

AIR INDUSTRIES GROUP
Form 10-Q
May 15, 2015

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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED March 31, 2015

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission file number 001-35927

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

Nevada
(State or other jurisdiction of
incorporation or organization)

80-0948413
(IRS Employer
Identification No.)

360 Motor Parkway, Suite 100, Hauppauge, New York 11788
(Address of principal executive offices)

(631) 881-4920
(Issuer's telephone number)

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

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

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

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Large accelerated filer Accelerated filer

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

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

As of May 11, 2015, the registrant had outstanding 7,559,501 shares of common stock.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, or Exchange Act. Forward-looking statements are predictive in nature and can be identified by the fact that they do not relate strictly to historical or current facts and generally include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions. Certain of the matters discussed herein concerning, among other items, our operations, cash flows, financial position and economic performance including, in particular, future sales, product demand, competition and the effect of economic conditions, include forward-looking statements.

Although we believe that these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital, capital expenditures, distribution channels, profitability, new products, adequacy of funds from operations, and general economic conditions, these statements and other projections contained herein expressing opinions about future outcomes and non-historical information, are subject to uncertainties and, therefore, there is no assurance that the outcomes expressed in these statements will be achieved. Investors are cautioned that forward-looking statements are not guarantees of future performance and actual results or developments may differ materially from the expectations expressed in forward-looking statements contained herein. Given these uncertainties, you should not place any reliance on these forward-looking statements which speak only as of the date hereof. Factors that could cause actual results to differ materially from those reflected in the forward-looking statements include, but are not limited to, those discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014 and elsewhere in this report and the risks discussed in our other filings with the SEC.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise, except as may be required under the securities laws of the United States.

PART I
FINANCIAL INFORMATION

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AIR INDUSTRIES GROUP
Condensed Consolidated Balance Sheets

	March 31, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current Assets		
Cash and Cash Equivalents	\$ 2,458,000	\$ 1,418,000
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$1,614,000 and \$1,566,000, respectively	12,484,000	11,916,000
Inventory	31,498,000	28,391,000
Deferred Tax Asset	1,437,000	1,421,000
Prepaid Expenses and Other Current Assets	543,000	875,000
Total Current Assets	48,420,000	44,021,000
Property and Equipment, Net	14,693,000	9,557,000
Capitalized Engineering Costs - Net of Accumulated Amortization of \$4,331,000 and \$4,184,000, respectively	785,000	712,000
Deferred Financing Costs, Net, Deposits and Other Assets	1,223,000	825,000
Intangible Assets, Net	4,206,000	4,513,000
Deferred Tax Asset	1,089,000	858,000
Goodwill	7,397,000	5,434,000
TOTAL ASSETS	\$ 77,813,000	\$ 65,920,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Notes Payable and Capitalized Lease Obligations - Current Portion	\$ 23,831,000	\$ 19,508,000
Accounts Payable and Accrued Expenses	8,827,000	6,948,000
Lease Impairment - Current	40,000	56,000
Deferred Gain on Sale - Current Portion	38,000	38,000
Customer Deposits	190,000	158,000
Dividends Payable	1,125,000	1,066,000
Income Taxes Payable	105,000	71,000
Total Current Liabilities	34,156,000	27,845,000
Long Term Liabilities		
Notes Payable and Capitalized Lease Obligations - Net of Current Portion	10,598,000	8,213,000
Lease Impairment - Net of Current Portion	4,000	4,000
Deferred Gain on Sale - Net of Current Portion	399,000	409,000
Deferred Rent	1,185,000	1,177,000
TOTAL LIABILITIES	46,342,000	37,648,000
Commitments and Contingencies		
Stockholders' Equity		

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Preferred Stock - Par Value \$.001 - Authorized 1,000,000 Shares, None Issued and Outstanding at March 31, 2015 and December 31, 2014	-	-
Common Stock - Par Value \$.001 - Authorized 25,000,000 Shares, 7,545,557 and 7,108,677 Shares Issued and Outstanding as of March 31, 2015 and December 31, 2014, respectively	7,000	7,000
Additional Paid-In Capital	45,885,000	42,790,000
Accumulated Deficit	(14,421,000)	(14,525,000)
TOTAL STOCKHOLDERS' EQUITY	31,471,000	28,272,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 77,813,000	\$ 65,920,000

See Notes to Condensed Consolidated Financial Statements

AIR INDUSTRIES GROUP

Condensed Consolidated Statements of Income for the Three Months Ended March 31,
(Unaudited)

	2015	2014
Net Sales	\$ 16,811,000	\$ 15,453,000
Cost of Sales	12,442,000	11,408,000
Gross Profit	4,369,000	4,045,000
Operating Expenses	3,903,000	2,816,000
Income from Operations	466,000	1,229,000
Interest and Financing Costs	(346,000)	(303,000)
Other Income (Expense), Net	8,000	(1,000)
Income before Provision for Income Taxes	128,000	925,000
Provision for Income Taxes	(24,000)	(584,000)
Net income	\$ 104,000	\$ 341,000
Income per share - basic	\$ 0.01	\$ 0.06
Income per share - diluted	\$ 0.01	\$ 0.06
Weighted average shares outstanding - basic	7,236,442	5,863,564
Weighted average shares outstanding - diluted	7,521,520	6,125,909

