is a fabricator of precision sheet metal assemblies for aerospace applications;
  - In June 2014, we acquired Eur-Pac Corporation ("Eur-Pac" or "EPC"). EPC was founded in 1947 and specializes in military packaging and supplies all branches of the United States Defense Department with ordnance parts and kits, hose assemblies, hydraulic, mechanical and electrical assemblies;
  - In September 2014, we acquired Electronic Connection Corporation ("ECC"). ECC was founded in 1989 and specializes in wire harnesses and leads for the aerospace and other industries;
  - In October 2014, we acquired AMK Welding, Inc. ("AMK"). AMK has been a provider of welding services to the aerospace industry since 1964. For more than ten years it was owned by Dynamic Materials Corporation and was part of what once was a group of aerospace companies owned by DMC;
  - In March 2015, we acquired Sterling Engineering Corporation ("Sterling"). Founded in 1941, Sterling provides complex machining services and its business is concentrated with aircraft jet engine and ground turbine manufacturers; and
- In September 2015, we acquired Compac Development Corporation ("Compac"). Founded in 1976, Compac specializes in the manufacture of RFI/EMI (Radio Frequency Interference – Electro-Magnetic Interference) shielded enclosures for electronic components.

As a result of our acquisition program, including those noted above, our revenues in 2015, with a contribution of only \$7,362,000 from Sterling and Compac, were \$80,442,000.

We currently divide our operations into three operating segments: Complex Machining; Aerostructures and Electronics; and Turbine Engine Components. As our businesses continue to develop and evolve, and we acquire additional companies, we may deem it appropriate to reallocate our companies into different operating segments and, once we achieve sufficient integration among our businesses, report as a unified company.

## Our Market

We operate in both the military and, to a lesser degree, commercial aviation industries. Defense revenues represent a preponderance of our sales. Our principal customers include Sikorsky Aircraft, Goodrich Landing Gear Systems, Northrop Grumman, the United States Department of Defense, GKN Aerospace, Lockheed, Boeing, Raytheon, Piper Aircraft, M7 Aerospace, Vought Aerospace, Ametek/Hughes-Treitler and Airbus.

Our products are incorporated into many aircraft platforms, the majority of which remain in production, and of which there are a substantial number of operating aircraft. We believe that we are the largest supplier of flight critical parts to Sikorsky's Black Hawk helicopter. We also make products for the CH-47 Chinook helicopter, Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2 Hawkeye, Boeing's 777, Airbus' 380 commercial airliners, and the US Navy F-18 and USAF F-16 fighter aircraft. Our Turbine Engine Components segment makes components for jet engines that are used on the USAF F-15, the Airbus A-330 and A-380, and the Boeing 777, in addition to a number of ground turbine applications.

Many of our products are "flight critical" and essential to aircraft performance and safety on takeoff, during flight and when landing. These products require advanced certifications as a condition to being a supplier. For many of our products we are the sole or one of a limited number of sources of supply. Many of the parts we supply are subject to wear and tear or fatigue and are routinely replaced on aircraft on a time of service or flight cycle basis. Replacement demand for these products will continue, albeit at perhaps a lower rate, so long as an aircraft remains in service, which is usually many years after production has stopped. In addition, as more fuel efficient engines are developed they will be substituted for engines currently in use.

The Department of Defense announced plans to significantly reduce spending beginning in Fiscal 2013. In addition, on March 1, 2013, as a result of the continuing budget impasse, automatic government spending cuts termed the Sequester were implemented. It appears that our revenues, particularly those of our Complex Machining segment, have been impacted by a slowing of orders in anticipation of a reduction or shift in the mix of defense spending and there can be no assurance that our financial condition and results of operations will not be materially adversely impacted by future reductions in defense spending or a change in the mix of products purchased by defense departments in the United States or other countries, or the perception on the part of our customers that such changes are about to occur. The President's proposed budget for Fiscal 2016, which went into effect October 1, 2015, provides for an increase in defense spending. Nevertheless, there can be no assurance that any such increase will increase demand for the products we supply or otherwise redound to our benefit.

## Sales and Marketing

Our approach to sales and marketing can be best understood through the concept of customer alignment. The aerospace industry is dominated by a small number of large prime contractors and equipment manufacturers. These customers rely heavily upon subcontractors to supply quality parts meeting specifications on a timely and cost effective basis. These customers and other customers we supply routinely rate their suppliers based on a variety of performance factors. One of our principal goals is to be highly rated and thus relied upon by all of our customers.

The large prime contractors are increasingly seeking subcontractors who can supply and are qualified to integrate the fabrication of larger, more complex and more complete subassemblies. We seek to position ourselves within the supply chain of these contractors and manufacturers to be selected for subcontracted projects. Successful positioning requires that we qualify to be a preferred supplier by achieving and maintaining independent third party quality approval certifications, specific customer quality system approvals and top supplier ratings through strong performance on existing contracts. We believe that the various capabilities we have acquired through our acquisition program increase the likelihood we will qualify for and be awarded larger, more complex projects. As an example of



our successful efforts to move up the supplier chain, our Aerostructures and Electronics segment has grown from being a supplier of welding services to being a supplier of welding subassemblies and is now a product integrator, providing customers with complete structural assemblies.

As part of our effort to become a product integrator and increase our value to our customers, we have recruited personnel to fabricate complete, fully-assembled products, and, more recently, design products. In our marketing efforts we let customers know that we now have employees with the talent and experience to manage the manufacture of sections of aircraft structures to be delivered to the final assembly phase of the aircraft manufacturing cycle, and customers have now engaged us for these services.

As we acquire new businesses, we often gain new or enhanced technical capabilities. We seek to exploit these new capabilities by introducing to our customer newly acquired products and capabilities we previously lacked. Businesses we acquire often bring to us customers we have not previously supplied and we market to these customers the products and services they need which we historically provided. This marketing effort has enabled us to grow some of the businesses we acquired and increased our value to our customers. For example, the acquisition of the business of Nassau Tool Works in 2012 expanded our capabilities in the “turning” of metal components. This enhanced capability was important in our Complex Machining segment winning a large multi-year commercial aerospace contract to supply Thrust Struts to a unit of UTAS for use in the Pratt & Whitney Geared Turbo Fan jet engine.

Initial contracts are usually obtained through competitive bidding against other qualified subcontractors, while follow-on contracts are usually retained by successfully performing initial contracts. The long term business of each of our current operating segments generally benefits from barriers to entry resulting from investments, certifications, familiarization with the needs and systems of customers, and manufacturing techniques developed during the initial manufacturing phase. As our business base grows with targeted customers, we endeavor to develop each of our relationships to one of a “partnership” where we participate in the resolution of pre-production design and build issues, and initial contracts are obtained as single source awards and follow-on pricing is determined through negotiations. Despite these efforts we estimate that a minority of our sales are based on negotiated prices.

#### Our Backlog

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

Within our Complex Machining and Turbine Engine Components segments, the production cycle of products can extend from several months to a year or longer. This gives rise to significant backlogs as customers must order product with sufficient lead time to ensure timely delivery. In contrast, the production cycle for a significant majority of the products produced in our Aerospace and Electronics segment is much shorter, a matter of several weeks or a few months. This shorter cycle allows customers to delay orders resulting in a much smaller backlog.

We have a number of long-term multi-year General Purchase Agreements or GPA’s with several of our customers. These agreements specify part numbers, specifications and prices of the covered products for a specified period, but do not authorize immediate production and shipment. Shipments are authorized periodically by the customer to fit their production schedule.

Our "firm backlog" includes only fully authorized orders received for products to be delivered within the forward 18-month period. As of February 29, 2016, our 18-month "firm backlog" was approximately \$81 million.

#### Competition

Winning a new contract is highly competitive. For the most part we manufacture to customer designs and specifications, and compete against companies that have similar manufacturing capabilities in a global marketplace. Consequently, the ability to obtain contracts requires providing quality products at competitive prices. To accomplish this requires that we strive for continuous improvement in our capabilities to assure our competitiveness and provide value to our customers. Our marketing strategy involves developing long-term ongoing working relationships with customers. These relationships enable us to develop entry barriers to would-be competitors by establishing and maintaining advanced quality approvals, certifications and tooling investments that are difficult and expensive to duplicate. Despite these barriers to entry, many of our competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers. Among our competitors are; Monitor Aerospace, a division of Stellex Aerospace; Hydromil, a division of Triumph Aerospace

Group; Heroux Aerospace and Ellanef Manufacturing, a division of Magellan Corporation.

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

#### Raw Materials and Replacement Parts

The manufacturing process for certain products, particularly those for which we serve as product integrator, requires significant purchases of raw materials, hardware and subcontracted details. As a result, much of our success in profitably meeting customer demand for these products requires efficient and effective subcontract management. Price and availability of many raw materials utilized in the aerospace industry are subject to volatile global markets. Most suppliers of raw materials are unwilling to commit to long-term contracts at fixed prices. This is a substantial risk as our strategy often involves long term fixed price commitments to our customers.

## Future Expansion Strategy

Since the 1990s, the aerospace and defense industries have undergone radical consolidation and realignment. The largest prime contractors have merged or been acquired resulting in fewer, and much larger, entities. Some examples are Boeing which acquired McDonnell Douglas; Lockheed Martin, formed by Lockheed's acquisition of Martin Marietta, together with the aerospace divisions of General Dynamics; Northrop Grumman, which fused together Northrop, Grumman, Westinghouse and Litton Industries into one entity. Where once there were nine companies there are now just three. In November 2015, Lockheed Martin acquired Sikorsky from United Technologies.

The consolidation of the prime contractors has caused a similar consolidation of suppliers. Major contractors seek to streamline and reduce the cost of managing supply chains by buying both larger quantities and more complete sub-assemblies from fewer suppliers. This has led to increased competitive pressure on many smaller firms. To survive in this environment, suppliers must invest in systems and infrastructures capable of interfacing with and meeting the needs of prime contractors. We have made the effort to do so since becoming a public company in 2005. Suppliers with \$15-\$100 million in annual sales, referred to as the "Tier III and IV Manufacturing Sector," must become fully capable of working interactively in a computer aided three dimensional automated engineering environment and must have independent third party quality system certifications. We believe this industry trend will increase pressure on smaller aerospace/defense critical component manufacturers, the Tier III and IV suppliers, as the cost of upgrading their systems to achieve the level of connectivity necessary to work interactively with prime contractors, to the extent they have not already done so, will adversely impact their profit margins. Our acquisitions are part of our strategy to react to and benefit from this market environment.

We intend to increase our business through internal growth and accretive acquisitions. Our ability to make acquisitions is dependent, in part, on our available cash and upon our ability to raise debt or equity as necessary to complete any acquisition.

## Employees

As of March 1, 2016, we employed approximately 366 people. Of these, approximately 42 were in administration, 29 were in sales and procurement, and 295 were in manufacturing.

Air Industries Machining, one of the components of our Complex Machining segment, is a party to a collective bargaining agreement (the "Agreement") with the United Service Workers, IUJAT, Local 355 (the "Union") with which we believe we maintain good relations. The Agreement, dated January 1, 2016, expires December 31, 2018 and covers all of AIM's production personnel, of which there are approximately 104 people. AIM is required to make a monthly contribution to each of the Union's United Welfare Fund and the United Services Worker's Security Fund. This is the only pension benefit required by the Agreement and the Company is not obligated for any future defined benefit to retirees. The Agreement contains a "no-strike" clause, whereby, during the term of the Agreement, the Union will not strike and AIM will not lockout its employees.

All of our employees are covered under a co-employment agreement with Insperity, Inc.

## Regulations

### Environmental Regulation; Employee Safety

We are subject to regulations administered by the United States Environmental Protection Agency, the Occupational Safety and Health Administration, various state agencies and county and local authorities acting in cooperation with federal and state authorities. Among other things, these regulatory bodies impose restrictions that require us to control

air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous chemicals and substances. The extensive regulatory framework imposes compliance burdens and financial and operating risks on us. Governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose civil and criminal fines in the case of violations.

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

#### Federal Aviation Administration

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

#### Government Contract Compliance

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

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

## ITEM 1A. RISK FACTORS

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

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

The risks below can be characterized into three groups:

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

### Risks Related to Our Business

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

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

On March 1, 2013, the US Government imposed across the board spending reductions commonly referred to as “the Sequester”. These included reductions in spending by the Department of Defense. During 2014 and 2015, we experienced a reduction in sales in our Complex Machining segment that we believe was the result of a slowing of orders as a result of the Sequester. In December 2015, the US Government agreed upon a spending budget for the Department of Defense for the 2016 and 2017 Fiscal Years and eliminated the Sequester. While we expect that spending will increase pursuant to these budgets, there can be no assurance that this increase will materialize or that it will lead to an increase in orders for our products.

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

We expect that our customer concentration will not change significantly in the near future. We derive most of our revenues from a small number of customers. Two customers represented approximately 35.9% and two customers represented approximately 47.3% of total sales for the years ended December 31, 2015 and 2014, respectively. The markets in which we sell our products are dominated by a relatively small number of customers which have contracts

with United States governmental agencies, thereby limiting the number of potential customers. Our success depends on our ability to develop and manage relationships with significant customers. We cannot be sure that we will be able to retain our largest customers or that we will be able to attract additional customers, or that our customers will continue to buy our products in the same amounts as in prior years. The loss of one or more of our largest customers, any reduction or interruption in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may have to make, could significantly harm our business.



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

Our Complex Machining segment derives most of its revenues from components for a few aircraft platforms, specifically the Sikorsky BlackHawk helicopter, the Northrop Grumman E-2 Hawkeye naval aircraft, the McDonnell Douglas (Boeing) C-17 Globemaster, the F-16 Falcon and the F-18 Hornet. Boeing closed its C-17 production line in 2015.. A reduction in demand for our products as a result of either a reduction in the production of new aircraft or a reduction in the use of existing aircraft in the fleet (reducing after-market demand) would have a material adverse effect on our operating results and financial condition.

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

The defense and aerospace component manufacturing market is highly competitive and we expect that competition will increase and perhaps intensify as the overall market remains static or declines. Many competitors have significantly greater technical, manufacturing, financial and marketing resources than we do. We expect that more companies will enter the defense and aerospace component manufacturing market. We may not be able to compete successfully against either current or future competitors. Increased competition could result in reduced revenue, lower margins or loss of market share, any of which could significantly harm our business our operating results and financial condition.

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

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

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

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

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

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

The prices of raw materials we use are volatile.

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

Some of the products we produce have long lead times.

Some of the products we produce, particularly those of our Complex Machining segment, require months to produce and we sometimes produce products in excess of the number ordered intending to sell the excess as spares when orders arise. As a result, our inventory turns slowly and often represents more than 40% of our assets. Any requirement to write down the value of our inventory due to obsolescence or a drop in the price of materials could have a material adverse effect on our consolidated financial position or results of operations.

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

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

There are risks associated with new programs.

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

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

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

We expect to experience growth in the number of employees and the scope of our operations as a result of internal growth and through acquisitions. This will result in increased responsibilities for management and could strain our financial and other resources. There can be no assurance that we will successfully integrate any future business acquired through acquisition.

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

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

Our future success also depends on our ability to address potential market opportunities and to manage expenses to match our ability to finance operations.

The need to control our expenses will place a significant strain on our management and operational resources. If we are unable to control our expenses effectively, our business, results of operations and financial condition may be adversely affected.

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

Our future success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel and on our ability to continue to attract, retain and motivate executive and other

key employees. Experienced management and technical, marketing and support personnel in the defense and aerospace industries are in demand and competition for their talents is intense. The loss of the services of one or more of our key employees or our failure to attract, retain and motivate qualified personnel could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

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

#### Risks Related to Our Indebtedness

Our indebtedness may materially adversely affect our operations.

As is more fully described under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources", we have significant indebtedness. Our loan facility is secured by substantially all of our assets. In the case of a continuing default under our loan facility, the lender will have the right to foreclose on our assets, which would have a material adverse effect on our business. Future payments of principal and interest or a change in policy by our lender may limit our ability to pay cash dividends to our stockholders.

Our leverage may adversely affect our ability to finance future operations and capital needs, may limit our ability to pursue business opportunities and may make our results of operations more susceptible to adverse economic conditions.

Our Indebtedness may limit our ability to pay dividends.

The terms of our Loan Facility with PNC requires that we maintain certain financial covenants and that we may pay a dividend only if after taking such dividend into effect we satisfy certain prescribed financial conditions. It is likely that any loan facility we might enter into in replacement of, or in addition to, the PNC Facility would contain similar provisions.

9

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

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

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

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

The number of shares of our common stock eligible for resale is enormous relative to the trading volume of our common stock. Any attempt to sell a substantial number of our shares will severely depress the market price of our common stock. In addition, we may use our capital stock in the future to finance acquisitions and to compensate employees and management, which will further dilute the interests of our existing shareholders and could eventually significantly depress the trading price of our common stock. Furthermore, we may sell additional shares of common stock if the Board deems it in our best interest.

