

AIR INDUSTRIES GROUP
Form 10-Q
May 16, 2016

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, 2016

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 April 30, 2016, the registrant had outstanding 7,560,040 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, 2015 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
(Unaudited)

| | March 31, 2016 | December 31, 2015 |
|--|----------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and Cash Equivalents | \$ 369,000 | \$ 529,000 |
| Accounts Receivable, Net of Allowance for Doubtful Accounts of \$902,000 and \$985,000, respectively | 9,811,000 | 13,662,000 |
| Inventory | 40,657,000 | 36,923,000 |
| Deferred Tax Asset | 2,356,000 | 1,725,000 |
| Prepaid Expenses and Other Current Assets | 1,444,000 | 1,583,000 |
| Assets Held for Sale, Net | 1,675,000 | 1,700,000 |
| Total Current Assets | 56,312,000 | 56,122,000 |
| Property and Equipment, Net | 15,264,000 | 15,299,000 |
| Capitalized Engineering Costs - Net of Accumulated Amortization of \$4,701,000 and \$4,595,000, respectively | 1,133,000 | 1,027,000 |
| Deferred Financing Costs, Net, Deposits and Other Assets | 963,000 | 1,094,000 |
| Intangible Assets, Net | 3,532,000 | 3,852,000 |
| Deferred Tax Asset, Net | 398,000 | 338,000 |
| Goodwill | 10,518,000 | 10,518,000 |
| TOTAL ASSETS | \$ 88,120,000 | \$ 88,250,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Current Portion | \$ 40,865,000 | \$ 40,893,000 |
| Accounts Payable and Accrued Expenses | 12,994,000 | 12,053,000 |
| Deferred Gain on Sale - Current Portion | 38,000 | 38,000 |
| Deferred Revenue | 1,310,000 | 958,000 |
| Income Taxes Payable | 24,000 | 14,000 |
| Total Current Liabilities | 55,231,000 | 53,956,000 |
| Long Term Liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Net of Current Portion | 3,917,000 | 3,912,000 |
| Deferred Gain on Sale - Net of Current Portion | 361,000 | 371,000 |
| Deferred Rent | 1,209,000 | 1,206,000 |
| TOTAL LIABILITIES | 60,718,000 | 59,445,000 |
| 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, 2016 and
 December 31, 2015

Common Stock - Par Value \$.001 - Authorized 25,000,000
 Shares, 7,560,040 Shares Issued and Outstanding as of March 31,
 2016 and December 31, 2015

| | | | |
|---|----------------------|--|----------------------|
| | 7,000 | | 7,000 |
| Additional Paid-In Capital | 44,182,000 | | 44,155,000 |
| Accumulated Deficit | (16,787,000) | | (15,357,000) |
| TOTAL STOCKHOLDERS' EQUITY | 27,402,000 | | 28,805,000 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 88,120,000 | | \$ 88,250,000 |

See Notes to Condensed Consolidated Financial Statements

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

| | 2016 | 2015 |
|---|-----------------|---------------|
| Net Sales | \$ 15,184,000 | \$ 16,811,000 |
| Cost of Sales | 12,363,000 | 12,442,000 |
| Gross Profit | 2,821,000 | 4,369,000 |
| Operating Expenses | 4,412,000 | 3,903,000 |
| (Loss) Income from Operations | (1,591,000) | 466,000 |
| Interest and Financing Costs | (505,000) | (346,000) |
| Other Income, Net | 10,000 | 8,000 |
| (Loss) Income before Income Taxes | (2,086,000) | 128,000 |
| Benefit from (Provision for) Income Taxes | 656,000 | (24,000) |
| Net (Loss) Income | \$ (1,430,000) | \$ 104,000 |
| (Loss) Income per share - basic | \$ (0.19) | \$ 0.01 |
| (Loss) Income per share - diluted | \$ (0.19) | \$ 0.01 |
| Weighted average shares outstanding - basic | 7,584,765 | 7,236,442 |
| Weighted average shares outstanding - diluted | 7,584,765 | 7,521,520 |