See Notes to Condensed Consolidated Financial Statements

AIR INDUSTRIES GROUP

Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31,
(Unaudited)

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ 104,000	\$ 341,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation of property and equipment	719,000	552,000
Amortization of intangible assets	307,000	291,000
Amortization of capitalized engineering costs	77,000	114,000
Bad debt expense	39,000	93,000
Non-cash compensation expense	17,000	3,000
Amortization of deferred financing costs	25,000	18,000
Gain on sale of real estate	(10,000)	(10,000)
Deferred income taxes	(147,000)	(108,000)
Changes in Assets and Liabilities		
(Increase) Decrease in Operating Assets:		
Accounts receivable	1,202,000	(4,418,000)
Inventory	(2,323,000)	(594,000)
Prepaid expenses and other current assets	288,000	89,000
Deposits	20,000	(1,000)
Other assets	(65,000)	(51,000)
Increase in Operating Liabilities:		
Accounts payable and accrued expenses	661,000	705,000
Deferred rent	9,000	19,000
Income taxes payable	33,000	616,000
Customer deposits	32,000	3,000
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	988,000	(2,338,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for acquisitions	(5,413,000)	-
Cash acquired in acquisitions	588,000	-
Capitalized engineering costs	(149,000)	(54,000)
Purchase of property and equipment	(143,000)	(187,000)
NET CASH USED IN INVESTING ACTIVITIES	(5,117,000)	(241,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Notes payable - sellers	(41,000)	(168,000)
Capital lease obligations	(91,000)	(108,000)
Note payable - revolver	3,557,000	4,183,000
Proceeds from note payable - term loans	3,500,000	-
Payments of note payable - term loans	(340,000)	(450,000)
Deferred financing costs	(334,000)	-
Payments related to lease impairment	(16,000)	(19,000)

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Dividends paid	(1,066,000)	(733,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	5,169,000	2,705,000
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,040,000	126,000
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,418,000	561,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 2,458,000	\$ 687,000

AIR INDUSTRIES GROUP
Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, (Continued)
(Unaudited)

	2015	2014
Supplemental cash flow information		
Cash paid during the period for interest	\$ 310,000	\$ 251,000
Supplemental cash flow information		
Cash paid during the period for income taxes	\$ 183,000	\$ 86,000
Supplemental schedule of non-cash investing and financing activities		
Dividends payable	\$ 1,125,000	\$ 880,000
Acquisition of property and equipment financed by capital lease	\$ 124,000	\$ -
Purchase of substantially all assets of Sterling and assumption of liabilities in the acquisition as follows:		
Fair Value of tangible assets acquired	\$ 8,281,000	\$ -
Goodwill	1,963,000	-
Cash acquired	588,000	-
Liabilities assumed	(1,216,000)	-
Common Stock Issued	(4,203,000)	-
Cash paid for acquisition	\$ 5,413,000	\$ -

See Notes to Condensed Consolidated Financial Statements

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. FORMATION AND BASIS OF PRESENTATION

Organization

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

The accompanying condensed consolidated financial statements presented are those of AIRI, and its wholly-owned subsidiaries; Air Industries Machining Corporation (“AIM”), Welding Metallurgy, Inc. (“WMI” or “Welding”), Miller Stuart, Inc. (“Miller Stuart”), Nassau Tool Works, Inc. (“NTW”), Woodbine Products, Inc. (“Woodbine” or “WPI”) effective April 1, 2014, Eur-Pac Corporation (“Eur-Pac” or “EPC”) effective June 1, 2014, Electronic Connection Corporation (“ECC”), effective September 1, 2014, AMK Welding, Inc. (“AMK”) effective October 1, 2014, and The Sterling Engineering Company (“Sterling”), effective March 1, 2015, (together, the “Company”).

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission.

Note 2. ACQUISITIONS

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 three of the principals of Sterling. The Company financed the acquisition of Sterling with the proceeds from the issuance of Term Loan D (see Note 6).

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

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

Fair value of tangible assets acquired	\$ 8,281,000
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Goodwill	1,963,000
Cash acquired	588,000
Liabilities assumed	(1,216,000)
Total	\$ 9,616,000

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AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended	
	March 31, 2015	March 31, 2014
Net Sales	\$ 18,650,000	\$ 18,343,000
Income (loss) from operations	\$ 275,000	\$ (85,000)

The below table sets forth selected financial information for the 2014 and 2015 acquisitions for the three months ended March 31, 2015 and 2014.

2015	WPI	EPC	ECC	AMK	Sterling
Net Sales	\$ 145,000	\$ 1,071,000	\$ 149,000	\$ 1,077,000	\$ 887,000
Income (loss) from operations	\$ 40,000	\$ 126,000	\$ 32,000	\$ (530,000)	\$ 78,000
2014	WPI	EPC	ECC	AMK	Sterling
Net Sales	\$ -	\$ -	\$ -	\$ -	\$ -
Income (loss) from operations	\$ -	\$ -	\$ -	\$ -	\$ -

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. The Company's customers consist mainly of publically-traded companies in the aerospace industry.