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

Our 2015 Equity Incentive Plan allows for the issuance of up to 350,000 shares of common stock, either as stock grants or options, to employees, officers, directors, advisors and consultants of the company. Our 2013 Equity Incentive Plan allows for the issuance of up to 600,000 shares of common stock, either as stock grants or options, to employees, officers, directors, advisors and consultants of the company. As of December 31, 2015, we had outstanding under the 2013 Plan options to purchase 564,342 shares. The committee administering the Plan, which has sole authority and discretion to grant options under the Plan, may grant options which become immediately exercisable in the event of a change in control of our company and in the event of certain mergers and reorganizations. We also had outstanding as of December 31, 2015, warrants to purchase 164,585 shares of common stock. The issuance of shares of our common stock upon exercise of outstanding stock options and warrants, or the possible issuance of shares upon exercise of further stock options granted under our stock option plans, may limit the price that investors are willing to pay in the future for shares of our common stock and have the effect of delaying or preventing a change in control of our company, and the issuance of shares under the plan will decrease the amount of earnings and assets available for distribution to existing holders of our common stock and dilute their voting power.

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

The JOBS Act permits "emerging growth companies" like us to rely on some of the reduced disclosure requirements that are already available to companies having a public float of less than \$75 million, for as long as we qualify as an emerging growth company. During that period, we are permitted to omit the auditor's attestation on internal control over financial reporting that would otherwise be required by the Sarbanes-Oxley Act. Companies with a public float of \$75 million or more must otherwise procure such an attestation beginning with their second annual report after their initial public offering. For as long as we qualify as an emerging growth company, we are also excluded from the

requirement to submit "say-on-pay", "say-on-pay frequency" and "say-on-parachute" votes to our stockholders and may avail ourselves of reduced executive compensation disclosure compared to larger companies. In addition, as described in the following risk factor, as an emerging growth company we can take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies.

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



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

Section 107 of the JOBS Act also provides that, as an emerging growth company, we can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. We can therefore delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of the benefits of this extended transition period. Our financial statements may therefore not be comparable to those of companies that comply with such new or revised accounting standards. Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates" for further discussion of the extended transition period for complying with new or revised accounting standards.

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

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

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

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

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

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

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

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

## ITEM 2. PROPERTIES

Our executive offices are located at 360 Motor Parkway, Suite 100, Hauppauge, New York 11788. We occupy our executive offices under a lease with approximately six years remaining in the term which ends January 2022. The annual rent was \$117,000 for the first lease year, decreased to \$103,278 for the lease year which began in January 2016, increases by approximately 3% per annum each year thereafter until the seventh lease year when the rent will be approximately \$103,000.

The operations of a portion of our Complex Machining segment are conducted on a 5.4-acre corporate campus in Bay Shore, New York. We occupy three buildings on the campus, consisting of 76,000 square feet.

On October 24, 2006, we entered into a “sale/leaseback” transaction whereby we sold the buildings and real property located at the corporate campus and entered into a 20-year triple-net lease for the property. Base annual rent for 2015 was approximately \$684,000 and increases by 3% each subsequent year. The lease grants us an option to renew the lease for an additional five years. Under the terms of the lease, we are required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance.

The remaining portion of the operations of our Complex Machining segment are conducted in a 60,000 square foot facility in West Babylon, New York. The space is occupied under a lease which provides for an annual base rent of approximately \$360,000 through October 30, 2018.

The operations of our Aerostructures and Electronics segment are principally conducted in an 81,035 square foot facility located in Hauppauge, New York. This space is occupied under a sublease which had an annual base rent of approximately \$614,000 for 2015 and increases by an agreed upon amount each anniversary of the commencement of the lease through December 31, 2026.

The balance of our Aerostructures and Electronics segment are located in a 16,000 square foot facility in Waterbury, Connecticut. The space is occupied under a lease which has an annual base rent of approximately \$115,000 and expires May 31, 2019; and a 9,200 square foot space in Bay Shore, New York. The space is occupied under a lease which has an annual base rent of approximately \$70,000 and expires April 30, 2018.

The operations of our Turbine Engine Components segment are conducted in a 33,850 square foot facility on a four acre parcel in South Windsor, Connecticut, which we own and a 74,923 square foot facility on a 24 acre parcel in Barkhamsted, Connecticut, which we own.

In March 2015, the property in South Windsor and the property in Barkhamsted were transferred to Air Realty Group, LLC, which is wholly owned by Air Industries Group.

On December 7, 2015, we entered into a contract with an unaffiliated third party pursuant to which the purchaser will acquire our South Windsor, Connecticut property for \$1,700,000, subject to routine closing adjustments. The closing of the transaction is anticipated to occur in the first week of April 2016. Upon closing of the transaction, we will enter into a lease for the property with an initial term of 15 years, with an option to renew the lease for an additional five

years. In addition to rent, initially \$155,000 per annum, subject to annual increase, we also will be responsible for real estate taxes and the maintenance of the buildings and the property.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

## PART II

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

## Market for Our Common Stock

Our common stock is listed on the NYSE MKT under the symbol "AIRI." The prices set forth below reflect the quarterly high and low closing prices of a share of our common stock for the periods indicated as reported by Yahoo Finance.

|                                  | High     | Low     |
|----------------------------------|----------|---------|
| Quarter Ended March 31, 2014     | \$ 9.64  | \$ 7.97 |
| Quarter Ended June 30, 2014      | \$ 12.48 | \$ 9.50 |
| Quarter Ended September 30, 2014 | \$ 11.00 | \$ 9.00 |
| Quarter Ended December 31, 2014  | \$ 12.12 | \$ 9.80 |
| Quarter Ended March 31, 2015     | \$ 10.52 | \$ 9.70 |
| Quarter Ended June 30, 2015      | \$ 10.74 | \$ 9.91 |
| Quarter Ended September 30, 2015 | \$ 10.13 | \$ 8.06 |
| Quarter Ended December 31, 2015  | \$ 9.17  | \$ 6.98 |

## Holders

On March 1, 2016, there were approximately 230 stockholders of record of our common stock. The number of record holders does not include persons who held our common stock in nominee or "street name" accounts through brokers.

## Dividends

We have paid quarterly dividends to our shareholders each quarter commencing with the first quarter of 2013 through the third quarter of 2015. It has been our practice to pay cash dividends to our shareholders when our Board of Directors deemed appropriate. All determinations relating to our dividend policy are made at the discretion of our Board of Directors and depend on a number of factors, including future earnings, capital requirements, financial conditions and future prospects and other factors the Board of Directors may deem relevant. Further, the payment of any cash dividends requires compliance with financial covenants of the loan agreement with our principal lender and, even if such financial covenants are met, since we are highly leveraged, our Board of Directors would consider any opinion our senior lender might express with regards to the payment of any cash dividends.

## Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes shares of our Common Stock to be issued upon exercise of options and warrants, the weighted-average exercise price of outstanding options and warrants and options available for future issuance pursuant to our equity compensation plans as of December 31, 2015:

| Plan Category  | Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted Average Exercise Price Of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 564,342   | \$ 7.35   | 385,658  |
| Equity compensation plans not approved by security holders | 164,585   | \$ 7.85   | None   |
| Tot Total  | 728,927   |   | 385,658  |

## Recent Sales of Unregistered Securities

Except as previously reported in our periodic reports filed under the Exchange Act, we did not issue any unregistered securities during the fiscal year ended December 31, 2015.

## Purchases of Our Equity Securities

No repurchases of our common stock were made during the fiscal year ended December 31, 2015.

## ITEM 6. SELECTED FINANCIAL DATA

Not required.

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

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

## Business Overview

We are an aerospace company operating primarily in the defense industry, though the proportion of our business represented by the commercial sector is increasing. We manufacture and design structural parts and assemblies that

focus on flight safety, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants, jet engines and other components. We also provide sheet metal fabrication of aerostructures, tube bending and welding services. Our Turbine Engine Components sector makes components for jet engines and ground turbines. Our products are currently deployed on a wide range of high profile military and commercial aircraft.



We became a public company in 2005 when our net sales were approximately \$30 million. At that time we had been manufacturing components and subassemblies for the defense and commercial aerospace industry for over 45 years and had established long-term relationships with leading defense and aerospace manufacturers. Since becoming public, we have completed a series of acquisitions of defense related businesses which have enabled us to broaden the range of products and services beyond those which we provide at the time we became a public company. Although prior to becoming a public company, we were primarily a machining shop, as a result of acquisitions, we now have capabilities and expertise in metal fabrication, welding and tube bending; the production of electromechanical systems, harness and cable assemblies; the fabrication of electronic equipment and printed circuit boards; the machining of turbine engine components, and the assembly of packages or “kits” containing supplies for all branches of the United States Defense Department, including ordnance parts, hose assemblies, hydraulic, mechanical and electrical assemblies.

Since January 1, 2014 we have acquired the following businesses:

- In April 2014 we acquired WPI. WPI is a fabricator of precision sheet metal assemblies for aerospace applications;
- In June 2014 we acquired Eur-Pac. EPC specializes in military packaging and supplies all branches of the United States Defense Department with ordnance parts and kits, hose assemblies, hydraulic, mechanical and electrical assemblies;
- In September 2014 we acquired ECC. ECC specializes in wire harnesses and leads for the aerospace and other industries;
- In October 2014 we acquired AMK. AMK has been a provider of welding services to the aerospace industry since 1964;
- In March 2015, we acquired Sterling. Sterling provides complex machining services and its business is concentrated with aircraft jet engine and ground turbine manufacturers; and
- In September 2015, we acquired Compac. Compac specializes in the manufacture of RFI/EMI (Radio Frequency Interference – Electro-Magnetic Interference) shielded enclosures for electronic components.

As a result of the foregoing acquisitions, our revenues in 2015, with a contribution of \$7,362,000 from Sterling and Compac, were \$80,442,000.

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

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

While our revenues are largely determined by the number of contracts we are awarded, the volume of product delivered and price of product under each contract, our costs are determined by a number of factors. The principal factors impacting our costs are the cost of materials and supplies, labor, financing and the efficiency at which we can

produce our products. The cost of materials used in the aerospace industry is highly volatile. In addition, the market for the skilled labor we require to operate our plants is highly competitive. The profit margin of the various products we sell varies based upon a number of factors, including the complexity of the product, the intensity of the competition for such product and, in some cases, the ability to deliver replacement parts on short notice. Thus, in assessing our performance from one period to another, a reader must understand that changes in profit margin can be the result of shifts in the mix of products sold.

A very large percentage of the products we produce are used on military as opposed to civilian aircraft. These products can be replacements for aircraft already in the fleet of the armed services, or for the production of new aircraft. Reductions to the Defense Department budget have reduced the demand for both new production and replacement spares. This has reduced our sales, particularly in our complex machining segment. In response to the reduction in military sales, we are focusing greater efforts on the civilian aircraft market though we still remain dependent upon the military for an overwhelming portion of our revenues.

## Segment Data

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

We currently divide our operations into three operating segments: Complex Machining; Aerostructures and Electronics; and Turbine Engine Components. As our businesses continue to develop and evolve, and we acquire additional companies, we may deem it appropriate to reallocate our companies into different operating segments and, once we achieve sufficient integration among our businesses, report as a unified company. Along with our operating subsidiaries, we report the results of our corporate division as an independent segment.

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

## Results of Operations

The results of operations of the businesses we have acquired are included in our financial results from their respective dates of acquisition. Acquisitions completed since January 1, 2014, are shown below:

| Acquisitions                         | Date of Acquisition |
|--------------------------------------|---------------------|
| Woodbine Products, Inc.              | April 1, 2014       |
| Eur-Pac Corporation                  | June 1, 2014        |
| Electronic Connection Corporation    | September 1, 2014   |
| AMK Welding, Inc.                    | October 1, 2014     |
| The Sterling Engineering Corporation | March 1, 2015       |
| Compac Development Corporation       | September 1, 2015   |

Years ended December 31, 2015 and 2014:

Selected Financial Information:

|  | 2015          | 2014          |
|--|---------------|---------------|
| Net sales  | \$ 80,442,000 | \$ 64,331,000 |
| Cost of sales  | 63,161,000    | 50,233,000    |
| Gross profit   | 17,281,000    | 14,098,000    |
| Operating expenses, acquisition costs and interest costs | (18,513,000)  | (13,658,000)  |
| Other income (expense) net                               | 114,000       | (141,000)     |
| Income tax benefit                                       | 286,000       | 368,000       |
| Net (loss) income  | \$ (832,000)  | \$ 667,000    |

Balance Sheet Data:

|                            | December 31,<br>2015 | December 31,<br>2014 |
|----------------------------|----------------------|----------------------|
| Cash and cash equivalents  | \$ 529,000           | \$ 1,418,000         |
| Working capital            | 2,166,000            | 16,132,000           |
| Total assets               | 88,250,000           | 66,180,000           |
| Total stockholders' equity | \$ 28,805,000        | \$ 28,272,000        |

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

|   | Year Ended December 31, |               |
|---|-------------------------|---------------|
|   | 2015                    | 2014          |
| <b>COMPLEX MACHINING</b>                |                         |               |
| Net Sales                               | \$ 42,356,000           | \$ 44,220,000 |
| Gross Profit                            | 10,412,000              | 8,691,000     |
| Pre Tax Income (Loss)                   | 1,825,000               | 711,000       |
| Assets                                  | 48,353,000              | 40,611,000    |
| <b>AEROSTRUCTURES &amp; ELECTRONICS</b> |                         |               |
| Net Sales                               | 27,134,000              | 18,273,000    |
| Gross Profit                            | 6,553,000               | 4,812,000     |
| Pre Tax Income (Loss)                   | 386,000                 | (554,000 )    |
| Assets                                  | 20,229,000              | 16,788,000    |
| <b>TURBINE ENGINE COMPONENTS</b>        |                         |               |
| Net Sales                               | 10,952,000              | 1,838,000     |
| Gross Profit                            | 316,000                 | 595,000       |
| Pre Tax Income (Loss)                   | (3,329,000 )            | 142,000       |
| Assets                                  | 19,076,000              | 8,150,000     |
| <b>CORPORATE</b>                        |                         |               |
| Net Sales                               | -                       | -             |
| Gross Profit                            | -                       | -             |
| Pre Tax Income (Loss)                   | -                       | -             |
| Assets                                  | 592,000                 | 631,000       |
| <b>CONSOLIDATED</b>                     |                         |               |
| Net Sales                               | 80,442,000              | 64,331,000    |
| Gross Profit                            | 17,281,000              | 14,098,000    |
| Pre Tax Income (Loss)                   | (1,118,000 )            | 299,000       |
| Benefit from Income Taxes               | 286,000                 | 368,000       |
| Net (Loss) Income                       | (832,000 )              | 667,000       |
| Assets                                  | \$ 88,250,000           | \$ 66,180,000 |

The following discussion of our results of operations constitutes management's review of the factors that affected our financial and operating performance for the years ended December 31, 2015 and 2014. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report.

For 2015, we had three operating segments: Complex Machining comprised of AIM and NTW; Aerostructures and Electronics comprised of WMI (including Decimal and Woodbine), Eur-Pac (including ECC), MSI and beginning in October 2015, Compac; and Turbine Engine Components comprised of AMK and beginning in March 2015, Sterling.

## Net Sales:

Consolidated net sales for the year ended December 31, 2015 were approximately \$80,442,000, an increase of \$16,111,000, or 25.0%, compared with \$64,331,000 for the year ended December 31, 2014. Net sales of our Complex Machining segment were approximately \$42,356,000, a decrease of \$1,864,000, or 4.2%, from \$44,220,000 in the prior year. The nature of the parts manufactured by our Complex Machining segment are such that they tend to be larger, more complex and higher priced than many of the parts supplied by our other segments. For example, the landing gear for an F-18 fight aircraft can cost approximately \$2,200,000; consequently, even a slight decline in the number of parts sold can lead to a significant decline in revenues and gross profit. The decline in sales at our Complex Machining segment was due to delays and reductions in government procurement orders due to Sequestration. Net sales of our Aerostructures and Electronics segment were approximately \$27,134,000 and increased by \$8,861,000, or 48.5%, from \$18,273,000 in the prior year. This can be attributed to greater volume from Miller Stuart as well as acquisitions that took place during 2015 and 2014. Compac was acquired in September 2015 while full year contributions from Eur-Pac (June 2014) and ECC (September 2014) were experienced. Net sales in our Turbine Engine Components segment were approximately \$10,952,000 and increased \$9,114,000, or 495.9%, from \$1,838,000 in the prior year. The increase during 2015 reflects the acquisition of Sterling Engineering and a full-year of AMK Welding which was acquired in October of 2014.

As indicated in the table below, four customers represented 59.3% and two customers represented 47.3% of total sales for the years ended December 31, 2015 and 2014, respectively.

| Customer                            | Percentage of Sales |      |
|-------------------------------------|---------------------|------|
|                                     | 2015                | 2014 |
| Sikorsky Aircraft                   | 20.5%               | 26.8 |
| Goodrich Landing Gear Systems       | 15.4%               | 20.5 |
| United States Department of Defense | 12.0%               | *    |
| Northrup Grumman Corporation        | 11.4%               | *    |

\* Customer was less than 10% of sales for the year ended December 31, 2014.  
Sikorsky Aircraft and Goodrich Landing Gear Systems are units of United Technologies Corporation.

As indicated in the table below, four customers represented 61.1% and three customers represented 50.4% of gross accounts receivable at December 31, 2015 and 2014, respectively.

| Customer                      | Percentage of Receivables |               |
|-------------------------------|---------------------------|---------------|
|                               | December 2015             | December 2014 |
| Goodrich Landing Gear Systems | 26.6%                     | 29.0          |
| Northrup Grumman Corporation  | 13.6%                     | 11.4          |
| Sikorsky Aircraft             | 10.5%                     | *             |
| GKN Aerospace                 | 10.4%                     | 10.0          |

\* Customer was less than 10% of Gross Accounts Receivable at December 31, 2014.  
Sikorsky Aircraft and Goodrich Landing Gear Systems are units of United Technologies Corporation.