See Notes to Condensed Consolidated Financial Statements

AIR INDUSTRIES GROUP

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

| | 2016 | 2015 |
|---|-------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Income (loss) | \$ (1,430,000) | \$ 104,000 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities | | |
| Depreciation of property and equipment | 904,000 | 719,000 |
| Amortization of intangible assets | 320,000 | 307,000 |
| Amortization of capitalized engineering costs | 105,000 | 77,000 |
| Bad debt expense | - | 39,000 |
| Non-cash compensation expense | 27,000 | 17,000 |
| Amortization of deferred financing costs | 170,000 | 25,000 |
| Gain on sale of real estate | (10,000) | (10,000) |
| Deferred income taxes | (691,000) | (147,000) |
| Changes in Assets and Liabilities | | |
| (Increase) Decrease in Operating Assets: | | |
| Accounts receivable | 3,850,000 | 1,202,000 |
| Inventory | (3,826,000) | (2,163,000) |
| Prepaid expenses and other current assets | 139,000 | 288,000 |
| Deposits and other assets | 35,000 | (45,000) |
| Increase (Decrease) in Operating Liabilities: | | |
| Accounts payable and accrued expenses | 941,000 | 661,000 |
| Deferred rent | 3,000 | 9,000 |
| Deferred revenue | 352,000 | (128,000) |
| Income taxes payable | 11,000 | 33,000 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 900,000 | 988,000 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capitalized engineering costs | (212,000) | (149,000) |
| Purchase of property and equipment | (355,000) | (143,000) |
| Cash paid for acquisitions | - | (5,413,000) |
| Cash acquired in acquisitions | - | 588,000 |
| NET CASH USED IN INVESTING ACTIVITIES | (567,000) | (5,117,000) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Note payable - revolver, net | 458,000 | 3,557,000 |
| Proceeds from note payable - term loans | - | 3,500,000 |
| Payments of note payable - term loans | (563,000) | (340,000) |
| Capital lease obligations | (313,000) | (91,000) |
| Deferred financing costs | (75,000) | (334,000) |
| Notes payable - sellers | - | (41,000) |
| Payments related to lease impairment | - | (16,000) |
| Dividends paid | - | (1,066,000) |

| | | |
|--|------------|--------------|
| NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES | (493,000) | 5,169,000 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (160,000) | 1,040,000 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 529,000 | 1,418,000 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | \$ 369,000 | \$ 2,458,000 |

AIR INDUSTRIES GROUP

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

| | 2016 | 2015 |
|--|--------------|--------------|
| Supplemental cash flow information | | |
| Cash paid during the period for interest | \$ 505,000 | \$ 310,000 |
| Supplemental cash flow information | | |
| Cash paid during the period for income taxes | \$ 13,000 | \$ 183,000 |
| Supplemental schedule of non-cash investing and financing activities | | |
| Classification of assets held for sale | \$ 1,675,000 | \$ - |
| Dividends payable | \$ - | \$ 1,125,000 |
| Acquisition of property and equipment financed by capital lease | \$ - | \$ 124,000 |
| Purchase of stock of The Sterling Engineering Corporation and assumption of liabilities in the acquisition as follows: | | |
| Fair Value of tangible assets acquired | \$ - | \$ 8,281,000 |
| 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 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").

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, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. 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, 2015, as filed with the Securities and Exchange Commission.

Reclassifications

Certain account balances in 2015 have been reclassified to conform to the current period presentation.

Note 2. ACQUISITIONS

The Company accounts for all business combinations in accordance with Financial Accounting Standards Board ("FASB") ASC 805, "Business Combinations" ("ASC 805"), using the acquisition method of accounting. Under this method, assets and liabilities, including any remaining non-controlling interests, are recognized at fair value at the date of acquisition. The excess of the purchase price over the fair value of assets acquired, net of liabilities assumed, and non-controlling interests is recognized as goodwill. Certain adjustments to the assessed fair values of the assets, liabilities, or non-controlling interests made subsequent to the acquisition date, but within the measurement period, which is up to one year, are recorded as adjustments to goodwill. Any adjustments subsequent to the measurement period are recorded in income. Results of operations of the acquired entity are included in the Company's results from the date of the acquisition onward and include amortization expense arising from acquired tangible and intangible assets. The Company expenses all costs as incurred related to an acquisition in the condensed consolidated statements

of income.