Inventory Valuation

Inventory at March 31, 2015 and 2014 was computed using the "gross profit" method.

The Company valued inventory at December 31, 2014 at the lower of cost on a first-in-first-out basis or market.

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Credit and Concentration Risks

There were two customers that represented 41.3% and two customers that represented 54.5% of total sales for the three months ended March 31, 2015 and 2014, respectively. This is set forth in the table below.

Customer	Percentage of Sales	
	2015 (unaudited)	2014 (unaudited)
1	23.2	32.3
2	18.1	**
3	*	22.2

* Customer was less than 10% of sales for the three months ended March 31, 2015

** Customer was less than 10% of sales for the three months ended March 31, 2014

There were two customers that represented 38.2% of gross accounts receivable and three customers that represented 50.4% of gross accounts receivable at March 31, 2015 and December 31, 2014, respectively. This is set forth in the table below.

Customer	Percentage of Receivables	
	March 2015 (unaudited)	December 2014
1	22.8	10.0
2	15.4	29.0
3	*	11.4

* Customer was less than 10% of Gross Accounts Receivable at March 31, 2015

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.

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:

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	March 31, 2015 (unaudited)	March 31, 2014 (unaudited)
Weighted average shares outstanding used to compute basic earnings per share	7,236,442	5,863,564
Effect of dilutive stock options and warrants	285,078	262,345
Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share	7,521,520	6,125,909

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AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 2015 (unaudited)	March 31, 2014 (unaudited)
Stock Options	156,891	17,048
Warrants	46,800	-
	203,691	17,048

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with FASB ASC 718, "Compensation – Stock Compensation." Under the fair value recognition provision of the ASC, stock-based compensation cost is estimated at the grant date based on the fair value of the award. The Company estimates the fair value of stock options and warrants granted using the Black-Scholes-Merton option pricing model. Stock based compensation amounted to \$17,000 and \$3,000 for the three months ended March 31, 2015 and 2014, respectively, and was included in operating expenses on the accompanying Condensed Consolidated Statements of Income.

Goodwill

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. The goodwill amount of \$7,397,000 relates to the acquisitions of Welding (\$291,000), NTW (\$162,000), Woodbine (\$2,565,000), Eur-PAC (\$1,656,000), ECC (\$109,000), AMK (\$651,000), and Sterling (\$1,963,000). 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 has determined that there has been no impairment of goodwill at March 31, 2015 and December 31, 2014.

Recently Issued Accounting Pronouncements

In January 2015, the Financial Accounting Standards Board (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.

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.

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.

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Reclassifications

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

Subsequent Events

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

Note 4. PROPERTY AND EQUIPMENT

The components of property and equipment at March 31, 2015 and December 31, 2014 consisted of the following:

	March 31, 2015 (unaudited)		December 31, 2014	
Land	\$ 500,000	\$	200,000	
Buildings and Improvements	3,353,000		1,680,000	31.5 years
Machinery and Equipment	16,126,000		12,514,000	5 - 8 years
Capital Lease Machinery and Equipment	1,925,000		1,800,000	5 - 8 years
Tools and Instruments	5,650,000		5,566,000	1.5 - 7 years
Automotive Equipment	162,000		162,000	5 years
Furniture and Fixtures	286,000		275,000	5 - 8 years
Leasehold Improvements	657,000		646,000	Term of Lease
Computers and Software	398,000		372,000	4-6 years
Total Property and Equipment	29,057,000		23,215,000	
Less: Accumulated Depreciation	(14,364,000)		(13,658,000)	
Property and Equipment, net	\$ 14,693,000	\$	9,557,000	

Depreciation expense for the three months ended March 31, 2015 and 2014 was approximately \$719,000 and \$552,000, respectively.

Note 5. INTANGIBLE ASSETS

The components of the intangibles assets consisted of the following:

	March 31, 2015 (unaudited)		December 31, 2014	
Customer Relationships	\$ 6,255,000	\$	6,255,000	5 to 14 years
Trade Names	1,280,000		1,280,000	20 years
Technical Know-how	660,000		660,000	10 years
Non-Compete	50,000		50,000	5 years
Professional Certifications	15,000		15,000	.25 to 2 years
Total Intangible Assets	8,260,000		8,260,000	
Less: Accumulated Amortization	(4,054,000)		(3,747,000)	
Intangible Assets, net	\$ 4,206,000	\$	4,513,000	

Amortization expense for the three months ended March 31, 2015 and 2014 was approximately \$307,000 and \$291,000, respectively.