#### Gross Profit:

Consolidated gross profit from operations for the year ended December 31, 2015 was \$17,281,000 and an increase of approximately \$3,183,000, or 22.6%, as compared to gross profit of \$14,098,000 for the year ended December 31, 2014. Consolidated gross profit as a percentage of sales was 21.5% and 21.9% for the years ended December 31, 2015 and 2014, respectively. The increase in gross profit resulted largely from improvements in our Complex Machining and Aerostructures and Electronics segments. The improvement in our Complex Machining segment was the result of cost reductions. The improvement in our Aerostructures and Electronics segment can be attributed to greater volume from Miller Stuart as well as acquisitions that took place during 2015 and 2014. Compac was acquired in September 2015 while full year contributions from Eur-Pac (June 2014) and ECC (September 2014) were experienced. The slight decrease in the overall gross margin percentage results primarily from low margins in our Turbine Engine Components sector. The sector began its operations in 2014 with the acquisition of AMK and expanded in 2015 when Sterling was acquired. AMK and Sterling have yet to reach their anticipated potential.

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

Consolidated SG&A costs for the year ended December 31, 2015 totaled approximately \$16,655,000 and increased by \$4,292,000 or 34.7% compared to \$12,363,000 for the year ended December 31, 2014. Approximately \$2,424,000 or 56.5% of the increase in SG&A costs relates to the acquisitions during the 2015 and 2014 fiscal years. The acquisitions in 2015 consisted of Sterling in March and Compac in September while the acquisitions in 2014, Eur-Pac (June 2014), ECC (September 2014) and AMK (October 2014), contributed a full year of costs.

Interest and financing costs of approximately \$1,858,000 for the year ended December 31, 2015 increased \$563,000 or 43.5% as compared to \$1,295,000 for the year ended December 31, 2014. This increase can be attributed to additional amounts of debt incurred from term loans due to the AMK and Sterling acquisitions, the purchase of inventory from Circor Aerospace and cash usage for operations.

The Company recognized an income tax benefit of approximately \$286,000 for year ended December 31, 2015 compared to an income tax benefit of \$368,000 for the year ended December 31, 2014. The tax benefit for 2015 was primarily the result of a change in deferred tax positions at December 31, 2015 for expired options, state tax rate changes and a true-up of deferred tax assets related to inventory. In 2014, the tax benefit was the result of the Company's determination that it no longer needed to provide a valuation allowance on certain deferred tax assets. This was based upon the fact that management believes that due to the sustained profitability of the Company and the probability that such profitability will continue, the net deferred tax assets is more likely than not to be realized.

Net loss for the year ended December 31, 2015 was \$(832,000), a decrease of \$1,499,000, or 224.7%, compared to net income of \$667,000 for the year ended December 31, 2014, for the reasons discussed above.

#### Impact of Inflation

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



## LIQUIDITY AND CAPITAL RESOURCES

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

The Loan Facility has been amended many times during its term. The Company entered into an amendment to the Loan Facility in November 2015 and paid an amendment fee of \$40,000. At December 31, 2015, the Loan Facility consisted of a \$33,000,000 revolving loan (which includes an inventory sub-limit of \$15,000,000) and four term loans (Term Loan A, Term Loan B, Term Loan C, and Term Loan D), described below.

Under the terms of the Loan Facility the revolving credit note bore interest at the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and three quarters of one percent (2.75%) with respect to Eurodollar Rate Loans. The revolving credit note had an interest rate of 4.00% per annum at December 31, 2015 and 2014, and an outstanding balance of \$29,604,000 and \$17,672,000, respectively. The maturity date of the revolving credit note is November 30, 2016.

As a requirement of our Loan Facility substantially all of our cash receipts from operations are deposited into our lockbox account at PNC. Each day, the Company's cash collections are swept directly by the bank and these cash receipts are used to reduce our indebtedness under our revolving credit note and are then borrowed according to a borrowing base to support our operations. Because the revolving loans contain a subjective acceleration clause which could permit PNC to require repayment prior to maturity, the loans are classified with the current portion of notes and capital lease obligations.

The repayment terms of Term Loan A were amended in 2014. On April 1, 2014, the Company borrowed \$2,676,000, representing an additional \$1,328,000, to partially fund the acquisition of Woodbine. The repayment terms of Term Loan A consists of thirty-two consecutive monthly principal installments, the first thirty-one in the amount of \$31,859 which commenced on the first business day of May 2014, and continued on the first business day of each month thereafter, with a thirty-second and final payment of any unpaid balance of principal and interest on the last business day of November 2016. Term Loans A and B bear interest at (a) the sum of the Alternate Base Rate plus one and three quarters of one percent (1.75%) with respect to Domestic Rate Loans and (b) the sum of the LIBOR Rate plus three percent (3.00%) with respect to LIBOR Rate Loans. At December 31, 2015 and 2014, the balance due under Term Loan A was \$2,039,000 and \$2,421,000, respectively.

On October 1, 2014, the Company borrowed \$3,500,000 under Term Loan B for the acquisition of AMK. The repayment of Term Loan B consists of sixty consecutive monthly principal installments, the first fifty-nine in the amount of \$58,333 which commenced on the first business day of December 2014, and continued on the first business day of each month thereafter, with a sixtieth and final payment of any unpaid balance of principal and interest on the last business day of November 2019. At December 31, 2015 and 2014, the balance due under Term Loan B was \$2,742,000 and \$3,442,000, respectively.

On December 31, 2014, the Company borrowed \$2,500,000 under Term Loan C to refinance the Seller Note and Mortgage of \$2,500,000 issued as part of the acquisition of AMK. The maturity date of Term Loan C is the first business day of January 2021, and it is to be paid in seventy two consecutive monthly principal installments, which commenced on the first business day of February 2015, and continue on the first business day of each month thereafter. The first seventy-one of the installments shall be in the amount of \$34,722 with a seventy second and final payment of any unpaid principal and interest on the first business day of January 2021. Term Loan C bears interest at (a) the sum of the Alternate Base Rate plus two percent (2.00%) with respect to Domestic Rate Loans and (b) the sum

of the LIBOR Rate plus three and one-quarter percent (3.25%) with respect to LIBOR Rate Loans. At December 31, 2015 and 2014, the balance due under Term Loan C was \$2,118,000 and \$2,500,000, respectively.

On March 9, 2015, the Company borrowed \$3,500,000 under Term Loan D for the acquisition of Sterling. The repayment of Term Loan D consists of twenty consecutive monthly principal installments, the first nineteen in the amount of \$62,847 which commenced on the first business day of April 2015, and continued on the first business day of each month thereafter, with a twentieth and final payment of any unpaid balance of principal and interest on the last business day of November 2016. Term Loan D bears interest at (a) the sum of the Alternate Base Rate plus two and one quarter percent (2.25%) with respect to Domestic Rate Loans and (b) the sum of the LIBOR Rate plus three and one-half percent (3.50%) with respect to LIBOR Rate Loans. At December 31, 2015, the balance due under Term Loan D was \$2,934,000.

The Loan Facility was amended in February 2016 to increase the revolving loan to \$37,500,000, including an overdraft facility of \$4,500,000. Under the terms of the Loan Facility, as amended, the revolving loan now bears interest at (a) the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one half of one percent (2.50%) with respect to LIBOR Rate Loans. We paid a fee of \$75,000 in connection with the amendment.

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

The terms of the Loan Facility require that, among other things, the Company maintain a specified Fixed Charge Coverage Ratio. In addition, the Company is limited in the amount of Capital Expenditures it can make. The Company is also limited to the amount of Dividends it can pay its shareholders as defined in the Loan Facility. As of December 31, 2015, the Company was not in compliance with the Fixed Charge Coverage Ratio covenant. Because the Loan Facility contains a subjective acceleration clause which could permit PNC to require repayment prior to maturity, the revolving loan is classified as current in the accompanying condensed consolidated balance sheet. The failure to maintain the requisite Fixed Charge Coverage Ratio constitutes a default under the Loan Facility and, PNC, at its option, may give notice to the Company that all amounts under the Loan Facility are immediately due and payable. Consequently, all amounts due under the Term Loans are also classified as current. As of the date of issuance of the accompanying financial statements, PNC has not given such notice. In addition, the Company has requested a waiver from PNC for the failure to meet the Fixed Charge Coverage Ratio covenant. At December 31, 2015, the Company was in compliance with all other terms of the Loan Facility. At December 31, 2014, the Company was in compliance with all terms of the Loan Facility.

As of December 31, 2015, our debt for borrowed monies in the amount of \$44,805,000 consisted of the revolving credit note due to PNC in the amount of \$29,604,000, the term loans due to PNC in the amount of \$9,833,000, a note in the amount of \$350,000, and capitalized lease obligations of \$5,018,000. This represents an increase of \$17,084,000 in our debt for borrowed monies at December 31, 2014 of \$27,721,000, when the revolving note due to PNC was \$17,672,000, the term loans due to PNC were \$8,363,000, we had a note due to the sellers of WMI with a balance of \$41,000, and capitalized lease obligations were \$1,645,000. The increase in the amount outstanding under the revolving credit note principally reflects amounts borrowed to support our acquisitions and the increase in our inventory.

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

On June 1, 2014, we acquired all of the common stock of EPC for \$1.6 million and 20,000 shares of the common stock of AIRI, valued at \$9.78 per share, which was the closing price on that date. Additionally, a working capital adjustment was due to the former stockholders of EPC in the amount of approximately \$78,000 and was paid in August 2014.

On September 1, 2014, we acquired all of the common stock of ECC for \$209,000. We financed the acquisition of ECC out of our working capital.

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

On October 1, 2014, we acquired all of the common stock of AMK Technical Services, (“AMK”) for \$6.9 million. The acquisition was financed with the proceeds from the issuance of Term Loan B from PNC in the amount of \$3,500,000, a mortgage on the property of AMK in the amount of \$2,500,000 in favor of the sellers of AMK, which was subsequently refinanced by PNC, with the remainder coming from our working capital.

On March 1, 2015, we acquired all of the common stock of Sterling for \$5.4 million in cash and 425,005 shares of the common stock of AIRI. The common stock was valued at \$9.89 per share, which was the closing share price on February 27, 2015. The acquisition was financed with the proceeds from the issuance of Term Loan D in the amount of \$3,500,000.

On September 1, 2015, the Company, through its wholly-owned subsidiary WMI, acquired certain assets, including production equipment, inventory and intangible assets, of Compac in an asset acquisition for \$1.2 million in cash plus a working capital adjustment of \$271,000. We financed the acquisition of Compac out of our working capital.

On December 7, 2015, we entered into a contract with an unaffiliated third party (the "purchaser") , whereby the purchaser will acquire our South Windsor, Connecticut property for \$1,700,000, subject to routine closing adjustments. The closing of the transaction is anticipated to occur in the first week of April 2016. Upon closing of the

transaction, we will enter into a lease for the property with an initial term of 15 years, with an option to renew the lease for an additional five years. In addition to rent, initially \$155,000 per annum, subject to annual increase, we also will be responsible for real estate taxes and the maintenance of the buildings and the property. The net proceeds from the sale of the property will be applied to the amounts owed to PNC.

On September 8, 2015, we borrowed \$350,000 from Michael N. Taglich, Chairman of our Board of Directors, and issued to him our promissory note in the principal amount of \$350,000 to evidence our obligation to repay the loan. The note bears interest at the rate of 4% per annum and is payable on September 7, 2016. Our obligation to pay the note is subordinated to our indebtedness to PNC.

We have paid quarterly dividends to our shareholders each quarter commencing with the first quarter of 2013 through the third quarter of 2015. On January 24, 2014, we paid a dividend equal to \$0.125 per share or \$733,000 to all shareholders of record as of January 9, 2014. On April 22, 2014, we paid a dividend equal to \$0.15 per share or \$885,000 to all shareholders of record as of April 15, 2014. On July 10, 2014, we paid a dividend equal to \$0.15 per share or \$1,064,000 to all shareholders of record as of June 30, 2014. On November 3, 2014, we paid a dividend equal to \$0.15 per share or \$1,065,000 to all shareholders of record as of October 20, 2014. On January 15, 2015 we paid a dividend equal to \$0.15 per common share or \$1,066,000 to all shareholders of record as of January 2, 2015. On April 24, 2015 we paid a dividend equal to \$0.15 per common share or \$1,134,000 to all shareholders of record as of April 13, 2015. On August 12, 2015, we paid a dividend equal to \$0.15 per common share or \$1,134,000 to all shareholders of record as of August 3, 2015. On December 1, 2015, we paid a dividend equal to \$0.15 per common share or \$1,133,000 to all shareholders of record as of November 23, 2015. It has been our practice to pay cash dividends to our shareholders when our Board of Directors deemed appropriate. All determinations relating to our dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions and future prospects and other factors the Board of Directors may deem relevant. Further, the payment of any cash dividends requires compliance with financial covenants of the loan agreement with our principal lender and, even if such financial covenants are met, since we are highly leveraged, our Board of Directors would consider any opinion our senior lender might express with regards to the payment of any cash dividends.

#### Cash Flow

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

|   | Year ended<br>December 31,<br>2015 | Year ended<br>December 31,<br>2014 |
|---|------------------------------------|------------------------------------|
| Cash (used in) provided by                |                                    |                                    |
| Operating activities                      | \$ (894)                           | \$ (2,799)                         |
| Investing activities                      | (8,560)                            | (9,663)                            |
| Financing activities                      | 8,565                              | 13,319                             |
| Net increase in cash and cash equivalents | \$ (889)                           | \$ 857                             |

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

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

For the year ended December 31, 2015, our net cash used in operating activities of \$894,000 was comprised of a net loss of \$832,000 less \$4,982,000 of cash used by changes in operating assets and liabilities plus adjustments for non-cash items of \$4,920,000. Adjustments for non-cash items consisted primarily of depreciation of property and equipment of \$3,090,000, amortization of capitalized engineering costs, intangibles and other items of \$1,807,000, bad debt expense of \$176,000, representing amounts reserved for as potentially uncollectible, and non-cash compensation of \$100,000, and deferred income taxes of \$484,000. These non-cash items were offset by \$38,000 of deferred gain on the sale of real estate. The increase in operating assets and liabilities consisted of a net increase in Operating Assets of \$9,087,000 and a net increase in Operating Liabilities of \$4,105,000. The increase in Operating Assets was comprised of an increase in inventory of \$8,412,000, and a net increase in prepaid expenses and other current assets, and deposits and other assets of \$766,000, partially offset by a decrease in accounts receivable of \$91,000 due to the timing of shipments to and cash receipts from customers. The net increase in Operating Liabilities was comprised of increases in accounts payable and accrued expenses of \$3,593,000 due to the timing of the receipt and payment of invoices, an increase in deferred rent of \$29,000, and an increase in deferred revenue of \$540,000, partially offset by, a decrease in income taxes payable of \$57,000.

### Cash Used in Investing Activities

Cash used in investing activities consists of capital expenditures for property and equipment, capitalized engineering costs and the cash payments for the businesses we acquire. A description of capitalized engineering costs can be found below and in footnote 3 Summary of Significant Accounting Policies in our Consolidated Financial Statements for the year ended December 31, 2015.

For the year ended December 31, 2015 cash used in investing activities was \$8,560,000. This was comprised of \$6,340,000 for the acquisitions of Sterling and Compac, net of cash acquired, \$656,000 for capitalized engineering costs and \$1,564,000 for the purchase of property and equipment.

### Cash Provided By Financing Activities

Cash provided by financing activities consists of dividend payments, the borrowings and repayments under our credit facilities with our senior lender, and increases in and repayment of capital lease obligations and other notes payable.

For the year ended December 31, 2015, cash provided by financing activities was \$8,565,000. This was comprised of additional borrowings of \$3,500,000 under our term loans and \$11,933,000 under our revolving credit facility, partially offset by repayments on our term loans of \$2,030,000, proceeds from capital lease refinance of \$500,000, proceeds from note payable of \$350,000, partially offset by, repayments under our capital leases of \$717,000, \$41,000 paid to the former shareholders of WMI, \$4,468,000 used for dividends, deferred financing costs of \$402,000 and \$60,000 related to lease impairment.

### CONTRACTUAL OBLIGATIONS

The following table sets forth our future contractual obligations as of December 31, 2015:

| Payment due by period (in thousands) |     |     |
|--------------------------------------|-----|-----|
| Less than                            | 1-3 | 3-5 |

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|                         | Total    | 1 year*  | years   | years   | More<br>than<br>5 years |
|-------------------------|----------|----------|---------|---------|-------------------------|
| Debt and capital leases | \$45,395 | \$41,135 | \$2,666 | \$1,594 | \$-                     |
| Operating leases        | 17,179   | 1,973    | 3,784   | 3,007   | 8,415                   |
| Total                   | \$62,574 | \$43,108 | \$6,450 | \$4,601 | \$8,415                 |

\* The revolving line of credit and term loans with our senior lender are classified as due in less than 1 year, see Note 9 to our Consolidated Financial Statements.

## OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of December 31, 2015.

### Critical Accounting Policies

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

#### Inventory Valuation

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

We generally purchase raw materials and supplies uniquely suited to the production of larger more complex parts, such as landing gear, only when non-cancellable contracts for orders have been received for finished goods. We occasionally produce larger more complex products, such as landing gear, finished goods in excess of purchase order quantities in anticipation of future purchase order demand. Historically this excess has been used in fulfilling future purchase orders. We purchase supplies and materials useful in a variety of products as deemed necessary even though orders have not been received. The Company periodically evaluates inventory items that are not secured by purchase orders and establishes reserves for obsolescence accordingly. The Company also reserves for excess quantities, slow-moving goods, and for other impairments of value.

#### Capitalized Engineering Costs

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

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

#### Revenue Recognition

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

and allowances. Freight out is included in operating expenses.

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



## Income Taxes

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

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

## Stock-Based Compensation

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

## Goodwill

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

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

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

## Long-Lived and Intangible Assets

Identifiable intangible assets are amortized using the straight-line method over the period of expected benefit. Long-lived assets and intangible assets subject to amortization to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. The Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying

amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. There has been no impairment as of December 31, 2015 and 2014.

## Recently Issued Accounting Pronouncements

In January 2015, the FASB issued ASU 2015-01, "Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items" ("ASU 2015-01"). ASU 2015-01 eliminates the concept of an extraordinary item from accounting principles generally accepted in the United States of America. As a result, an entity will no longer be required to segregate extraordinary items from the results of ordinary operations, to separately present an extraordinary item on its income statement, net of tax, after income from continuing operations or to disclose income taxes and earnings-per-share data applicable to an extraordinary item. However, ASU 2015-01 will still retain the presentation and disclosure guidance for items that are unusual in nature and occur infrequently. ASU 2015-01 becomes effective for interim and annual periods beginning on or after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the effects of Adopting ASU 2015-01 on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company's consolidated financial statements.

In February 2015, the FASB issued amended guidance to the consolidation standard which updates the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendment modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities and affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, among other provisions. This amended guidance will be effective for the Company beginning fiscal year 2016. Early adoption is permitted. The Company is currently assessing the impact the adoption of the amended guidance will have on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company's consolidated financial statements.

In April 2015, the FASB issued amended guidance which requires debt issuance costs to be presented as a direct deduction from the carrying value of the associated debt liability rather than as separate assets on the balance sheet. The recognition and measurement guidance for debt issuance costs are not affected by this amendment. This amended guidance will be effective for the Company beginning fiscal year 2016. Early adoption is permitted, and the new guidance will be applied on a retrospective basis. The Company does not expect the adoption of this amended guidance to have a significant impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). The amendments in ASU 2014-09 affect any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in ASC 605, "Revenue Recognition" and most industry-specific guidance and creates ASC 606, "Revenue from Contracts with Customers." On July 9, 2015, the FASB decided to delay the effective date of the new revenue standard by one year and the amendments are now effective prospectively for reporting periods beginning after December 15, 2017 and early adoption is not permitted. The Company is currently assessing the impact on its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330) Simplifying the Measurement of Inventory" ("ASU 2015-11"). ASU 2015-11 requires an entity to measure inventory at the lower of cost and net realizable value when the FIFO or average cost method is used. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, and should be applied prospectively. Earlier adoption is permitted. The Company is currently assessing the impact the adoption of the amended guidance will have on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company's consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, "Business Combinations (Topic 805) Simplifying the Accounting for Measurement-Period Adjustments". To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments in this update eliminate the requirement to retrospectively account for those adjustments. The amendments in this update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years, and should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this update, with earlier application permitted for financial statements that have not been issued. The Company does not expect the adoption of this amended guidance to have a significant impact on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes", which requires companies to classify all deferred tax assets and liabilities as non-current on the balance sheet instead of separating deferred taxes into current and non-current amounts. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods thereafter, with early adoption permitted and either with prospective or retrospective application permitted. We do not expect this new guidance to have a material impact on our financial statements.

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

#### JOBS Act

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Financial Statements

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

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation was conducted under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO"), its principal executive officer, and Chief Accounting Officer ("CAO"), its principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) as of December 31, 2015. Based on that evaluation, due to the material weaknesses in the Company's internal control over financial reporting discussed below, the CEO and CAO concluded that our disclosure controls and procedures were not effective as of December 31, 2015.

Management's Report on Internal Control over Financial Reporting

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

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

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

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

Our management relies upon the criteria established in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in designing a system intended to meet the needs of our Company and provide reasonable assurance for its assessment.

In connection with their review of our internal controls over financial reporting for the fiscal year ended December 31, 2015, and after our independent registered public accountants met with the Audit Committee to discuss the Company's internal control environment, our Chief Executive Officer and Chief Accounting Officer concluded that our internal controls over financial reporting were not effective as of December 31, 2015. In particular, our controls over financial reporting were not effective due to a material weakness as a result of the inability of our internal accounting personnel to identify, analyze, record and disclose the tax and financial reporting implications of certain complex accounting matters related to non-standard and unusual transactions.. To remedy this weakness we plan to supplement our accounting staff with additional experienced financial professionals, redefining and realigning responsibilities and by defining additional controls, reporting processes and procedures to address the accounting requirements and disclosures for non-standard and unusual transactions. In addition, until we locate and engage appropriate accounting personnel, we will engage third party consultants to assist in accounting for non-recurring complex transactions.

In addition, our Chief Executive Officer and Chief Accounting Officer determined, after our independent registered public accountants met with the Audit Committee to discuss the Company's internal control environment, that we have a material weakness with respect to inventory accounting, in particular with respect to tracking for the aging of certain items reserving for slow moving inventory and obsolescence and, consequently, valuation of our inventory. In recent years, we have expanded our business in part through acquisitions, primarily of private companies. The companies we have acquired have not had the level of accounting systems and controls, in particular with respect to inventory, appropriate for a public company. To remedy this weakness we plan to supplement our accounting staff with additional experienced financial professionals to be located at certain of the companies we acquired and to upgrade the systems utilized by these companies so that they maintain records and produce the reports necessary for a public company.

The material weaknesses discussed above will not be considered remediated until the necessary personnel have been engaged and the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively

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

#### Change in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during our fiscal quarter and year ended December 31, 2015 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

#### ITEM 9B. OTHER INFORMATION.

None



PART III

Item 10. Directors, Executive Officers, and Corporate Governance

Incorporated by reference from the information in our Proxy Statement for our 2016 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report relates.

Item 11. Executive Compensation

Incorporated by reference from the information in our Proxy Statement for our 2016 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report relates.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated by reference from the information in our Proxy Statement for our 2016 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report relates.

Item 13. Certain Relationships and Related Transactions and Director Independence

Incorporated by reference from the information in our Proxy Statement for our 2016 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report relates.

Item 14. Principal Accountant Fees and Services

Incorporated by reference from the information in our Proxy Statement for our 2016 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report relates.

## PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

## Exhibit No. Description

- 2.1 Agreement and Plan of Merger dated July 29, 2013 between Air Industries Group, Inc. and Air Industries Group (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 2.2 Articles of Merger between Air Industries Group and Air Industries Group, Inc. filed with the Secretary of State of Nevada on August 28, 2013 (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 2.3 Certificate of Merger between Air Industries Group and Air Industries Group, Inc. filed with the Secretary of State of Nevada on August 29, 2013 (incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 3.1 Articles of Incorporation of Air Industries Group (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed August 30, 2013).
- 3.2 Amended and Restated By-Laws of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2014 filed on March 31, 2015).
- 4.1 Form of Warrant Agreement dated as of December 31, 2008 between the Registrant and Taglich Brothers, Inc. (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed January 7, 2009).
- 4.2 Form of Placement Agent's Warrant Agreement (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed May 29, 2014).
- 10.1 Contract of Sale, dated as of November 7, 2005, by and between KPK Realty Corp. and Gales Industries Incorporated for the purchase of the property known as 1460 North Fifth Avenue and 1479 North Clinton Avenue, Bay Shore, NY (incorporated by reference to Exhibit 10.6 of the Registrant's Current Report on Form 8-K filed December 6, 2005).
- 10.2 Mortgage and Security Agreement, dated as of November 30, 2005, by and between Air Industries Machining, Corp. and PNC Bank (incorporated by reference to Exhibit 10.20 of the Registrant's Current Report on Form 8-K filed December 6, 2005).
- 10.3 Long Term Agreement, dated as of August 18, 2000, between Air Industries Machining, Corp. and Sikorsky Aircraft Corporation (incorporated by reference to Exhibit 10.21 of the Registrant's Current Report on Form 8-K filed December 6, 2005).
- 10.4 Long Term Agreement, dated as of September 7, 2000, between Air Industries Machining, Corp. and Sikorsky Aircraft Corporation (incorporated by reference to Exhibit 10.22 of the Registrant's Current Report on Form 8-K filed December 6, 2005).

10.5 Stock Purchase Agreement, dated March 9, 2009, between Gales Industries Incorporated and John Gantt and Lugenia Gantt, the shareholders of Welding Metallurgy, Inc. (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed March 14, 2009).

10.6 Amendment No. 1 dated August 2, 2009 to the Stock Purchase Agreement, dated March 9, 2009, between Gales Industries Incorporated and John Gantt and Lugenia Gantt, the shareholders of Welding Metallurgy, Inc. (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K/A filed August 3, 2009).

- 10.7 7% Promissory Note of Registrant in the principal amount of \$2,000,000 in favor of John and Lugenia Gantt (incorporated by reference from the Registrant's Current Report on Form 8-K filed August 26, 2009).
- 10.8 Registration Rights Agreement dated as of August 24, 2009 by and among the Registrant and John and Lugenia Gantt (incorporated by reference from the Registrant's Current Report on Form 8-K filed August 26, 2009).
- 10.9 Amended and Restated Promissory Note dated as of August 26, 2009 payable to John and Lugenia Gantt (the "Amended and Restated Gantt Note") (incorporated by reference from Exhibit 10.46 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 (the "2007 Form 10-K").
- 10.10 Amendment dated as of October 9, 2009 to Amended and Restated Gantt Note (incorporated by reference from Exhibit 10.47 to the Registrant's 2007 Form 10-K).
- 10.11 Amended and Restated Revolving Credit, Term Loan and Security Agreement (the "PNC Loan Agreement") dated June 27, 2013 by and among PNC Bank, National Association, as Lender and Agent, and Air Industries Machining, Corp., Welding Metallurgy, Inc., Nassau Tool Works, Inc. and Air Industries Group, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed June 27, 2013).
- 10.12 Guarantor's Ratification by Air Industries Group, Inc. under PNC Agreement (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed June 27, 2013).
- 10.13 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.24 to the Registrant's Form 10).
- 10.14 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-8 (Registration No. 333-191560) filed on October 4, 2013).
- 10.15 2015 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-8 (Registration No. 333-206341) filed on August 13, 2015).
- 10.16 Subscription documents for purchase of common stock and conversion of junior subordinated notes into common stock. (incorporated by reference to Exhibit 10.25 to the Registrant's Form 10).
- 10.17 Placement Agent Agreement dated as of May 21, 2012 between the Registrant and Taglich Brothers Inc. (incorporated by reference to Exhibit 10.26 to the Registrant's Form 10).
- 10.18 Common Stock Purchase Agreement dated October 25, 2013 with Kimura Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed October 29, 2013).

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- 10.19 First Amendment to PNC Loan Agreement (incorporated by reference from Exhibit 10.22 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K").
- 10.20 Amended and Restated PNC Loan Agreement (incorporated by reference from Exhibit 10.23 to the Registrant's 2013 Form 10-K.)
- 10.21 Amended and Restated Revolving Credit Note issued under the PNC Loan Agreement (incorporated by reference from Exhibit 10.24 to the Registrant's 2013 Form 10-K).
- 10.22 Second Amendment to Term Note issued under the PNC Loan Agreement (incorporated by reference from Exhibit 10.25 to the Registrant's 2013 Form 10-K).

- 10.23 Stock Purchase Agreement dated as of April 1, 2014 by and among WMI and the shareholders of Woodbine Products, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed April 2, 2014).
- 10.24 Third Amendment to Amended and Restated Loan and Security Agreement with PNC Bank, N.A (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed April 2, 2014).
- 10.25 Form of Subscription Agreement, dated as of May 28, 2014 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed May 29, 2014).
- 10.26 Placement Agent Agreement, dated as of May 28, 2014, between the Registrant and Taglich Brothers, Inc. (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed May 29, 2014).
- 10.27 Stock Purchase Agreement dated as of June 4, 2014, by and among the Registrant and the shareholders of Eur-Pac Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed June 4, 2014).
- 10.28 Stock Purchase Agreement dated as of October 1, 2014, between the Registrant and Dynamic Materials Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed (October 2, 2014).
- 10.29 Promissory Note of Registrant payable to AMK Welding, Inc. (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed October 2, 2014).
- 10.30 Mortgage and Security Agreement in favor of Dynamic Materials Corporation (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed October 2, 2014).
- 10.31 Term Note (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed October 2, 2014).
- 10.32 Capital Market Advisory Agreement dated as of January 1, 2014 between the Registrant and Taglich Brothers, Inc. (incorporated by reference to Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2014 filed on March 31, 2015).
- 10.33 Agreement and Plan of Merger dated as of February 27, 2015, by and among the Registrant, SEC Acquisition Corp., The Sterling Engineering Corporation ("Old Sterling") and the shareholders of Old Sterling (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed March 5, 2015).
- 10.34 Term Note in the principal amount of \$3,500,000 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed March 10, 2015).
- 10.35 Open End Mortgage Deed and Security Agreement with respect to South Windsor, Connecticut premises (incorporated by reference to Exhibit 10.3 to the Registrant's

Current Report on Form 8-K filed March 10, 2015).

10.36 Collateral Assignment of Rents, Leases and Profits with respect to South Windsor, Connecticut premises (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed March 10, 2015).

10.37 Open End Mortgage Deed and Security Agreement with respect to Barkhamsted, Connecticut premises (incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed March 10, 2015).

- 10.38 Collateral Assignment of Rents, Leases and Profits with respect to Barkhamsted, Connecticut premises (incorporated by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed March 10, 2015).
- 10.39 Offer Letter to Daniel R. Godin (incorporated by reference to Exhibit 10.42 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2014 filed on March 31, 2015).
- 10.40 Asset Purchase Agreement dated as of August 31, 2013 between the Registrant, on the one hand, and Compaq Development Corporation, Peter C. Rao and Vito Valenti, the shareholders of Compaq Development Corporation, on the other hand (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed September 1, 2015).
- 10.41 Fifth Amended and Restated Revolving Credit Note (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed November 23, 2015).
- 10.42 Tenth Amendment to Amended and Restated Loan and Security Agreement with PNC Bank, N.A (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed November 23, 2015).
- 10.43 Eleventh Amendments to Amended and Restated Loan and Security Agreement with PNC Bank, N.A (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 12, 2016).
- 10.44 Sixth Amended and Restated Revolving Credit Note (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed February 12, 2016).
- 10.45 Promissory Note dated as of September 8, 2015 payable to Michael N. Taglich in the principal amount of \$350,000.
- 10.46 Real Estate Purchase and Sale Contract dated December 7, 2015 for the sale of 283 Sullivan Avenue, South Windsor, CT ("South Windsor Contract").
- 10.47 First Amendment to South Windsor Contract dated January 26, 2016.
- 10.48 Second Amendment to South Windsor Contract dated February 24, 2016.
- 21.1 Subsidiaries.
- 23.1 Consent of Rotenberg Meril Solomon Bertiger & Guttilla, P.C.
- 31.1 Certification of principal executive officer pursuant to Rule 13a-14 or Rule 15d-14 of Securities Exchange Act of 1934.
- 31.2 Certification of principal financial officer pursuant to Rule 13a-14 or Rule 15d-14 of the Exchange Act of 1934.
- 32.1



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

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

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

35

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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 report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: April 4, 2016

## AIR INDUSTRIES GROUP

By: /s/ Daniel R. Godin  
Daniel R. Godin  
President and CEO  
(principal executive officer)

By: /s/ James Sartori  
James Sartori  
VP, Chief Accounting Officer  
(principal financial and accounting officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant on April 4, 2016 in the capacities indicated.

| Signature                                    | Capacity                     |
|--|------------------------------|
| /s/ Daniel R. Godin<br>Daniel R. Godin       | President and CEO            |
| /s/ James Sartori<br>James Sartori           | VP, Chief Accounting Officer |
| /s/ Michael N. Taglich<br>Michael N. Taglich | Chairman of the Board        |
| /s/ Seymour G. Siegel<br>Seymour G. Siegel   | Director                     |
| /s/ Robert F. Taglich<br>Robert F. Taglich   | Director                     |
| /s/ David J. Buonanno<br>David J. Buonanno   | Director                     |
| /s/ Robert Schroeder<br>Robert Schroeder     | Director                     |
| /s/ Michael Brand                            |                              |

Michael Brand

Director

36

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Air Industries Group

We have audited the accompanying consolidated balance sheets of Air Industries Group and Subsidiaries (the "Company") as of December 31, 2015 and 2014 and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years then ended. The consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2015 and 2014 and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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

ROTENBERG MERIL SOLOMON BERTIGER & GUTTILLA, P.C.