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).

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AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

The below table sets forth selected financial information for Sterling for the three months ended March 31, 2016 and the portion of the three months ended March 31, 2015 during which Sterling was a subsidiary of the Company.

| | | |
|------------------------|------|------------|
| | 2016 | Sterling |
| Net Sales | \$ | 1,574,000 |
| Income from operations | \$ | (375,000) |
| | 2015 | Sterling |
| Net Sales | \$ | 887,000 |
| Income from operations | \$ | 78,000 |

AIR INDUSTRIES GROUP
NOTES TO CONDENSED 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.

Inventory Valuation

Inventory at March 31, 2016 was computed using the "gross profit" method.

The Company valued inventory at December 31, 2015 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 four customers that represented 58.4% and two customers that represented 41.3% of total sales for the three months ended March 31, 2016 and 2015, respectively. This is set forth in the table below.

| Customer | Percentage of Sales | |
|----------|---------------------|---------------------|
| | 2016 (Unaudited) | 2015 (Unaudited) |
| 1 | 23.2 | 23.2 |
| 2 | 12.7 | * |
| 3 | 11.9 | 18.1 |
| 4 | 10.6 | * |

* Customer was less than 10% of sales for the three months ended March 31, 2015.
Customers 1 and 3 are owned by the same corporate entity.

There were three customers that represented 40.1% of gross accounts receivable and four customers that represented 61.1% of gross accounts receivable at March 31, 2016 and December 31, 2015, respectively. This is set forth in the table below.

| Customer | Percentage of Receivables | |
|----------|------------------------------|------------------|
| | March 2016 (Unaudited) | December 2015 |
| 1 | 17.4 | 26.6 |
| 2 | 12.1 | 13.6 |
| 3 | 10.6 | 10.5 |
| 4 | * | 10.4 |

* Customer was less than 10% of Gross Accounts Receivable at March 31, 2016.
Customers 1 and 3 are owned by the same corporate entity.

During the three months ended March 31, 2016 and 2015, 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 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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:

| | Three Months Ended March 31, | |
|---|---------------------------------|---------------------|
| | 2016 (Unaudited) | 2015 (Unaudited) |
| Weighted average shares outstanding used to compute basic earnings per share | 7,584,765 | 7,236,442 |
| Effect of dilutive stock options and warrants | - | 285,078 |
| Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share | 7,584,765 | 7,521,520 |

The following table sets forth options and warrants which were excluded from the diluted per share calculation because the exercise price was greater than the average market price of the common shares:

| | Three Months Ended | |
|---------------|----------------------------------|----------------------------------|
| | March 31, 2016 (Unaudited) | March 31, 2015 (Unaudited) |
| Stock Options | 252,000 | 156,891 |
| Warrants | 56,800 | 46,800 |
| | 308,800 | 203,691 |

The following table sets forth options and warrants which were excluded from the diluted per share calculation for the three months ended March 31, 2016 even though the exercise price was less than the average market price of the common shares and unvested restricted stock because the effect of including these potential shares was anti-dilutive due to the net loss incurred during that period:

| | |
|---------------------------|---------|
| Stock Options | 312,342 |
| Warrants | 107,785 |
| Unvested Restricted Stock | 27,000 |
| | 447,127 |

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 \$27,000 and \$17,000 for the three months ended March 31, 2016 and 2015, respectively, and was included in operating expenses on the accompanying Condensed Consolidated Statements of Operations.

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 March 31, 2016 and 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 annually for impairment, or if circumstances occur that more likely than not reduce the fair value of the reporting unit below its carrying amount.

AIR INDUSTRIES GROUP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company has determined that there has been no impairment of goodwill at March 31, 2016.