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 6. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

	March 31, 2015 (unaudited)	December 31, 2014
Revolving credit note payable to PNC Bank N.A. ("PNC")	\$ 21,228,000	\$ 17,672,000
Term loans, PNC	11,523,000	8,363,000
Capital lease obligations	1,678,000	1,645,000
Notes payable to sellers of WMI	-	41,000
Subtotal	34,429,000	27,721,000
Less: Current portion of notes and capital obligations	(23,831,000)	(19,508,000)
Notes payable and capital lease obligations, net of current portion	\$ 10,598,000	\$ 8,213,000

PNC Bank N.A. ("PNC")

The Company has a credit facility with PNC (the "Loan Facility") secured by substantially all of its assets. The Loan Facility has been amended many times during its term. The Company entered into the latest amendment to the Loan Facility in March 2015 and paid an amendment fee of \$25,000. The Loan Facility now provides for maximum borrowings of approximately \$32,000,000 consisting of the following at March 31, 2015:

- (i) a \$23,000,000 revolving loan (includes inventory sub-limit of \$15,000,000) and
- (ii) Four term loans (Term Loan A, Term Loan B, Term Loan C and Term Loan D).

Under the terms of the Loan Facility the revolving credit note now bears interest at (a) the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one half of one percent (2.50%) with respect to LIBOR Rate Loans. Prior to the amendment the revolving credit note bore interest at the sum of the Alternate Base Rate plus three quarters of one percent (0.75%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and three quarters of one percent (2.75%) with respect to Eurodollar Rate Loans. The revolving credit note had an interest rate of 4.00% per annum at March 31, 2015 and December 31, 2014, and an outstanding balance of \$21,228,000 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 we then borrow according to a borrowing base. As such, the Company generally has no cash on hand. Cash shown on the balance sheet at any date reflects drawdowns against the revolving credit loan for disbursement checks written that have not yet been presented for payment. 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 an additional \$1,328,000 to partially fund the acquisition of Woodbine. The repayment terms of Term Loan A now consists of thirty-two consecutive monthly principal installments, the first thirty-one of which shall be in the amount of \$31,859 commencing on the first business day of May 2014, and continuing on the first business day of each month thereafter, with a thirty-second and final payment of any unpaid balance of principal and interest on the last business day of

November 2016. Term 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 March 31, 2015 and December 31, 2014, the balance due under Term Loan A was \$2,326,000 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 of which shall be in the amount of \$58,333 commencing on the first business day of December 2014, and continuing on the first business day of each month thereafter, with a sixtieth and final payment of any unpaid balance of principal and interest on the last business day of November 2019. Term Loan B bears interest at the same rate as Term Loan A. The first interest payment was on the first business day of November 2014. At March 31, 2015 and December 31, 2014, the balance due under Term Loan B was \$3,267,000 and \$3,442,000, respectively.

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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 the 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 commence 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 March 31, 2015 and December 31, 2014, the balance due under Term Loan C was \$2,430,000 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 of which shall be in the amount of \$62,847 commencing on the first business day of April 2015, and continuing 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 March 31, 2015, the balance due under Term Loan D was \$3,500,000.

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

The terms of the Loan Facility require that, among other things, the Company maintain a specified Fixed Charge Coverage Ratio. In addition, the Company is limited in the amount of Capital Expenditures it can make. The Company is also limited to the amount of Dividends it can pay its shareholders as defined in the Loan Facility. As of both March 31, 2015 and 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 March 31, 2015 the future minimum principal payments for the term loans are as follows:

For the twelve months ending	Amount
March 31, 2016	\$ 2,253,000
March 31, 2017	5,806,000
March 31, 2018	1,117,000
March 31, 2019	1,117,000
March 31, 2020	883,000
Thereafter	347,000
PNC Term Loans payable	11,523,000
Less: Current portion	(2,253,000)
Long-term portion	\$ 9,270,000

Interest expense related to these credit facilities amounted to approximately \$285,000 and \$186,000 for the three months ended March 31, 2015 and 2014, respectively.

Capital Leases Payable – Equipment

The Company is committed under several capital leases for manufacturing and computer equipment. All leases have bargain purchase options exercisable at the termination of each lease. Capital lease obligations totaled \$1,678,000 and \$1,645,000 as of March 31, 2015 and December 31, 2014, respectively, with various interest rates ranging from approximately 4% to 7%.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2014, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

For the twelve months ending	Amount
March 31, 2016	\$ 446,000
March 31, 2017	446,000
March 31, 2018	446,000
March 31, 2019	374,000
March 31, 2020	192,000
Thereafter	8,000
Total future minimum lease payments	1,912,000
Less: imputed interest	(234,000)
Less: current portion	(350,000)
Total Long Term Portion	\$ 1,328,000

Notes Payable - Sellers

In connection with the acquisition of Welding on August 24, 2007, the Company incurred a note payable (the "Note") to the former stockholders of Welding. At December 31, 2014, the balance owed under the Note was \$41,000. On January 5, 2015 the remaining balance of \$41,000 was paid and the obligation was extinguished.

Interest expense related to the Note was \$0 and \$12,000 for the three months ended March 31, 2015 and 2014, respectively.

Junior Subordinated Notes

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

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

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

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

Interest expense on the Junior Subordinated Notes amounted to \$0 and \$30,000 for the three months ended March 31, 2015 and 2014, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 7. STOCKHOLDERS' EQUITY

Common Stock Issuances

During the three months ended March 31, 2015, the Company issued 11,875 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.