Saddle Brook, New Jersey

April 4, 2016

F-1

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AIR INDUSTRIES GROUP  
Consolidated Balance Sheets

|  | December 31,<br>2015 | December 31,<br>2014 |
|--|----------------------|----------------------|
| <b>ASSETS</b>  |                      |                      |
| Current Assets   |                      |                      |
| Cash and Cash Equivalents  | \$ 529,000           | \$ 1,418,000         |
| Accounts Receivable, Net of Allowance for Doubtful Accounts<br>of \$985,000 and \$1,566,000, respectively          | 13,662,000           | 11,916,000           |
| Inventory  | 36,923,000           | 28,651,000           |
| Deferred Tax Asset, net  | 1,725,000            | 1,421,000            |
| Prepaid Expenses and Other Current Assets  | 1,583,000            | 831,000              |
| Assets Held for Sale   | 1,700,000            | -                    |
| <b>Total Current Assets</b>  | <b>56,122,000</b>    | <b>44,237,000</b>    |
| <br>   |                      |                      |
| Property and Equipment, Net  | 15,299,000           | 9,557,000            |
| Capitalized Engineering Costs - Net of Accumulated<br>Amortization<br>of \$4,595,000 and \$4,184,000, respectively | 1,027,000            | 712,000              |
| Deferred Financing Costs, Net, Deposits and Other Assets   | 1,094,000            | 869,000              |
| Intangible Assets, Net   | 3,852,000            | 4,513,000            |
| Deferred Tax Asset, Net  | 338,000              | 858,000              |
| Goodwill   | 10,518,000           | 5,434,000            |
| <br>   |                      |                      |
| <b>TOTAL ASSETS</b>  | <b>\$ 88,250,000</b> | <b>\$ 66,180,000</b> |
| <br>   |                      |                      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                      |                      |
| Current Liabilities  |                      |                      |
| Notes Payable and Capitalized Lease Obligations - Current<br>Portion   | \$ 40,893,000        | \$ 19,508,000        |
| Accounts Payable and Accrued Expenses  | 12,053,000           | 6,948,000            |
| Lease Impairment - Current Portion   | -                    | 56,000               |
| Deferred Gain on Sale - Current Portion  | 38,000               | 38,000               |
| Deferred Revenue   | 958,000              | 418,000              |
| Dividends Payable  | -                    | 1,066,000            |
| Income Taxes Payable   | 14,000               | 71,000               |
| <b>Total Current Liabilities</b>   | <b>53,956,000</b>    | <b>28,105,000</b>    |
| <br>   |                      |                      |
| Long Term Liabilities  |                      |                      |
| Notes Payable and Capitalized Lease Obligations - Net of<br>Current Portion  | 3,912,000            | 8,213,000            |
| Lease Impairment - Net of Current Portion  | -                    | 4,000                |
| Deferred Gain on Sale - Net of Current Portion   | 371,000              | 409,000              |
| Deferred Rent  | 1,206,000            | 1,177,000            |
| <b>TOTAL LIABILITIES</b>   | <b>59,445,000</b>    | <b>37,908,000</b>    |
| <br>   |                      |                      |
| Commitments and Contingencies  |                      |                      |

## Stockholders' Equity

Preferred Stock - Par Value \$.001 - Authorized 1,000,000

Shares, None Issued and

Outstanding at December 31, 2015 and 2014

-

-

Common Stock - Par Value \$.001 - Authorized 25,000,000

Shares, 7,560,040 and

7,108,677 Shares Issued and Outstanding as of December 31,

2015 and 2014,

respectively

7,000

7,000

Additional Paid-In Capital

44,155,000

42,790,000

Accumulated Deficit

(15,357,000 )

(14,525,000 )

TOTAL STOCKHOLDERS' EQUITY

28,805,000

28,272,000

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$

88,250,000

\$

66,180,000

See Notes to Consolidated Financial Statements

## AIR INDUSTRIES GROUP

Consolidated Statements of Operations For the Years Ended December 31,

|  | 2015          | 2014          |
|--|---------------|---------------|
| Net Sales                                      | \$ 80,442,000 | \$ 64,331,000 |
| Cost of Sales                                  | 63,161,000    | 50,233,000    |
| Gross Profit                                   | 17,281,000    | 14,098,000    |
| Operating Expenses                             | 16,557,000    | 11,960,000    |
| Acquisition Costs                              | 98,000        | 403,000       |
| Income from Operations                         | 626,000       | 1,735,000     |
| Interest and Financing Costs                   | (1,858,000 )  | (1,295,000 )  |
| Other Income (Expense), Net                    | 114,000       | (141,000 )    |
| (Loss) Income before Benefit from Income Taxes | (1,118,000 )  | 299,000       |
| Benefit from Income Taxes                      | 286,000       | 368,000       |
| Net (Loss) Income                              | \$ (832,000 ) | \$ 667,000    |
| (Loss) Income per share - basic                | \$ (0.11 )    | \$ 0.10       |
| (Loss) Income per share - diluted              | \$ (0.11 )    | \$ 0.10       |
| Weighted average shares outstanding - basic    | 7,478,223     | 6,591,755     |
| Weighted average shares outstanding - diluted  | 7,478,223     | 6,915,688     |

See Notes to Consolidated Financial Statements

AIR INDUSTRIES GROUP  
Consolidated Statements of  
Stockholders' Equity  
For the Years Ended December 31,  
2015 and 2014

|  | Preferred<br>Stock<br>Shares | Common<br>Stock<br>Shares | Common Stock<br>Amount | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Total<br>Stockholders'<br>Equity |              |
|--|------------------------------|---------------------------|------------------------|----------------------------------|------------------------|----------------------------------|--------------|
| Balance, January 1, 2014   | -                            | \$-                       | 5,844,093              | \$6,000                          | \$36,799,000           | \$(15,192,000)                   | \$21,613,000 |
| Issuance of Shares For Public Offering                             | -                            | -                         | 1,170,000              | 1,000                            | 9,561,000              | -                                | 9,562,000    |
| Issuance of Shares For Acquisitions                                | -                            | -                         | 50,000                 | -                                | 485,000                | -                                | 485,000      |
| Exercise of Options/Warrants                                       | -                            | -                         | 44,584                 | -                                | -                      | -                                | -            |
| Dividends Paid   | -                            | -                         | -                      | -                                | (3,031,000)            | -                                | (3,031,000)  |
| Dividends Payable  | -                            | -                         | -                      | -                                | (1,066,000)            | -                                | (1,066,000)  |
| Stock Compensation Expense   | -                            | -                         | -                      | -                                | 42,000                 | -                                | 42,000       |
| Net Income   | -                            | -                         | -                      | -                                | -                      | 667,000                          | 667,000      |
| Balance, December 31, 2014   | -                            | -                         | 7,108,677              | 7,000                            | 42,790,000             | (14,525,000)                     | 28,272,000   |
| Issuance of Shares For Acquisitions and<br>Restricted Stock Grants | -                            | -                         | 425,005                | -                                | 4,666,000              | -                                | 4,666,000    |
| Issuance of Shares For Records<br>Correction                       | -                            | -                         | 539                    | -                                | -                      | -                                | -            |
| Exercise of Options/Warrants                                       | -                            | -                         | 25,819                 | -                                | -                      | -                                | -            |
| Dividends Paid   | -                            | -                         | -                      | -                                | (3,401,000)            | -                                | (3,401,000)  |
| Stock Compensation Expense   | -                            | -                         | -                      | -                                | 100,000                | -                                | 100,000      |
| Net Loss   | -                            | -                         | -                      | -                                | -                      | (832,000)                        | (832,000)    |
| Balance, December 31, 2015   | -                            | \$-                       | 7,560,040              | \$7,000                          | \$44,155,000           | \$(15,357,000)                   | \$28,805,000 |

See Notes to Consolidated Financial Statements



## AIR INDUSTRIES GROUP

Consolidated Statements of Cash Flows For the Years Ended December 31,

|   | 2015                | 2014                |
|---|---------------------|---------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                     |                     |
| Net Income (loss)   | \$ (832,000 )       | \$ 667,000          |
| Adjustments to reconcile net income (loss) to net cash used in operating activities |                     |                     |
| Depreciation of property and equipment  | 3,090,000           | 2,364,000           |
| Amortization of intangible assets   | 1,262,000           | 1,163,000           |
| Amortization of capitalized engineering costs                                       | 341,000             | 375,000             |
| Bad debt expense  | 176,000             | 299,000             |
| Non-cash compensation expense   | 100,000             | 42,000              |
| Amortization of deferred financing costs  | 204,000             | 49,000              |
| Gain on sale of real estate   | (38,000 )           | (38,000 )           |
| Deferred income taxes   | (215,000 )          | (1,043,000 )        |
| <b>Changes in Assets and Liabilities</b>  |                     |                     |
| <b>(Increase) Decrease in Operating Assets:</b>                                     |                     |                     |
| Accounts receivable   | 91,000              | (2,417,000 )        |
| Inventory   | (8,412,000 )        | (1,646,000 )        |
| Prepaid expenses and other current assets   | (748,000 )          | (244,000 )          |
| Deposits and other assets   | (18,000 )           | (164,000 )          |
| <b>Increase (Decrease) in Operating Liabilities:</b>                                |                     |                     |
| Accounts payable and accrued expenses   | 3,593,000           | (577,000 )          |
| Deferred rent   | 29,000              | 45,000              |
| Deferred revenue  | 540,000             | (249,000 )          |
| Income taxes payable  | (57,000 )           | (1,425,000 )        |
| <b>NET CASH USED IN OPERATING ACTIVITIES</b>  | <b>(894,000 )</b>   | <b>(2,799,000 )</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                     |                     |
| Cash paid for acquisitions  | (6,945,000 )        | (8,930,000 )        |
| Cash acquired in acquisitions   | 605,000             | 173,000             |
| Capitalized engineering costs   | (656,000 )          | (335,000 )          |
| Purchase of property and equipment  | (1,564,000 )        | (571,000 )          |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>  | <b>(8,560,000 )</b> | <b>(9,663,000 )</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                     |                     |
| Notes payable - sellers   | (41,000 )           | (691,000 )          |
| Note payable - revolver, net  | 11,933,000          | 3,142,000           |
| Proceeds from note payable - term loans   | 3,500,000           | 7,328,000           |
| Payments of note payable - term loans   | (2,030,000 )        | (913,000 )          |
| Proceeds from note payable  | 350,000             | -                   |
| Capital lease obligations   | (717,000 )          | (143,000 )          |
| Proceeds from capital lease refinance   | 500,000             | -                   |
| Deferred financing costs  | (402,000 )          | (151,000 )          |
| Payments related to lease impairment  | (60,000 )           | (67,000 )           |
| Dividends paid  | (4,468,000 )        | (3,748,000 )        |

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|   |                   |                     |
|---|-------------------|---------------------|
| Proceeds from public issuance in 2014 and private placement in 2013 | -                 | 9,530,000           |
| Costs to raise capital  | -                 | (968,000 )          |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                    | <b>8,565,000</b>  | <b>13,319,000</b>   |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>         | <b>(889,000 )</b> | <b>857,000</b>      |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>               | <b>1,418,000</b>  | <b>561,000</b>      |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>                     | <b>\$ 529,000</b> | <b>\$ 1,418,000</b> |

F-5

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## AIR INDUSTRIES GROUP

## Consolidated Statements of Cash Flows For the Years Ended December 31, (Continued)

|  | 2015         | 2014         |
|--|--------------|--------------|
| Supplemental cash flow information   |              |              |
| Cash paid during the period for interest   | \$ 1,649,000 | \$ 1,074,000 |
| Supplemental cash flow information   |              |              |
| Cash paid during the period for income taxes   | \$ 445,000   | \$ 2,494,000 |
| Supplemental schedule of non-cash investing and financing activities   |              |              |
| Dividends payable  | \$ -         | \$ 1,066,000 |
| Acquisition of property and equipment financed by capital lease  | \$ 1,811,000 | \$ -         |
| Conversion of junior subordinated notes  | \$ -         | \$ 1,000,000 |
| Classification of assets held for sale   | \$ 1,700,000 | \$ -         |
| Purchase of assets of Compac and assumption of liabilities in the acquisition as follows:                              |              |              |
| Fair Value of tangible assets acquired   | \$ 406,000   | \$ -         |
| Intangible assets  | 600,000      | -            |
| Goodwill   | 560,000      | -            |
| Liabilities assumed  | (95,000 )    | -            |
| Cash paid for acquisition  | \$ 1,471,000 | \$ -         |
| Purchase of stock of The Sterling Engineering Corporation and assumption of liabilities in the acquisition as follows: |              |              |
| Fair Value of tangible assets acquired   | \$ 8,181,000 | \$ -         |
| Goodwill   | 4,540,000    | -            |
| Cash acquired  | 588,000      | -            |
| Liabilities assumed  | (3,169,000 ) | -            |
| Common stock issued  | (4,666,000 ) | -            |
| Cash paid for acquisition  | \$ 5,474,000 | \$ -         |
| Purchase of substantially all assets of AMK Welding, Inc. and assumption of liabilities in the acquisition as follows: |              |              |
| Fair Value of tangible assets acquired   | \$ -         | \$ 5,637,000 |
| Intangible assets, subject to amortization   | -            | 950,000      |
| Goodwill   | -            | 635,000      |
| Cash acquired  | -            | 184,000      |
| Liabilities assumed  | -            | (453,000 )   |
| Due to seller  | -            | (2,500,000 ) |
| Cash paid for acquisition  | \$ -         | \$ 4,453,000 |

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|   |    |   |              |
|---|----|---|--------------|
| <b>Purchase of stock of Woodbine Products, Inc.</b>           |    |   |              |
| Fair value of tangible assets acquired                        | \$ | - | \$ 309,000   |
| Goodwill  |    | - | 2,565,000    |
| Liabilities assumed   |    | - | (19,000 )    |
| Common stock issued   |    | - | (290,000 )   |
| Cash paid for acquisition                                     | \$ | - | \$ 2,565,000 |
| <b>Purchase of stock of Eur-Pac Corporation</b>               |    |   |              |
| Fair value of tangible assets acquired                        | \$ | - | \$ 412,000   |
| Goodwill  |    | - | 1,656,000    |
| Liabilities assumed   |    | - | (170,000 )   |
| Common stock issued   |    | - | (195,000 )   |
| Cash paid for acquisition                                     | \$ | - | \$ 1,703,000 |
| <b>Purchase of stock of Electronic Connection Corporation</b> |    |   |              |
| Fair value of tangible assets acquired                        | \$ | - | \$ 126,000   |
| Goodwill  |    | - | 109,000      |
| Cash acquired   |    | - | 5,000        |
| Liabilities assumed   |    | - | (31,000 )    |
| Cash paid for acquisition                                     | \$ | - | \$ 209,000   |

See Notes to Consolidated Financial Statements

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. FORMATION AND BASIS OF PRESENTATION

Organization

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

The accompanying consolidated financial statements presented are those of AIRI, and its wholly-owned subsidiaries; Air Industries Machining Corp. (“AIM”), Welding Metallurgy, Inc. (“WMI” or “Welding”), Miller Stuart, Inc. (“Miller Stuart”), Nassau Tool Works, Inc. (“NTW”), Woodbine Products, Inc. (“Woodbine” or “WPI”), Decimal Industries, Inc. (“Decimal”), Eur-Pac Corporation (“Eur-Pac” or “EPC”), Electronic Connection Corporation (“ECC”), AMK Welding, Inc. (“AMK”), Air Realty Group, LLC (“Air Realty”) The Sterling Engineering Corporation (“Sterling”) effective March 1, 2015, and Compac Development Corporation (“Compac”) effective September 1, 2015, (together, the “Company”).

Note 2. ACQUISITIONS

Woodbine

On April 1, 2014, the Company, through its wholly-owned subsidiary Welding, acquired all of the common stock of Woodbine for \$2.4 million and 30,000 shares of the common stock of AIRI. The common stock was valued at \$9.68 per share, which was the closing share price on April 1, 2014. Additionally, a working capital adjustment in the amount of \$165,000 was paid to the former stockholders of Woodbine during June of 2014. The Company financed the acquisition of Woodbine by increasing its borrowings on its existing revolving loan and term loan facilities (see Note 9).

Woodbine, founded in 1954, is a long established manufacturer of aerospace components whose customers include major aircraft component suppliers. Woodbine specializes in welded and brazed chassis structures housing electronics in aircraft. Woodbine’s products and customers are very complementary to those of Decimal, the assets and business of which was acquired in July 2013.

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

|  |             |
|--|-------------|
| Fair value of tangible assets acquired | \$ 309,000  |
| Goodwill                               | 2,565,000   |
| Liabilities assumed                    | (19,000)    |
| Total                                  | \$2,855,000 |

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Eur-Pac

On June 1, 2014, the Company acquired all of the common stock of Eur-Pac for \$1.6 million and 20,000 shares of the common stock of AIRI. The common stock was valued at \$9.78 per share, which was the closing share price on that date. Additionally, a working capital adjustment in the amount of \$78,000 was paid in August 2014. The Company financed the acquisition of Eur-Pac with a portion of the proceeds of its Registered Direct Offering (see Note 11).

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

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

|  |              |
|--|--------------|
| Fair Value of tangible assets acquired | \$ 412,000   |
| Goodwill                               | 1,656,000    |
| Liabilities assumed                    | (170,000)    |
| Total                                  | \$ 1,898,000 |

#### ECC

On September 1, 2014, the Company through its wholly-owned subsidiary Eur-Pac, acquired all of the common stock of ECC for \$209,000. The Company financed the acquisition from its working capital.

ECC is a manufacturer of stripped, terminated, bonded and tinned lead wires, used by a variety of contractors, manufacturers and OEMs.