Debt Issuance Costs

Effective January 1, 2016, the Company adopted FASB ASU 2015-15 “Interest-Imputation of Interest (Subtopic 835-30), Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting”. The amendments to the SEC paragraphs in this update state that given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The adoption of this amended guidance did not have a significant impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)” (“ASU 2016-01”). The main objective of ASU 2016-01 is enhancing the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect the adoption of this amended to have a significant impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The main objective of ASU 2016-02 is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. To meet that objective, the FASB is amending the FASB Accounting Standards Codification and creating Topic 842, Leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company does not expect the adoption of this amended to have a significant impact on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation—Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment” (“ASU 2016-09”). ASU 2016-09 is part of the FASB Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. ASU 2016-09 will affect all entities that issue share-based payment awards to their employees. The areas for simplification involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company does not expect the adoption of this amended to have a significant impact on its consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2016-10”). The core principle of the guidance in Topic 606 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be

entitled in exchange for those goods or services. The amendments in ASU 2016-10 affect the guidance in ASU 2014-09, "Revenue from Contracts with Customers", which is not yet effective. The effective date and transition requirements of ASU 2016-10 are the same as the effective date and transition requirements of ASU 2014-09. They are effective prospectively for reporting periods beginning after December 15, 2017 and early adoption is not permitted. The Company is currently assessing the impact of the adoption of these amendments 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

Subsequent Events

On April 11, 2016, the Company executed a Sale - Leaseback Arrangement, whereby the Company sold the building and real property located in South Windsor, Connecticut (the "Property") for a purchase price of \$1,700,000. The net proceeds from the sale of the property will be applied to the amounts owed to PNC Bank.

At March 31, 2016, the Company classified the Property as Assets Held for Sale with a balance of \$1,675,000.

Simultaneous with the closing of the sale of the Property, the Company entered 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".

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, 2016 and December 31, 2015 consisted of the following:

| | March 31, 2016 (Unaudited) | December 31, 2015 | |
|---------------------------------------|----------------------------------|----------------------|---------------|
| Land | \$ 300,000 | \$ 300,000 | |
| Buildings and Improvements | 1,658,000 | 1,658,000 | 31.5 years |
| Machinery and Equipment | 15,281,000 | 15,109,000 | 5 - 8 years |
| Capital Lease Machinery and Equipment | 6,265,000 | 5,869,000 | 5 - 8 years |
| Tools and Instruments | 7,155,000 | 6,993,000 | 1.5 - 7 years |
| Automotive Equipment | 217,000 | 191,000 | 5 years |
| Furniture and Fixtures | 443,000 | 425,000 | 5 - 8 years |
| Leasehold Improvements | 944,000 | 910,000 | Term of Lease |
| Computers and Software | 518,000 | 482,000 | 4 - 6 years |
| Total Property and Equipment | 32,781,000 | 31,937,000 | |
| Less: Accumulated Depreciation | (17,517,000) | (16,638,000) |) |
| Property and Equipment, net | \$ 15,264,000 | \$ 15,299,000 | |

Depreciation expense for the three months ended March 31, 2016 and 2015 was approximately \$904,000 and \$719,000, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 5. INTANGIBLE ASSETS

The components of intangibles assets consisted of the following:

| | March 31, 2016 (Unaudited) | | December 31, 2015 | |
|--------------------------------|----------------------------------|--------------|----------------------|----------------|
| Customer Relationships | \$ 6,555,000 | \$ 6,555,000 | | 5 to 14 years |
| Trade Names | 1,480,000 | 1,480,000 | | 20 years |
| Technical Know-how | 660,000 | 660,000 | | 10 years |
| Non-Compete | 150,000 | 150,000 | | 5 years |
| Professional Certifications | 15,000 | 15,000 | | .25 to 2 years |
| Total Intangible Assets | 8,860,000 | 8,860,000 | | |
| Less: Accumulated Amortization | (5,328,000) | (5,008,000) | | |
| Intangible Assets, net | \$ 3,532,000 | \$ 3,852,000 | | |

Amortization expense for the three months ended March 31, 2016 and 2015 was approximately \$320,000 and \$307,000, respectively.