Dividends

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 March 31, 2015, the Board of Directors approved a quarterly dividend of \$0.15 per common share or \$1,125,000 paid on April 24, 2015 to all shareholders of record as of the close of business on April 13, 2015.

Note 8. INCOME TAXES

The provision for income taxes at March 31, 2015 and 2014 are set forth below:

	2015 (unaudited)	2014 (unaudited)
Current		
Federal	\$ 166,000	\$ 536,000
State	5,000	156,000
Total Expense	171,000	692,000
Deferred Tax Benefit	(147,000)	(108,000)
Net Provision for Income Taxes	\$ 24,000	\$ 584,000

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 2015 (unaudited)	December 31, 2014
Deferred tax assets:		
Current:		
Bad debts	\$ 646,000	\$ 650,000
Inventory - 263A adjustment	782,000	762,000
Account payable, accrued expenses and reserves	9,000	9,000
Total current deferred tax asset before valuation allowance	1,437,000	1,421,000
Valuation Allowance	-	-
Total current deferred tax asset after valuation allowance	\$ 1,437,000	\$ 1,421,000
Non-Current		
Capital loss carry forwards	\$ 1,088,000	\$ 1,088,000
Section 1231 loss carry forward	4,000	4,000
Stock based compensation - options and restricted stock	534,000	527,000
Capitalized engineering costs	518,000	522,000
Deferred rent	474,000	483,000
Amortization - NTW Transaction	730,000	663,000
Lease impairment	16,000	22,000
Deferred gain on sale of real estate	175,000	179,000
Other	100,000	-
Total deferred tax assets before valuation allowance	3,639,000	3,488,000
Valuation allowance	(1,092,000)	(1,092,000)
Total deferred tax assets after valuation allowance	\$ 2,547,000	\$ 2,396,000
Deferred tax liabilities:		
Property and equipment	\$ (1,013,000)	\$ (1,082,000)
Goodwill - NTW Transaction	(12,000)	(11,000)
Goodwill - AMK Transaction	(9,000)	(4,000)
Amortization - Welding Transaction	(424,000)	(441,000)
Total Deferred Tax Liability	(1,458,000)	(1,538,000)
Net non-current deferred tax asset	\$ 1,089,000	\$ 858,000

During the year ended December 31, 2014, the Company determined that it no longer needed to provide a valuation allowance on the net deferred tax assets except for the capital loss and section 1231 loss carryforwards. This was based upon the fact that management believes that the net deferred tax assets are more likely than not to be realized. The valuation allowance at both March 31, 2015 and December 31, 2014 amounted to \$1,092,000.

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

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 9. 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, Miller Stuart, Eur-Pac and ECC; and Turbine Engine Components which includes AMK and beginning March 2015 includes Sterling.

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.

Effective January 1, 2015, all operating costs are allocated to the Company's operating segments. Prior to January 1, 2015 certain operating costs that were not directly attributable to a particular segment were included in corporate and presented as an independent segment. Results for the three months ended March 31, 2014 have been reclassified to conform to the current period presentation.

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Three Months Ended March 31,	
	2015	2014
	(unaudited)	(unaudited)
COMPLEX MACHINING		
Net Sales	\$ 9,064,000	\$ 12,140,000
Gross Profit	2,091,000	3,207,000
Pre Tax Income (Loss)	(180,000)	1,279,000
Assets	62,554,000	35,972,000
AEROSTRUCTURES AND ELECTRONICS		
Net Sales	5,782,000	3,313,000
Gross Profit	2,162,000	838,000
Pre Tax Income (Loss)	770,000	(354,000)
Assets	18,049,000	12,547,000
TURBINE ENGINE COMPONENTS		
Net Sales	1,965,000	-
Gross Profit	116,000	-
Pre Tax Income (Loss)	(462,000)	-
Assets	17,791,000	-
CORPORATE		
Net Sales	-	-
Gross Profit	-	-
Pre Tax Income (Loss)	-	-
Assets	26,430,000	8,156,000
CONSOLIDATED		
Net Sales	16,811,000	15,453,000
Gross Profit	4,369,000	4,045,000
Pre Tax Income	128,000	925,000
Provision for Taxes	24,000	584,000
Net Income	104,000	341,000
Elimination of Assets	(47,011,000)	(2,121,000)
Assets	\$ 77,813,000	\$ 54,554,000

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements and the notes to those statements included elsewhere in this Form 10-Q and with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014. This discussion contains forward-looking statements that involve risks and uncertainties. You should specifically consider the various risk factors identified in our Form 10-K for the year ended December 31, 2014, which was filed on March 31, 2015, 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, welding and kitting services. Our Turbine Engine Components sector makes components and provides services for jet engines and ground turbines. Our products are currently deployed on a wide range of high profile military and commercial aircraft including Sikorsky's UH-60 Blackhawk and CH-47 Chinook helicopters, Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2D Hawkeye, Boeing's 777 and 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.