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

|  |            |
|--|------------|
| Fair value of tangible assets acquired | \$ 126,000 |
| Goodwill                               | 109,000    |
| Cash acquired                          | 5,000      |
| Liabilities assumed                    | (31,000)   |
| Total                                  | \$ 209,000 |

#### AMK

On October 1, 2014, the Company acquired all of the common stock of AMK, for \$6.9 million. At closing, the Company paid \$4,453,000 and issued a Seller Note and Mortgage of \$2,500,000. The note bore interest at the rate of 5% per annum and interest and principal were due and payable on or before December 31, 2015. The note was paid in 2014 with the proceeds from the issuance of Term Loan B and the mortgage released in January 2015 (see Note 9).

AMK is a long established provider of sophisticated welding and machining services for diversified aerospace and industrial customers.

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

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|  |    |           |
|--|----|-----------|
| Fair value of tangible assets acquired     | \$ | 5,637,000 |
| Intangible assets, subject to amortization |    | 950,000   |
| Goodwill                                   |    | 635,000   |
| Cash acquired                              |    | 184,000   |
| Liabilities assumed                        |    | (453,000) |
| Total                                      | \$ | 6,953,000 |

F-8

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Sterling

On March 1, 2015, the Company acquired all of the common stock of Sterling for \$5.4 million in cash and 425,005 shares of the common stock of AIRI. The common stock was valued at \$9.89 per share, which was the closing share price on February 27, 2015. The cash consideration is subject to adjustment for working capital changes. The Company has also entered into employment and non-compete agreements for two and three year periods with two of the principals of Sterling. In connection with these agreements, the Company granted 52,000 shares of restricted common stock to these individuals, which was accounted for as additional purchase price. The Company financed the acquisition of Sterling with the proceeds from the issuance of Term Loan D (see Note 9).

At the time of acquisition, Sterling had capital lease obligations for equipment with a remaining balance of approximately \$1.3 million. On April 21, 2015, the Company refinanced the \$1.3 million capital lease obligations with the same financing company. This refinancing generated approximately \$500,000 of cash for the Company. This capital lease obligation has been accounted for and summarized with the remainder of the Company's capital leases as disclosed in Note 9.

Sterling founded in 1941 manufactures components for aircraft and ground turbine engines.

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

|  |               |
|--|---------------|
| Fair value of tangible assets acquired | \$ 8,181,000  |
| Goodwill                               | 4,540,000     |
| Cash acquired                          | 588,000       |
| Liabilities assumed                    | (3,169,000)   |
| Total                                  | \$ 10,140,000 |

### Compac

On September 1, 2015, the Company, through its wholly-owned subsidiary WMI, acquired certain assets, including production equipment, inventory and intangible assets, of Compac in an asset acquisition for \$1.2 million in cash plus a working capital adjustment of \$271,000.

Compac located in Bay Shore, New York specializes in the manufacture of RFI/EMI (Radio Frequency Interference – Electro-Magnetic Interference) shielded enclosures for electronic components.

In connection with the asset purchase, the Company has assumed Compac's lease for its Bay Shore facility which extends through April 30, 2018 and has annual rent of approximately \$80,000, which is offset by rent received from the sub-tenant of approximately \$20,000 per year.

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

|  |            |
|--|------------|
| Fair value of tangible assets acquired | \$ 406,000 |
| Intangible assets                      | 600,000    |
| Goodwill                               | 560,000    |



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|                     |              |
|---------------------|--------------|
| Liabilities assumed | (95,000)     |
| Total               | \$ 1,471,000 |

F-9

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The below table sets forth selected financial information for the 2014 and 2015 acquisitions, which are included in our reported results of operations, for the years ended December 31, 2015 and 2014.

For the Year Ended December 31, 2015

|                               | Woodbine   | Eur-Pac      | ECC        | AMK            | Sterling       | Compac      |
|-------------------------------|------------|--------------|------------|----------------|----------------|-------------|
| Net Sales                     | \$ 753,000 | \$4,802,000  | \$ 605,000 | \$4,057,000    | \$6,894,000    | \$467,000   |
| Income (loss) from operations | \$ 21,000  | \$(642,000 ) | \$ 176,000 | \$(1,949,000 ) | \$(1,196,000 ) | \$(14,000 ) |

For the Year Ended December 31, 2014

|                               | Woodbine     | Eur-Pac     | ECC       | AMK         | Sterling | Compac |
|-------------------------------|--------------|-------------|-----------|-------------|----------|--------|
| Net Sales                     | \$ 1,047,000 | \$2,756,000 | \$281,000 | \$1,838,000 | \$-      | \$-    |
| Income (loss) from operations | \$ 300,000   | \$637,000   | \$67,000  | \$359,000   | \$-      | \$-    |

The below table sets forth selected proforma financial information as if AMK and Sterling were owned for the years ended December 31, 2015 and 2014.

For the Year Ended December 31, 2015

|                               |              |
|-------------------------------|--------------|
| Net Sales                     | \$82,281,000 |
| Income (loss) from operations | \$773,000    |

For the Year Ended December 31, 2014

|                               |              |
|-------------------------------|--------------|
| Net Sales                     | \$77,935,000 |
| Income (loss) from operations | \$1,313,000  |

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## Principal Business Activity

The Company through its AIM subsidiary is primarily engaged in manufacturing aircraft structural parts, and assemblies for prime defense contractors in the aerospace industry in the United States. NTW is a manufacturer of aerospace components, principally landing gear for F-16 and F-18 fighter aircraft. Welding is a specialty welding and products provider whose significant customers include the world's largest aircraft manufacturers, subcontractors, and original equipment manufacturers. Miller Stuart is a manufacturer of aerospace components whose customers include major aircraft manufacturers and the US Military. Miller Stuart specializes in electromechanical systems, harness and cable assemblies, electronic equipment and printed circuit boards. Woodbine is a manufacturer of aerospace components whose customers include major aircraft component suppliers. Woodbine specializes in welded and brazed chassis structures housing electronics in aircraft. Eur-Pac specializes in military packaging and supplies. Eur-Pac's primary business is "kitting" of supplies for all branches of the United States Defense Department including ordnance parts, hose assemblies, hydraulic, mechanical and electrical assemblies. AMK is a provider of sophisticated welding and machining services for diversified aerospace and industrial customers. Sterling manufactures components for aircraft and ground turbine engines. Compac specializes in the manufacture of RFI/EMI (Radio Frequency Interference – Electro-Magnetic Interference) shielded enclosures for electronic components. The Company's customers consist mainly of publicly traded companies in the aerospace industry.

## Principles of Consolidation

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

## Cash and Cash Equivalents

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

## Accounts Receivable

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

## Inventory Valuation

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

The Company generally purchases raw materials and supplies uniquely suited to the production of larger more complex parts, such as landing gear, only when non-cancellable contracts for orders have been received for finished goods. It occasionally produces larger more complex products, such as landing gear, in excess of purchase order quantities in anticipation of future purchase order demand. Historically this excess has been used in fulfilling future purchase orders. The Company purchases supplies and materials useful in a variety of products as deemed necessary

even though orders have not been received. The Company periodically evaluates inventory items that are not secured by purchase orders and establishes reserves for obsolescence accordingly. The Company also reserves for excess quantities, slow-moving goods, and for other impairments of value.

F-11

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Capitalized Engineering Costs

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

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

### Property and Equipment

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

### Long-Lived and Intangible Assets

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

Long-lived assets and intangible assets subject to amortization to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. The Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. There has been no impairment as of December 31, 2015 and 2014.

### Deferred Financing Costs

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

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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/or the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable.

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

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

The Company had approximately \$2,914,000 or 3.6% of net sales that were billed but not shipped under such bill and hold arrangements as of December 31, 2015.

Payments received in advance from customers for products delivered are recorded as deferred revenue until earned, at which time revenue is recognized. The Terms and Conditions contained in our customer purchase orders often provide for liquidated damages in the event that a stop work order is issued prior to the final delivery.

The Company utilizes a Returned Merchandise Authorization or RMA process for determining whether to accept returned products. Customer requests to return products are reviewed by the contracts department and if the request is approved, a credit is issued upon receipt of the product. Net sales represent gross sales less returns and allowances.

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 allowance for doubtful accounts, useful lives of property and equipment, provisions for inventory obsolescence, accrued expenses and whether to accrue for various contingencies. Actual results could differ from those estimates. Changes in facts and circumstances may result in revised estimates, which are recorded in the period in which they become known.

### Credit and Concentration Risks

There were four customers that represented 59.3% of total sales, and two customers that represented 47.3% of total sales for the years ended December 31, 2015 and 2014, respectively. This is set forth in the table below.

| Customer | Percentage of Sales |      |
|----------|---------------------|------|
|          | 2015                | 2014 |
| 1        | 20.5                | 26.8 |
| 2        | 15.4                | 20.5 |
| 3        | 12.0                | *    |
| 4        | 11.4                | *    |

\* Customer was less than 10% of sales for the year ended December 31, 2014  
Customers 1 and 2 are owned by the same corporate entity.

There were four customers that represented 61.1% of gross accounts receivable and three customers that represented 50.4% of gross accounts receivable at December 31, 2015 and 2014, respectively. This is set forth in the table below.

| Customer | Percentage of Receivables |               |
|----------|---------------------------|---------------|
|          | December 2015             | December 2014 |
| 1        | 26.6                      | 29.0          |
| 2        | 13.6                      | 11.4          |
| 3        | 10.5                      | *             |
| 4        | 10.4                      | 10.0          |

\* Customer was less than 10% of gross accounts receivable at December 31, 2014  
Customers 1 and 3 are owned by the same corporate entity.

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

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





AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Income Taxes

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

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

### Earnings per share

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

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

|  | 2015      | 2014      |
|--|-----------|-----------|
| Weighted average shares outstanding used to compute basic earnings per share                           | 7,478,223 | 6,591,755 |
| Effect of dilutive stock options and warrants  | -         | 323,933   |
| Weighted average shares outstanding and dilutive securities used to compute diluted earnings per share | 7,478,223 | 6,915,688 |

The following securities have been excluded from the calculation as the exercise price was greater than the average market price of the common shares:

|               | December 31,<br>2015 | December 31,<br>2014 |
|---------------|----------------------|----------------------|
| Stock Options | 234,000              | 22,888               |
| Warrants      | 46,800               | 46,800               |
|               | 280,800              | 69,688               |

The following securities have been excluded from the calculation even though the exercise price was less than the average market price of the common shares because the effect of including these potential shares was anti-dilutive due to the net loss incurred during that period:

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|               | December 31,<br>2015 | December 31,<br>2014 |
|---------------|----------------------|----------------------|
| Stock Options | 330,342              | -                    |
| Warrants      | 117,785              | -                    |
|               | 448,127              | -                    |

F-15

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock-Based Compensation

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

Goodwill

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. The goodwill amount of \$10,518,000 at December 31, 2015 relates to the acquisitions of Welding (\$291,000), NTW (\$162,000), Woodbine (\$2,565,000), Eur-Pac (\$1,656,000), ECC (\$109,000), AMK (\$635,000), Sterling (\$4,540,000) and Compac (\$560,000). Goodwill is not amortized, but is tested at least annually for impairment, or if circumstances occur that more likely than not reduce the fair value of the reporting unit below its carrying amount.

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

The Company performs impairment testing for goodwill annually, or more frequently when indicators of impairment exist. As discussed above, the Company adopted ASU 2011-08 and performed a qualitative assessment in the fourth quarter of 2015 to determine whether it was more likely than not that the fair value of each of Welding, including Woodbine, NTW, Eur-Pac, ECC, AMK, Sterling and Compac was less than its carrying amount.

The Company has determined that there has been no impairment of goodwill at December 31, 2015 and 2014.

Freight Out

Freight out is included in operating expenses and amounted to \$197,000 and \$98,000 for the years ended December 31, 2015 and 2014, respectively.

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## JOBS Act

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

## Recently Issued Accounting Pronouncements

In January 2015, the FASB issued ASU 2015-01, “Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items” (“ASU 2015-01”). ASU 2015-01 eliminates the concept of an extraordinary item from accounting principles generally accepted in the United States of America. As a result, an entity will no longer be required to segregate extraordinary items from the results of ordinary operations, to separately present an extraordinary item on its income statement, net of tax, after income from continuing operations or to disclose income taxes and earnings-per-share data applicable to an extraordinary item. However, ASU 2015-01 will still retain the presentation and disclosure guidance for items that are unusual in nature and occur infrequently. ASU 2015-01 becomes effective for interim and annual periods beginning on or after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the effects of Adopting ASU 2015-01 on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company’s consolidated financial statements.

In February 2015, the FASB issued amended guidance to the consolidation standard which updates the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendment modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities (“VIEs”) or voting interest entities and affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, among other provisions. This amended guidance will be effective for the Company beginning fiscal year 2016. Early adoption is permitted. The Company is currently assessing the impact the adoption of the amended guidance will have on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company’s consolidated financial statements.

In April 2015, the FASB issued amended guidance which requires debt issuance costs to be presented as a direct deduction from the carrying value of the associated debt liability rather than as separate assets on the balance sheet. The recognition and measurement guidance for debt issuance costs are not affected by this amendment. This amended guidance will be effective for the Company beginning fiscal year 2016. Early adoption is permitted, and the new guidance will be applied on a retrospective basis. The Company does not expect the adoption of this amended guidance to have a significant impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). The amendments in ASU 2014-09 affect any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in ASC 605, “Revenue Recognition” and most industry-specific guidance and creates ASC 606, “Revenue from Contracts with Customers.” On July 9, 2015, the FASB decided to delay the effective date of the new revenue standard by one year and the amendments are now effective prospectively for reporting periods beginning after December 15, 2017 and early adoption is not permitted. The Company is currently assessing the impact on its consolidated financial statements.

F-17

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In July 2015, the FASB issued ASU 2015-11, “Inventory (Topic 330) Simplifying the Measurement of Inventory” (“ASU 2015-11”). ASU 2015-11 requires an entity to measure inventory at the lower of cost and net realizable value when the FIFO or average cost method is used. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, and should be applied prospectively. Earlier adoption is permitted. The Company is currently assessing the impact the adoption of the amended guidance will have on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company’s consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, “Business Combinations (Topic 805) Simplifying the Accounting for Measurement-Period Adjustments”. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments in this update eliminate the requirement to retrospectively account for those adjustments. The amendments in this update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years, and should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this update, with earlier application permitted for financial statements that have not been issued. The Company does not expect the adoption of this amended guidance to have a significant impact on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes, which requires companies to classify all deferred tax assets and liabilities as non-current on the balance sheet instead of separating deferred taxes into current and non-current amounts. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods thereafter, with early adoption permitted and either with prospective or retrospective application permitted. We do not expect this new guidance to have a material impact on our financial statements.

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

#### Reclassifications

Certain account balances in 2014 have been reclassified to conform to the current year presentation.

#### Subsequent Events

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

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4. ACCOUNTS RECEIVABLE

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

|                                 | December 31,<br>2015 | December 31,<br>2014 |
|---------------------------------|----------------------|----------------------|
| Accounts Receivable Gross       | \$ 14,647,000        | \$ 13,482,000        |
| Allowance for Doubtful Accounts | (985,000)            | (1,566,000)          |
| Accounts Receivable Net         | \$ 13,662,000        | \$ 11,916,000        |

The allowance for doubtful accounts for the years ended December 31, 2015 and 2014 is as follows:

|   | Balance at<br>Beginning of<br>Year | Charged to<br>Costs and<br>Expenses | Deductions<br>from Reserves | Balance at End<br>of Year |
|---|------------------------------------|-------------------------------------|-----------------------------|---------------------------|
| <b>Year ended December 31,<br/>2015</b> |                                    |                                     |                             |                           |
| Allowance for Doubtful<br>Accounts      | \$ 1,566,000                       | \$ 177,000                          | \$ 758,000                  | \$ 985,000                |
| <b>Year ended December 31,<br/>2014</b> |                                    |                                     |                             |                           |
| Allowance for Doubtful<br>Accounts      | \$ 783,000                         | \$ 816,000                          | \$ 33,000                   | \$ 1,566,000              |

Note 5. INVENTORY

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

|                   | December 31,<br>2015 | December 31,<br>2014 |
|-------------------|----------------------|----------------------|
| Raw Materials     | \$ 9,188,000         | \$ 7,168,000         |
| Work In Progress  | 19,743,000           | 14,886,000           |
| Finished Goods    | 11,838,000           | 10,072,000           |
| Inventory Reserve | (3,846,000)          | (3,475,000)          |
| Total Inventory   | \$ 36,923,000        | \$ 28,651,000        |

The Company periodically evaluates inventory and establishes reserves for obsolescence, excess quantities, slow-moving goods, and for other impairment of value.

|   | Balance at<br>Beginning of<br>Year | Additions to<br>Reserve | Deductions<br>from Reserves | Balance at End<br>of Year |
|---|------------------------------------|-------------------------|-----------------------------|---------------------------|
| <b>Year ended December 31,<br/>2015</b> |                                    |                         |                             |                           |

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|                                 |    |             |    |           |    |         |    |             |
|---------------------------------|----|-------------|----|-----------|----|---------|----|-------------|
| Reserve for Inventory           | \$ | (3,475,000) | \$ | (785,000) | \$ | 414,000 | \$ | (3,846,000) |
| Year ended December 31,<br>2014 |    |             |    |           |    |         |    |             |
| Reserve for Inventory           | \$ | (2,742,000) | \$ | (743,000) | \$ | 10,000  | \$ | (3,475,000) |

F-19

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6. PROPERTY AND EQUIPMENT

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

|                                       | December 31,<br>2015 | December 31,<br>2014 |               |
|---------------------------------------|----------------------|----------------------|---------------|
| Land                                  | \$ 300,000           | \$ 200,000           |               |
| Buildings and Improvements            | 1,658,000            | 1,680,000            | 31.5 years    |
| Machinery and Equipment               | 15,109,000           | 12,495,000           | 5 - 8 years   |
| Capital Lease Machinery and Equipment | 5,869,000            | 1,800,000            | 5 - 8 years   |
| Tools and Instruments                 | 6,993,000            | 5,566,000            | 1.5 - 7 years |
| Automotive Equipment                  | 191,000              | 162,000              | 5 years       |
| Furniture and Fixtures                | 425,000              | 294,000              | 5 - 8 years   |
| Leasehold Improvements                | 910,000              | 646,000              | Term of Lease |
| Computers and Software                | 482,000              | 372,000              | 4 - 6 years   |
| Total Property and Equipment          | 31,937,000           | 23,215,000           |               |
| Less: Accumulated Depreciation        | (16,638,000)         | (13,658,000 )        |               |
| Property and Equipment, net           | \$ 15,299,000        | \$ 9,557,000         |               |

Depreciation expense for the years ended December 31, 2015 and 2014 was approximately \$3,090,000 and \$2,364,000, respectively.

Note 7. INTANGIBLE ASSETS

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

|                                | December 31,<br>2015 | December 31,<br>2014 |                |
|--------------------------------|----------------------|----------------------|----------------|
| Customer Relationships         | \$ 6,555,000         | \$ 6,255,000         | 5 to 14 years  |
| Trade Names                    | 1,480,000            | 1,280,000            | 15-20 years    |
| Technical Know-how             | 660,000              | 660,000              | 10 years       |
| Non-Compete                    | 150,000              | 50,000               | 5 years        |
| Professional Certifications    | 15,000               | 15,000               | .25 to 2 years |
| Total Intangible Assets        | 8,860,000            | 8,260,000            |                |
| Less: Accumulated Amortization | (5,008,000)          | (3,747,000)          |                |
| Intangible Assets, net         | \$ 3,852,000         | \$ 4,513,000         |                |

The expense for amortization of the intangibles for the years ended December 31, 2015 and 2014 was approximately \$1,262,000 and \$1,163,000, respectively.

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Future amortization of intangibles as of December 31, 2015 is as follows:

| For the year ending | Amount       |
|---------------------|--------------|
| December 31, 2016   | \$ 1,279,000 |
| December 31, 2017   | 754,000      |
| December 30, 2018   | 284,000      |
| December 31, 2019   | 284,000      |
| December 31, 2020   | 284,000      |
| Thereafter          | 967,000      |
| Total               | \$ 3,852,000 |

Note 8. SALE AND LEASEBACK TRANSACTION

On October 24, 2006, the Company consummated a Sale - Leaseback Arrangement, whereby the Company sold the buildings and real property located in Bay Shore, New York (the "Property") for a purchase price of \$6,200,000. The Company accounted for the transaction under the provisions of FASB ASC 840-40, "Leases – Sale-Leaseback Transactions". The Company realized a gain on the sale of \$1,051,000 of which \$300,000 was recognized during the year ended December 31, 2006. The remaining \$751,000 is being recognized ratably over the remaining term of the twenty year lease at approximately \$38,000 per year. The gain is included in Other Income in the accompanying Consolidated Statements of Operations. The unrecognized portion of the gain in the amount of \$409,000 and \$447,000 as of December 31, 2015 and 2014, respectively, is classified as Deferred Gain on Sale in the accompanying Consolidated Balance Sheets.

Simultaneous with the closing of the sale of the Property, the Company entered into a 20-year triple-net lease (the "Lease") with the purchaser for the property. Base annual rent is approximately \$540,000 for the first five years, \$560,000 for the sixth year, and thereafter increases 3% per year. The Lease grants the Company an option to renew the Lease for an additional period of five years. The Company has on deposit with the purchaser \$89,000 as security for the performance of its obligations under the Lease. In addition, the Company has on deposit \$150,000 with the landlord as security for the completion of certain repairs and upgrades to the Property. This amount is included in the caption Deferred Finance costs, Net, Deposit and Other Assets in the accompanying Consolidated Balance Sheets. Pursuant to the terms of the Lease, the Company is required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance. The lease also contains customary representations, warranties, obligations, conditions and indemnification provisions and grants the purchaser customary remedies upon a breach of the lease by the Company, including the right to terminate the Lease and hold the Company liable for any deficiency in future rent. See Note 13 Commitments and Contingencies.

Note 9. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

|  | December 31,<br>2015 | December 31,<br>2014 |
|--|----------------------|----------------------|
| Revolving credit note payable to PNC Bank N.A. ("PNC") | \$ 29,604,000        | \$ 17,672,000        |
| Term loans, PNC  | 9,833,000            | 8,363,000            |
| Capital lease obligations                              | 5,018,000            | 1,645,000            |

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|   |              |              |
|---|--------------|--------------|
| Related party notes payable   | 350,000      | -            |
| Other note payable  | -            | 41,000       |
| Subtotal  | 44,805,000   | 27,721,000   |
| Less: Current portion of notes and capital obligations              | (40,893,000) | (19,508,000) |
| Notes payable and capital lease obligations, net of current portion | \$ 3,912,000 | \$ 8,213,000 |

F-21

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PNC Bank N.A. ("PNC")

The Company has a credit facility with PNC (the "Loan Facility") secured by substantially all of its assets. The Loan Facility has been amended many times during its term. The Company entered into an amendment to the Loan Facility in November 2015 and paid an amendment fee of \$40,000. At December 31, 2015, the Loan Facility consisted of a \$33,000,000 revolving loan (which includes an inventory sub-limit of \$15,000,000) and four term loans (Term Loan A, Term Loan B, Term Loan C, and Term Loan D), described below.

Under the terms of the Loan Facility the revolving credit note bore interest at the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and three quarters of one percent (2.75%) with respect to Eurodollar Rate Loans. The revolving credit note had an interest rate of 4.00% per annum at December 31, 2015 and 2014, and an outstanding balance of \$29,604,000 and \$17,672,000, respectively. The maturity date of the revolving credit note is November 30, 2016.

Each day, the Company's cash collections are swept directly by the bank to reduce the revolving loans and the Company then borrows according to a borrowing base. Because the revolving loans contain a subjective acceleration clause which could permit PNC to require repayment prior to maturity, the loans are classified with the current portion of notes and capital lease obligations.

The repayment terms of Term Loan A were amended in 2014. On April 1, 2014, the Company borrowed \$2,676,000, representing an additional \$1,328,000, to partially fund the acquisition of Woodbine. The repayment terms of Term Loan A consists of thirty-two consecutive monthly principal installments, the first thirty-one in the amount of \$31,859 which commenced on the first business day of May 2014, and continued on the first business day of each month thereafter, with a thirty-second and final payment of any unpaid balance of principal and interest on the last business day of November 2016. Term Loans A and B bear interest at (a) the sum of the Alternate Base Rate plus one and three quarters of one percent (1.75%) with respect to Domestic Rate Loans and (b) the sum of the LIBOR Rate plus three percent (3.00%) with respect to LIBOR Rate Loans. At December 31, 2015 and 2014, the balance due under Term Loan A was \$2,039,000 and \$2,421,000, respectively.

On October 1, 2014, the Company borrowed \$3,500,000 under Term Loan B for the acquisition of AMK. The repayment of Term Loan B consists of sixty consecutive monthly principal installments, the first fifty-nine in the amount of \$58,333 which commenced on the first business day of December 2014, and continued on the first business day of each month thereafter, with a sixtieth and final payment of any unpaid balance of principal and interest on the last business day of November 2019. At December 31, 2015 and 2014, the balance due under Term Loan B was \$2,742,000 and \$3,442,000, respectively.

On December 31, 2014, the Company borrowed \$2,500,000 under Term Loan C to refinance the Seller Note and Mortgage of \$2,500,000 issued as part of the acquisition of AMK. The maturity date of Term Loan C is the first business day of January 2021, and it is to be paid in seventy two consecutive monthly principal installments, which commenced on the first business day of February 2015, and continue on the first business day of each month thereafter. The first seventy-one of the installments shall be in the amount of \$34,722 with a seventy second and final payment of any unpaid principal and interest on the first business day of January 2021. Term Loan C bears interest at (a) the sum of the Alternate Base Rate plus two percent (2.00%) with respect to Domestic Rate Loans and (b) the sum of the LIBOR Rate plus three and one-quarter percent (3.25%) with respect to LIBOR Rate Loans. At December 31, 2015 and 2014, the balance due under Term Loan C was \$2,118,000 and \$2,500,000, respectively.



AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On March 9, 2015, the Company borrowed \$3,500,000 under Term Loan D for the acquisition of Sterling. The repayment of Term Loan D consists of twenty consecutive monthly principal installments, the first nineteen in the amount of \$62,847 which commenced on the first business day of April 2015, and continued on the first business day of each month thereafter, with a twentieth and final payment of any unpaid balance of principal and interest on the last business day of November 2016. Term Loan D bears interest at (a) the sum of the Alternate Base Rate plus two and one quarter percent (2.25%) with respect to Domestic Rate Loans and (b) the sum of the LIBOR Rate plus three and one-half percent (3.50%) with respect to LIBOR Rate Loans. At December 31, 2015, the balance due under Term Loan D was \$2,934,000.

The Loan Facility was amended in February 2016 to increase the revolving loan to \$37,500,000, including an overdraft facility of \$4,500,000. Under the terms of the Loan Facility, as amended, the revolving loan now bears interest at (a) the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one half of one percent (2.50%) with respect to LIBOR Rate Loans. We paid a fee of \$75,000 in connection with the amendment.

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

The terms of the Loan Facility require that, among other things, the Company maintain a specified Fixed Charge Coverage Ratio. In addition, the Company is limited in the amount of Capital Expenditures it can make. The Company is also limited to the amount of Dividends it can pay its shareholders as defined in the Loan Facility. As of December 31, 2015, the Company was not in compliance with the Fixed Charge Coverage Ratio covenant. Because the Loan Facility contains a subjective acceleration clause which could permit PNC to require repayment prior to maturity, the revolving loan is classified as current in the accompanying condensed consolidated balance sheet. The failure to maintain the requisite Fixed Charge Coverage Ratio constitutes a default under the Loan Facility and, PNC, at its option, may give notice to the Company that all amounts under the Loan Facility are immediately due and payable. Consequently, all amounts due under the Term Loans are also classified as current. As of the date of issuance of the accompanying financial statements, PNC has not given such notice. In addition, the Company has requested a waiver from PNC for the failure to meet the Fixed Charge Coverage Ratio covenant. At December 31, 2015, the Company was in compliance with all other terms of the Loan Facility. At December 31, 2014, the Company was in compliance with all terms of the Loan Facility.

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

As of December 31, 2015 the future minimum principal payments for the term loans are as follows:

| For the year ending | Amount       |
|---------------------|--------------|
| December 31, 2016   | \$ 6,090,000 |
| December 31, 2017   | 1,117,000    |
| December 31, 2018   | 1,117,000    |
| December 31, 2019   | 1,058,000    |
| December 31, 2020   | 416,000      |
| Thereafter          | 35,000       |

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|                        |             |
|------------------------|-------------|
| PNC Term Loans payable | 9,833,000   |
| Less: Current portion  | (9,833,000) |
| Long-term portion      | \$ -        |

Interest expense related to these credit facilities amounted to approximately \$1,414,000 and \$853,000 for the years ended December 31, 2015 and 2014, respectively.

F-23

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 \$5,018,000 and \$1,645,000 as of December 31, 2015 and 2014, respectively, with various interest rates ranging from approximately 4% to 7%.

As of December 31, 2015, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

| For the year ending                 | Amount       |
|-------------------------------------|--------------|
| December 31, 2016                   | \$ 1,348,000 |
| December 31, 2017                   | 1,348,000    |
| December 31, 2018                   | 1,318,000    |
| December 31, 2019                   | 1,139,000    |
| December 31, 2020                   | 455,000      |
| Thereafter                          | -            |
| Total future minimum lease payments | 5,608,000    |
| Less: imputed interest              | (590,000)    |
| Less: current portion               | (1,106,000)  |
| Total Long Term Portion             | \$ 3,912,000 |

### Related Party Note Payable

On September 8, 2015, the Company issued a promissory note (the “Taglich Note”) to Michael Taglich in the principal amount of \$350,000. The Taglich Note bears interest at the rate of 4% per annum. The principal and interest are due to be paid on September 7, 2016. The Company's obligation under the Taglich Note is subordinated to its indebtedness to PNC.

Interest expense related to the Taglich Note was \$1,000 for the year ended December 31, 2015.

### Other Notes Payable

In connection with the acquisition of Welding on August 24, 2007, the Company incurred a note payable (“WMI Note”) to the former stockholders of Welding. The Company's obligation under the WMI Note was subordinated to its indebtedness to PNC.

The WMI Note and payment terms were adjusted and/or amended several times and on January 5, 2015 the remaining balance of \$41,000 was paid and the obligation was satisfied. At December 31, 2015 and 2014, the balance owed under the WMI Note was \$0 and \$41,000, respectively.

Interest expense related to the WMI Note was \$0 and \$30,000 for the years ended December 31, 2015 and 2014, respectively.





AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Junior Subordinated Notes

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

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

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

The due dates of the remaining Junior Subordinated Notes were extended from November 18, 2013 to mature on November 30, 2016 and were subordinated to the Company's obligations to PNC. The Junior Subordinated Notes were satisfied in June 2014.

The balance owed on the Junior Subordinated Notes was \$0 at both December 31, 2015 and 2014.

Interest expense on the Junior Subordinated Notes amounted to \$0 and \$61,000 for the years ended December 31, 2015 and 2014, respectively.

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

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

|                  | December 31,<br>2015 | December 31,<br>2014 |
|------------------|----------------------|----------------------|
| Accounts Payable | \$ 9,722,000         | \$ 5,636,000         |
| Accrued Expenses | 1,807,000            | 812,000              |
| Other Payables   | 524,000              | 500,000              |
|                  | \$ 12,053,000        | \$ 6,948,000         |

Note 11. STOCKHOLDERS' EQUITY

Common Stock Issuances

During the year ended December 31, 2015, the Company issued 25,819 shares of its common stock pursuant to the cashless exercise of Stock Options.

During the year ended December 31, 2014, the Company issued 26,972 shares of its common stock pursuant to the cashless exercise of Warrants and 17,612 shares of its common stock pursuant to the cashless exercise of Stock Options.

On March 1, 2015, in connection with the acquisition of Sterling, the Company issued 425,005 shares of its common stock to the former stockholders of Sterling.

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

On June 3, 2014, in connection with its Registered Direct Offering (“the Offering”), the Company issued 1,170,000 shares of its common stock. These securities were offered pursuant to the Company’s effective “shelf” registration statement on Form S-3 (File NO. 333-191748), which was declared effective by the Securities and Exchange Commission on December 11, 2013. Taglich Brothers acted as the exclusive placement agent for the Offering (see Note 16). The gross proceeds of the offering were \$10,530,000 comprised of \$9,530,000 in cash and \$1,000,000 in the conversion of our Junior Subordinated Notes (see Note 9). The Company paid to Taglich Brothers a commission of approximately \$842,000 and warrants to purchase up to 46,800 shares of common stock at a per share price of \$11.25. Additionally, the Company paid legal fees on behalf of Taglich Brothers in the amount of \$75,000 and paid a qualified independent underwriter approximately \$50,000 for their services. The Company netted cash of approximately \$8,562,000 from the Offering. A portion of these funds were used to finance the acquisition of Eur-Pac Corporation (see Note 2).

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

During the year ended December 31, 2015, the Company granted 52,000 shares of restricted common stock pursuant to an agreement in connection with the acquisition of Sterling. The value of \$463,000 related to this grant has been

recorded as additional paid in capital.

F-26

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Dividends

On January 24, 2014, the Company paid a dividend equal to \$0.125 per common share to all shareholders of record as of January 9, 2014. The approximate amount of the dividend was \$717,000.

On April 22, 2014, the Company paid a dividend equal to \$0.15 per common share to all shareholders of record as of April 15, 2014. The approximate amount of the dividend was \$885,000.

On July 10, 2014 the Company paid a dividend equal to \$0.15 per common share to all shareholders of record as of June 30, 2014. The approximate amount of the dividend was \$1,064,000.

On November 3, 2014, the Company paid a dividend equal to \$0.15 per common share to all shareholders of record as of October 20, 2014. The approximate amount of the dividend was \$1,065,000.

On January 15, 2015 the Company paid a dividend equal to \$0.15 per common share or \$1,066,000 to all shareholders of record as of January 2, 2015.

On April 24, 2015 the Company paid a dividend equal to \$0.15 per common share or \$1,134,000 to all shareholders of record as of April 13, 2015.

On August 12, 2015, the Company paid a dividend equal to \$0.15 per common share or \$1,134,000 to all shareholders of record as of August 3, 2015.

On December 1, 2015, the Company paid a dividend equal to \$0.15 per common share or \$1,133,000 to all shareholders of record as of November 23, 2015.