Air Industries Machining Corporation ("AIM") became a public company in 2005 when its net sales were approximately \$30 million. AIM has manufactured components and subassemblies for the defense and commercial aerospace industry for over 45 years and has established long-term relationships with leading defense and aerospace manufacturers. Since becoming public, we have completed a series of acquisitions of defense aerospace and recently commercial aerospace businesses which have enabled us to broaden the range of products and services beyond those which were provide by AIM. For example, where AIM was 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.

In June 2012, we acquired the business and operations now conducted by Nassau Tool Works, Inc. ("NTW") in an asset acquisition (the "NTW Acquisition"). We acquired the business and operations of Decimal Industries, Inc. ("Decimal") in an asset acquisition on July 1, 2013 (the "Decimal Transaction"). The assets and business of Decimal Industries became part of our subsidiary, Welding Metallurgy, Inc. ("WMI"). On November 6, 2013, WMI acquired 100% of the stock of Miller Stuart Inc., ("MS").

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

- In April 2014 we acquired Woodbine Products, Inc. ("WPI"). WPI is a fabricator of precision sheet metal assemblies for aerospace applications. WPI has been consolidated into WMI.;
- In June 2014 we acquired Eur-Pac Corporation ("EPC"). 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 Electronic Connection Corporation (“ECC”). ECC 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 primarily for aircraft jet engine and ground turbine manufacturers since 1964;
- In March 2015 we acquired The Sterling Engineering Corporation (“Sterling”). Sterling provides complex machining services and its business is concentrated with aircraft jet engine and ground turbine manufacturers.

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 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.

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.

Results of Operations

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

For the three months ended March 31, 2015, we had three operating segments: Complex Machining comprised of AIM and NTW; Aerostructures and Electronics comprised of WMI (including Decimal and Woodbine Products), Eur-Pac (including ECC) and MS; and Turbine Engine Components comprised of AMK and Sterling. For the three months ended March 31, 2014, we had three operating segments, AIM, WMI (including MS) and NTW, and

separately reported our corporate overhead. Effective January 1, 2015, all operating costs are allocated to the Company's operating segments. Prior to January 1, 2015 certain operating costs that were not directly attributable to a particular segment were included in corporate and presented as an independent segment. Results for the three months ended March 31, 2014 have been reclassified to conform to the current period presentation.

The results of operations of the businesses we have acquired are included in our financial results from their respective dates of acquisition.

Selected Financial Information:

Three Months Ended March 31, 2015 and
2014:

	2015	2014
Net sales	\$ 16,811,000	\$ 15,453,000
Cost of sales	12,442,000	11,408,000
Gross profit	4,369,000	4,045,000
Operating expenses and interest costs	(4,249,000)	(3,119,000)
Other income (expense) net	8,000	(1,000)
Income taxes	(24,000)	(584,000)
Net Income	\$ 104,000	\$ 341,000

Balance Sheet Data:

	March 31, 2015	December 31, 2014
Cash and cash equivalents	\$ 2,458,000	\$ 1,418,000
Working capital	14,264,000	16,176,000
Total assets	77,813,000	65,920,000
Total stockholders' equity	\$ 31,471,000	\$ 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:

	Three Months Ended March 31,	
	2015	2014
	(unaudited)	(unaudited)
COMPLEX MACHINING		
Net Sales	\$ 9,064,000	\$ 12,140,000
Gross Profit	2,091,000	3,207,000
Pre Tax Income (Loss)	(180,000)	1,279,000
Assets	62,554,000	35,972,000
AEROSTRUCTURES AND ELECTRONICS		
Net Sales	5,782,000	3,313,000
Gross Profit	2,162,000	838,000
Pre Tax Income (Loss)	770,000	(354,000)
Assets	18,049,000	12,547,000
TURBINE ENGINE COMPONENTS		
Net Sales	1,965,000	-
Gross Profit	116,000	-
Pre Tax Income (Loss)	(462,000)	-
Assets	17,791,000	-
CORPORATE		
Net Sales	-	-
Gross Profit	-	-
Pre Tax Income (Loss)	-	-
Assets	26,430,000	8,156,000
CONSOLIDATED		
Net Sales	16,811,000	15,453,000
Gross Profit	4,369,000	4,045,000
Pre Tax Income	128,000	925,000
Provision for Taxes	24,000	584,000
Net Income	104,000	341,000
Elimination of Assets	(47,011,000)	(2,121,000)
Assets	\$ 77,813,000	\$ 54,554,000

Net Sales:

Consolidated net sales for the three months ended March 31, 2015 were approximately \$16,811,000, an increase of \$1,358,000, or 8.8%, compared with \$15,453,000 for the three months ended March, 2014. Net sales of our Complex Machining segment were approximately \$9,064,000, a decline of \$3,076,000, or (25.3%), from \$12,140,000 in the prior period. The nature of the parts manufactured by our Complex Machining segment tend to be larger, more complex and have higher unit prices than many of the parts supplied by our other segments. As a result, a small decline in the number of parts ordered can result in a significant reduction in sales. We believe that the decline in sales at our Complex Machining segment was due to budgetary constraints at the Department of Defense (“DoD”) commonly referred to as Sequestration. These budget constraints have cancelled some contracts and delayed others. Net sales of our Aerostructures & Electronics segment were approximately \$5,782,000 and increased by \$2,469,000, or 74.5%, from \$3,313,000 in the prior period. The increase in sales was entirely related to the three acquisitions completed during the period from April 1, 2014 through September 1, 2014. Net sales in our Turbine Engine Components segment were \$1,965,000 for the three months ended March 31, 2015, reflecting the operations of AMK for the three months ended March 31, 2015 and Sterling from March 1, 2015.

As indicated in the table below, two customers represented 41.3% and two customers represented 54.5% of total sales for the three months ended March 31, 2015 and 2014, respectively.

Customer	Percentage of Sales	
	2015	2014
Sikorsky Aircraft	23.2	32.3
Goodrich Landing Gear Systems	18.1	**
Associated Aircraft Manufacturing	*	22.2

* Customer was less than 10% of sales for the three months ended March 31, 2015

** Customer was less than 10% of sales for the three months ended March 31, 2014

Sikorsky Aircraft and Goodrich Landing Gear Systems are units of United Technologies Corporation.

Gross Profit:

Consolidated gross profit from operations for the three months ended March 31, 2015 was \$4,369,000 an increase of approximately \$324,000, or (8.0%), as compared to gross profit of \$4,045,000 for the three months ended March 31, 2014. Consolidated gross profit as a percentage of sales was 26.0% and 26.2% for the three months ended March 31, 2015 and 2014, respectively. The increase in gross profit results from an increase within Aerostructures & Electronics and a minor contribution from our Turbine Engine Components segment that offset a decline in our Complex Machining sector. The decrease in gross profit in our Complex Machining sector arose primarily at our Nassau Tool Works subsidiary which experienced both lower sales and a decrease in gross profit percentage as a result of lower sales.

Operating Expenses:

Consolidated Operating Expenses for the three months ended March 31, 2015 totaled approximately \$3,903,000 and increased by \$1,087,000, or 38.6%, compared to \$2,816,000 for the three months ended March 31, 2014. The increase reflects approximately \$1,390,000 resulting from the acquisitions completed subsequent to March 31, 2014, partially offset by a decrease in operating expenses at our ongoing businesses.

Interest and financing costs for the three months ended March 31, 2015 were approximately \$346,000 an increase of approximately \$43,000, or (14.2%) compared to \$303,000 for the three months ended March 31, 2014. The increase results from additional amounts outstanding due to acquisitions.

The Company recognized a provision for taxes of approximately \$24,000 for three months ended March 31, 2015 compared to a provision for taxes of approximately \$584,000 for three months ended March 31, 2014, a reduction of \$560,000 primarily resulting from the decrease in net income. The effective income tax rate for the three months ended March 31, 2015, was lower than the prior year comparative quarter primarily due to New York state tax incentives for qualified manufacturers and prior year overaccruals.

Net income for the three months ended March 31, 2015 was \$104,000, a decrease of \$237,000, or (69.5%), compared to net income of \$341,000 for the three months ended March 31, 2014. The decrease in net income results primarily from a decline in our Complex Machining sector and the loss incurred in Turbine Engine Components partially offset by the increase of \$1,124,000 in our Aerostructures & Electronics sector.

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. Our Company is required to maintain a lockbox account with PNC, into which substantially all of its cash receipts are paid. If PNC were to cease lending, our Company would lack funds to continue its operations.

Our Loan Facility with PNC was amended four times during the period from April 1, 2014 through March 31, 2015, most recently on March 1, 2015 in connection with the acquisition of Sterling.

The Loan Facility now provides for maximum borrowings under a revolving loan of \$23,000,000 (including an inventory sub-limit of \$15,000,000) limited to the borrowing base as defined and four term loans, Term Loan A, initially in the amount of \$2,613,000, a second, Term Loan B which was issued October 1st in connection with the acquisition of AMK, initially in the amount of \$3,500,000, a third, Term Loan C which was issued December 31st to satisfy the seller note issued in connection with the acquisition of AMK, initially in the amount of \$2,500,000 and the fourth, Term Loan D which was issued in March 2015 in connection with the acquisition of Sterling, initially in the amount of \$3,500,000.

The maturity date of Term Loan A is the last business day of November 2016, and it is to be paid in thirty-two consecutive monthly principal installments, which commenced on the first business day of May 2014, and continue on the first business day of each month thereafter. The first thirty-one of the installments shall be in the amount of \$31,859, with a thirty-second and final payment of any unpaid balance of principal and interest on the last business day of November 2016.

The maturity date of Term Loan B is the last business day of November 2019, and it is to be paid in sixty consecutive monthly principal installments, which commence on the first business day of December 2014, and continue on the first business day of each month thereafter. The first fifty-nine of the installments shall be in the amount of \$58,333, with a sixtieth and final payment of any unpaid principal and interest on the last business day of November 2019.

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 commence 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.