## Derivative Liabilities

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

## Warrants Issued To Taglich Brothers

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

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12. EMPLOYEE BENEFITS PLANS

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

Union

Substantially the entire workforce at AIM is subject to a union contract with the United Service Workers Union TUJAT Local 355, EIN 11-1772919 (the "Union"). The contract expires on December 31, 2018.

Medical benefits for union employees are provided through a policy with Insperity, the costs of which are substantially borne by the Company. In addition, the Company is obligated to make contributions for union dues and a security fund (defined contribution plan) for the benefit of each union employee. Contributions to the security fund amounted to \$247,000 and \$242,000 for the years ended December 31, 2015 and 2014, respectively.

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

Others

All other Company employees, are covered under a co-employment agreement with Insperity.

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

Note 13. COMMITMENTS AND CONTINGENCIES

Real Estate Leases

The Company leases its facilities under various operating lease agreements, which contain renewal options and escalation provisions. Rent expense was \$2,225,000 and \$2,270,000 for the years ended December 31, 2015 and 2014, respectively. The Company is responsible for paying all operating costs under the terms of the leases. As of December 31, 2015, the aggregate future minimum lease payments are as follows:

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

|                     | Plant Avenue Annual Rent | Fifth Avenue Annual Rent | Lamar Street Annual Rent | Motor Parkway Annual Rent | Porter Street Annual Rent | Clinton Avenue Annual Rent | Total Rents         |
|---------------------|--------------------------|--------------------------|--------------------------|---------------------------|---------------------------|----------------------------|---------------------|
| For the year ending |                          |                          |                          |                           |                           |                            |                     |
| December 31, 2016   | \$615,000                | \$704,000                | \$360,000                | \$103,000                 | \$115,000                 | \$76,000                   | \$1,973,000         |
| December 31, 2017   | 543,000                  | 725,000                  | 360,000                  | 106,000                   | 115,000                   | 78,000                     | 1,927,000           |
| December 31, 2018   | 559,000                  | 747,000                  | 300,000                  | 110,000                   | 115,000                   | 26,000                     | 1,857,000           |
| December 31, 2019   | 576,000                  | 769,000                  | -                        | 113,000                   | 48,000                    | -                          | 1,506,000           |
| December 31, 2020   | 593,000                  | 792,000                  | -                        | 116,000                   | -                         | -                          | 1,501,000           |
| Thereafter          | 3,272,000                | 5,040,000                | -                        | 103,000                   | -                         | -                          | 8,415,000           |
| <b>Total Rents</b>  | <b>\$6,158,000</b>       | <b>\$8,777,000</b>       | <b>\$1,020,000</b>       | <b>\$651,000</b>          | <b>\$393,000</b>          | <b>\$180,000</b>           | <b>\$17,179,000</b> |

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

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

As of December 31, 2015, the accrued lease impairment was \$0.

On December 7, 2015, the Company executed a Sale - Leaseback Arrangement, whereby the Company agreed to sell the buildings and real property located in South Windsor, Connecticut (the "Property") for a purchase price of \$1,700,000. The contract expects to close in April 2016. At December 31, 2015, the Company classified the Property as Assets Held for Sale with a balance of \$1,700,000.

Simultaneous with the closing of the sale of the Property, the Company will enter into a 15-year lease (the "Lease") with the purchaser for the property. Base annual rent is approximately \$155,000 for the first year and increases approximately 3% per year, each year thereafter. The Lease grants the Company an option to renew the Lease for an additional period of five years. Pursuant to the terms of the Lease, the Company is required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance. The Lease also contains representations, warranties, obligations, conditions and indemnification provisions in favor of the purchaser and grants the purchaser 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.

The Company will account for the transaction under the provisions of FASB ASC 840-40, "Leases – Sale-Leaseback Transactions".

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14. INCOME TAXES

The provision for (benefit from) income taxes as of December 31, is set forth below:

|                               | 2015          | 2014          |
|-------------------------------|---------------|---------------|
| Current                       |               |               |
| Federal                       | \$ -          | \$ 939,000    |
| State                         | 53,000        | 16,000        |
| Prior year overaccruals       |               |               |
| Federal                       | (123,000 )    | 10,000        |
| State                         | -             | (290,000 )    |
| Total (Benefit) Expense       | (70,000 )     | 675,000       |
| Deferred Tax Benefit          | (216,000 )    | (1,043,000 )  |
| Net Benefit from Income Taxes | \$ (286,000 ) | \$ (368,000 ) |

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

|  | 2015  |   | 2014   |   |
|--|-------|---|--------|---|
| U.S. statutory income tax rate                               | -34.0 | % | 34.0   | % |
| State taxes  | 4.7   | % | 10.0   | % |
| Permanent differences, overaccruals and non-deductible items | 3.0   | % | -167.0 | % |
| Rate change and provision to return true-up                  | -40.2 | % | 0.0    | % |
| Expired stock options  | 40.8  | % | 0.0    | % |
| Total  | -25.7 | % | -123.0 | % |



AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The components of net deferred tax assets at December 31, 2015 and December 31, 2014 are set forth below:

|  | December 31,<br>2015 | December 31,<br>2014 |
|--|----------------------|----------------------|
| Deferred tax assets  |                      |                      |
| Current:   |                      |                      |
| Net operating losses   | \$ 462,000           | \$ -                 |
| Bad debts  | 336,000              | 650,000              |
| Inventory - 263A adjustment                                      | 8,000                | 9,000                |
| Accounts payable, accrued expenses and reserves                  | 919,000              | 762,000              |
| Total current deferred tax assets before valuation allowance     | 1,725,000            | 1,421,000            |
| Valuation allowance  | -                    | -                    |
| Total current deferred tax assets after valuation allowance      | 1,725,000            | 1,421,000            |
| Non-current:   |                      |                      |
| Capital loss carry forwards                                      | -                    | 1,088,000            |
| Section 1231 loss carry forward                                  | 4,000                | 4,000                |
| Stock based compensation - options and restricted stock          | 79,000               | 527,000              |
| Capitalized engineering costs                                    | 432,000              | 522,000              |
| Deferred rent  | 410,000              | 483,000              |
| Amortization - NTW Transaction                                   | 789,000              | 663,000              |
| Inventory reserves   | 680,000              | -                    |
| Lease impairment   | -                    | 22,000               |
| Deferred gain on sale of real estate                             | 126,000              | 179,000              |
| Other  | 257,000              | -                    |
| Total non-current deferred tax assets before valuation allowance | 2,777,000            | 3,488,000            |
| Valuation allowance  | (4,000 )             | (1,092,000 )         |
| Total non-current deferred tax assets after valuation allowance  | 2,773,000            | 2,396,000            |
| Deferred tax liabilities:  |                      |                      |
| Property and equipment   | (2,091,000 )         | (1,082,000 )         |
| Amortization - NTW Goodwill                                      | (13,000 )            | (11,000 )            |
| Amortization - AMK Goodwill                                      | (18,000 )            | (4,000 )             |
| Amortization - Welding Transaction                               | (313,000 )           | (441,000 )           |
| Total non-current deferred tax liabilities                       | (2,435,000 )         | (1,538,000 )         |
| Net non current deferred tax asset                               | \$ 338,000           | \$ 858,000           |

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

During the year ended December 31, 2014, the Company provided a valuation allowance on the deferred tax assets related to capital loss and section 1231 loss carryforwards. The valuation allowance at December 31, 2015 and 2014 amounted to \$4,000 and \$1,092,000, respectively. Management believes that the remainder of the net deferred tax assets are more likely than not to be realized.

At December 31, 2015 and 2014, the Company had no material unrecognized tax benefits and no adjustments to liabilities or operations were required. The Company does not expect that its unrecognized tax benefits will materially increase within the next twelve months. The Company recognizes interest and penalties related to uncertain tax positions in interest expense. As of December 31, 2015 and 2014, the Company has not recorded any provisions for accrued interest and penalties related to uncertain tax positions.

In certain cases, the Company's uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. The Company files federal and state income tax returns in jurisdictions with varying statutes of limitations. The 2012 through 2015 tax years generally remain subject to examination by federal and state tax authorities.

## Note 15. STOCK OPTIONS AND WARRANTS

## Stock-Based Compensation

On March 30, 2015, the Board of Directors adopted the Company's 2015 Equity Incentive Plan ("2015 Plan"). The 2015 Plan is virtually identical to the Company's 2013 Equity Incentive Plan. The 2015 Plan was approved by the Company's stockholders on June 25, 2015. The Plan authorized the grant of rights with respect to up to 350,000 shares. No stock options have been issued under the Plan as of December 31, 2015.

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

During the years ended December 31, 2015 and 2014, the Board of Directors approved the issuance of 18,000 and 24,000 options, respectively, to the non-employee members of the Company's Board of Directors. These options vested immediately.

On December 1, 2014, the Board of Directors approved the issuance of 120,000 options to the Company's chief executive officer. These options vest ratably over three years.

At various dates during 2015, the Board of Directors approved the issuance of 81,000 options to certain management employees. These options vest ratably over two to four years.

The Company recorded stock based compensation expense of \$100,000 and \$42,000 in its consolidated statement of operations for the years ended December 31, 2015 and 2014, respectively, and such amounts were included as a component of general and administrative expense.



AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

|  | 2015          | 2014          |
|--|---------------|---------------|
| Risk-free interest rates                         | 1.31% - 1.49% | 1.55% - 1.68% |
| Expected life (in years)                         | 5 - 6         | 5 - 7         |
| Expected volatility                              | 25%           | 25%           |
| Dividend yield                                   | 5.9%          | 5.6% - 6.1%   |
| Weighted-average grant date fair value per share | \$1.10        | \$1.10        |

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

A summary of the status of the Company's stock options as of December 31, 2015 and 2014, and changes during the two years then ended are presented below.

|                                      | Options  | Wtd. Avg.<br>Exercise Price |
|--------------------------------------|----------|-----------------------------|
| Balance, December 31, 2013           | 422,332  | \$ 9.34                     |
| Granted during the period            | 144,000  | 10.13                       |
| Exercised during the period          | (33,133) | 4.74                        |
| Terminated/Expired during the period | (4,660)  | 103.45                      |
| Balance, December 31, 2014           | 528,539  | 9.01                        |
| Granted during the period            | 99,000   | 10.20                       |
| Exercised during the period          | (46,473) | 4.50                        |
| Terminated/Expired during the period | (16,724) | 84.78                       |
| Balance, December 31, 2015           | 564,342  | \$ 7.35                     |
| Exercisable at December 31, 2015     | 410,190  | \$ 6.56                     |

AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about stock options at December 31, 2015:

| Range of Exercise Prices | Remaining Number Outstanding | Wtd. Avg. Life | Wtd. Avg. Exercise Price |
|--------------------------|------------------------------|----------------|--------------------------|
| \$0.00 - \$5.00          | 199,696                      | 3.6 years      | \$4.37                   |
| \$5.01 - \$20.00         | 364,646                      | 4.2 years      | 8.98                     |
| \$0.00 - \$20.00         | 564,342                      | 4.0 years      | \$7.35                   |

As of December 31, 2015, there was \$184,000 of unrecognized compensation cost related to non-vested stock option awards, which is to be recognized over the remaining weighted average vesting period of three years.

The aggregate intrinsic value at December 31, 2015 was based on the Company's closing stock price of \$8.15 was \$945,232. The aggregate intrinsic value was calculated based on the positive difference between the closing market price of the Company's Common Stock and the exercise price of the underlying options. The total number of in-the-money options exercisable as of December 31, 2015 was 316,842.

The weighted average fair value of options granted during the years ended December 31, 2015 and 2014 was \$1.10 and \$1.10 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2015 and 2014 was \$169,626 and \$191,552, respectively. The total fair value of shares vested during the years ended December 31, 2015 and 2014 was \$33,845 and \$51,828, respectively.

#### Warrants

The following tables summarize the Company's outstanding warrants as of December 31, 2015 and changes during the two years then ended:

|                                      | Warrants | Wtd. Avg. Exercise Price |
|--------------------------------------|----------|--------------------------|
| Balance, December 31, 2013           | 118,585  | \$ 6.30                  |
| Granted during the period            | 56,800   | 10.80                    |
| Exercised during the period          | (10,800) | 6.30                     |
| Terminated/Expired during the period | -        | -                        |
| Balance, December 31, 2014           | 164,585  | 7.85                     |
| Granted during the period            | -        | -                        |
| Exercised during the period          | -        | -                        |
| Terminated/Expired during the period | -        | -                        |
| Balance, December 31, 2015           | 164,585  | \$ 7.85                  |
| Exercisable at December 31, 2015     | 164,585  | \$ 7.85                  |

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

|                          | 2015 | 2014          |
|--------------------------|------|---------------|
| Risk-free interest rates | n/a  | 1.55% - 1.56% |

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|  |     |               |
|--|-----|---------------|
| Expected life (in years)                         | n/a | 5             |
| Expected volatility                              | n/a | 20.56%        |
| Dividend yield                                   | n/a | 6%            |
|  | n/a |               |
| Weighted-average grant date fair value per share | n/a | \$0.67-\$1.38 |

F-34

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AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about warrants at December 31, 2015:

| Range of Exercise Prices | Warrants | Wtd. Avg. Life | Wtd. Avg. Exercise Price |
|--------------------------|----------|----------------|--------------------------|
| \$6.30                   | 107,785  | 1.5 years      | \$6.30                   |
| \$8.72 - \$11.25         | 56,800   | 3.4 years      | 10.80                    |
| \$6.30 - \$11.25         | 164,585  | 2.1 years      | \$7.85                   |

Note 16. RELATED PARTY TRANSACTIONS

Taglich Brothers is a corporation co-founded by two of the directors of the Company. In addition, a third director of the Company is a vice president of Taglich Brothers.

As discussed in Note 9, on September 8, 2015, the Company issued a promissory note payable to Michael Taglich, one of the co-founders of Taglich Brothers and a director of the Company in the principal amount of \$350,000.

On January 1, 2014, we entered into a Capital Market Advisory Agreement with Taglich Brothers pursuant to which Taglich Brothers provides us, on a non-exclusive basis, business advisory services for a monthly fee of \$7,000, a warrant to purchase 10,000 shares of our common stock at an exercise price of \$8.72 per share, vesting quarterly over a one-year period and any reasonable out of pocket expenses.

As discussed above, in connection with our public offering of 1,170,000 shares of common stock completed on June 3, 2014, we paid Taglich Brothers, which acted as placement agent for the offering, \$842,400, representing 8% of the gross proceeds of the offering as a sales commission, plus an additional \$75,000 in reimbursement of expenses, including counsel fees. In addition, we granted Taglich Brothers placement agent warrants to purchase 46,800 shares of common stock, representing 4% of the shares sold in the offering as additional compensation. The Warrants are exercisable for cash or on a cashless basis at a per share exercise price equal to \$11.25, commencing May 29, 2015 and expiring May 28, 2019.

Note 17. SEGMENT REPORTING

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

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

The Company currently divides its operations into three operating segments: Complex Machining which consists of AIM and NTW; Aerostructures and Electronics which consists of WMI, WPI, MSI, Eur-Pac, ECC, and Compac beginning September 1, 2015; and Turbine Engine Components which consists of AMK and Sterling, beginning March 2015. Along with our operating subsidiaries, we report the results of our corporate division as an independent segment.





AIR INDUSTRIES GROUP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accounting policies of each of the segments are the same as those described in the Summary of Significant Accounting Policies. The Company evaluates performance based on revenue, gross profit contribution and assets employed. Corporate level operating costs are allocated to segments. These costs include corporate costs such as legal, audit, tax and other professional fees including those related to being a public company.

|   | Year Ended December 31, |               |
|---|-------------------------|---------------|
|   | 2015                    | 2014          |
| <b>COMPLEX MACHINING</b>                |                         |               |
| Net Sales                               | \$ 42,356,000           | \$ 44,220,000 |
| Gross Profit                            | 10,412,000              | 8,691,000     |
| Pre Tax Income (Loss)                   | 1,825,000               | 711,000       |
| Assets                                  | 48,353,000              | 40,611,000    |
| <b>AEROSTRUCTURES &amp; ELECTRONICS</b> |                         |               |
| Net Sales                               | 27,134,000              | 18,273,000    |
| Gross Profit                            | 6,553,000               | 4,812,000     |
| Pre Tax Income (Loss)                   | 386,000                 | (554,000 )    |
| Assets                                  | 20,229,000              | 16,788,000    |
| <b>TURBINE ENGINE COMPONENTS</b>        |                         |               |
| Net Sales                               | 10,952,000              | 1,838,000     |
| Gross Profit                            | 316,000                 | 595,000       |
| Pre Tax Income (Loss)                   | (3,329,000 )            | 142,000       |
| Assets                                  | 19,076,000              | 8,150,000     |
| <b>CORPORATE</b>                        |                         |               |
| Net Sales                               | -                       | -             |
| Gross Profit                            | -                       | -             |
| Pre Tax Income (Loss)                   | -                       | -             |
| Assets                                  | 592,000                 | 631,000       |
| <b>CONSOLIDATED</b>                     |                         |               |
| Net Sales                               | 80,442,000              | 64,331,000    |
| Gross Profit                            | 17,281,000              | 14,098,000    |
| Pre Tax Income (Loss)                   | (1,118,000 )            | 299,000       |
| Benefit from Income Taxes               | 286,000                 | 368,000       |
| Net (Loss) Income                       | (832,000 )              | 667,000       |
| Assets                                  | \$ 88,250,000           | \$ 66,180,000 |