The maturity date of Term Loan D is the last business day of November 2016, and it is to be paid in twenty consecutive monthly principal installments, the first nineteen of which shall be in the amount of \$62,847 commencing on the first business day of April, 2015, and continuing on the first business day of each month thereafter, with a twentieth and final payment of any unpaid balance of principal and interest payable on the last business day of November 2016.

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 acquisition was financed with the proceeds from the issuance of a new term loan (Term Loan D) from PNC in the amount of \$3,500,000.

As of March 31, 2015, our debt for borrowed monies in the amount of \$34,429,000 consisted of the revolving credit note due to PNC in the amount of \$21,228,000, the term loans due to PNC in the amount of 11,523,000, and capitalized lease obligations of \$1,678,000. This represents an increase of \$6,708,000 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, a note due the sellers of WMI had a balance of \$41,000, and capitalized lease obligations were \$1,645,000. The increase in the amount outstanding under the revolving credit note and term loans principally reflects amounts borrowed to support our acquisitions and the increase in our inventory.

Anticipated uses of Cash

As a requirement of our Loan Facility substantially all of our cash receipts from operations are deposited into our lockbox account at PNC. These cash receipts are used to reduce our indebtedness under our revolving credit note and are then borrowed according to a borrowing base to support our operations.

Subject to the discretion of our Board of Directors and compliance with PNC's loan covenants, we intend to continue to make quarterly dividend payments on our common stock. On January 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 of \$0.15 per common share or \$1,125,000 to all shareholders of record as of the close of business on April 13, 2015.

We have paid quarterly dividends to our shareholders each quarter commencing with the first quarter of 2013.

Cash Flow

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

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Cash provided by (used in)		
Operating activities	\$ 988,000	\$ (2,338,000)
Investing activities	(5,117,000)	(241,000)
Financing activities	5,169,000	2,705,000
Net increase in cash and cash equivalents	\$ 1,040,000	\$ 126,000

Cash Provided By Operating Activities

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

For the three months ended March 31, 2015, our net cash provided by operating activities of \$988,000 was comprised of net income of \$104,000 less \$143,000 of cash used by changes in operating assets and liabilities plus adjustments for non-cash items of \$1,027,000. Adjustments for non-cash items consisted primarily of depreciation of property and equipment of \$719,000, amortization of capitalized engineering costs, intangibles and other items of \$409,000, bad debt expense of \$39,000, and non-cash compensation of \$17,000. These non-cash items were offset by \$10,000 of deferred gain on the sale of real estate and \$147,000 of deferred income taxes. The net increase in operating assets and liabilities consisted of a net increase in Operating Assets of \$878,000 and an increase in Operating Liabilities of \$735,000. The increase in Operating Assets was comprised of a decrease in accounts receivable of \$1,202,000 due to the timing of shipments to and cash receipts from customers, an increase in inventory of \$2,323,000, and a net increase in prepaid expenses and other assets of \$243,000. The increase in Operating Liabilities was comprised of increases in accounts payable and accrued expenses of \$661,000 due to the timing of the receipt and payment of invoices, an increase in income taxes payable of \$33,000 and increases in customer deposits of \$32,000 and deferred rent of \$9,000.

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 business we acquired. 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, 2014.

For the three months ended March 31, 2015 cash used in investing activities was \$5,117,000. This was comprised of \$4,825,000 for the acquisition Sterling, net of cash acquired, \$149,000 for capitalized engineering costs and \$143,000 for the purchase of property and equipment.

Cash Provided By Financing Activities

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

payments.

For the three months ended March 31, 2015, cash provided by financing activities was \$5,169,000. This was comprised of additional borrowings of \$3,500,000 under our term loans and \$3,557,000 under our revolving credit facility, partially offset by repayments on our term loans of \$340,000, capital lease obligations of \$91,000, \$41,000 paid to the former shareholders of WMI, \$1,066,000 used for dividends, deferred financing costs of \$334,000 and \$16,000 related to lease impairment.

OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of March 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

For interim reporting, the Company computes its inventory using the “gross profit” method.

For annual reporting, 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, 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.

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

Capitalized Engineering Costs

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

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

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." The Company recognizes revenue when products are shipped and/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 March 31, 2015 and December 31, 2014.

Recently Issued Accounting Pronouncements

In January 2015, the Financial Accounting Standards Board (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.

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.

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.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

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

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

(b) Changes in Internal Control over Financial Reporting

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

PART II

OTHER INFORMATION

Item 1A. Risk Factors.

Reference is made to the risks and uncertainties disclosed in our 2014 Form 10-K, which are incorporated by reference into this report. Prospective investors are encouraged to consider the risks described in our 2014 Form 10-K, our Management's Discussion and Analysis of Financial Condition and Result of Operation contained in this Report and other information publicly disclosed or contained in documents we file with the Securities and Exchange Commission before purchasing our common stock.

Item 6 - Exhibits

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

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

SIGNATURES

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

Dated: May 15, 2015

AIR INDUSTRIES GROUP

By: /s/ Daniel R. Godin
Daniel R. Godin
President and CEO
(Principal Executive Officer)

By: /s/ James Sartori
James Sartori
Chief Accounting Officer
(Principal Financial Officer)