Note 6. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

| | March 31, 2016 (Unaudited) | | December 31, 2015 |
|---|----------------------------------|---------------|----------------------|
| Revolving credit note payable to PNC Bank N.A. ("PNC") | \$ 30,062,000 | \$ 29,604,000 | |
| Term loans, PNC | 9,270,000 | 9,833,000 | |
| Capital lease obligations | 5,100,000 | 5,018,000 | |
| Related party note payable | 350,000 | 350,000 | |
| Subtotal | 44,782,000 | 44,805,000 | |
| Less: Current portion of notes and capital lease obligations | (40,865,000) | (40,893,000) | |
| Notes payable and capital lease obligations, net of current portion | \$ 3,917,000 | \$ 3,912,000 | |

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 Loan Facility was most recently amended in February 2016 to increase the revolving loan to \$37,500,000, including an overdraft facility of \$4,500,000. We paid a fee of \$75,000 in connection with the amendment. The Loan Facility consists of a \$37,500,000 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, 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, and had an outstanding balance of \$30,062,000 and \$29,604,000, as of March 31, 2016 and December 31, 2015, respectively.

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.

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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 March 31, 2016 and December 31, 2015, the balance due under Term Loan A was \$1,943,000 and \$2,039,000, 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 March 31, 2016 and December 31, 2015, the balance due under Term Loan B was \$2,567,000 and \$2,742,000, 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 March 31, 2016 and December 31, 2015, the balance due under Term Loan C was \$2,014,000 and \$2,118,000, 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 March 31, 2016 and December 31, 2015, the balance due under Term Loan D was \$2,746,000 and \$2,934,000, respectively.

To the extent that the Company disposes of collateral used to secure the Loan Facility, other than inventory, the Company must promptly repay the draws on the credit facility in 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 March 31, 2016 and 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. As of March 31, 2016 and December 31, 2015, the Company was in compliance with all other terms of the Loan Facility.

The Company is currently in discussions with PNC and has reached an agreement in principle regarding a twelfth amendment of our Loan Facility. As part of this Amendment, the bank will extend the maturity date of the revolving portion of the Loan Facility to April 30, 2018. In addition, we have acknowledged that there are currently outstanding excess advances of approximately \$6,500,000 and that such over advances shall be repaid by the payment of \$1,500,000 on the closing date of the twelfth amendment and by the payment of \$100,000 on each Monday thereafter beginning on the second Monday following the closing date. So long as they are outstanding, the over advances shall bear interest at a per annum rate equal to the LIBOR rate plus 4.5%. We will pay the bank a fee of \$100,000 on the first Monday after the closing of the twelfth amendment and reimburse it for all expenses incurred in connection with entering into the amendment. Further, as part of the amendment the bank will waive our failure to comply with the Fixed Charge Ratio covenant contained in the Loan Facility for the period from December 31, 2015 to March 31, 2016.

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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, 2016, the scheduled future minimum principal payments for the term loans are as follows, however as discussed above, the balance of the term loans have been classified as current:

| For the twelve months ending | Amount |
|------------------------------|--------------|
| March 31, 2017 | \$ 5,806,000 |
| March 31, 2018 | 1,117,000 |
| March 31, 2019 | 1,117,000 |
| March 31, 2020 | 883,000 |
| March 31, 2021 | 347,000 |
| PNC Term Loans payable | 9,270,000 |
| Less: Current portion | (9,270,000) |
| Long-term portion | \$ - |

Interest expense related to these credit facilities amounted to approximately \$435,000 and \$285,000 for the three months ended March 31, 2016 and 2015, respectively.

Capital Leases Payable – Equipment

The Company is committed under several capital leases for manufacturing and computer equipment. Each lease has a bargain purchase option exercisable at the termination of the lease. Capital lease obligations totaled \$5,100,000 and \$5,018,000 as of March 31, 2016 and December 31, 2015, respectively, with various interest rates ranging from approximately 4% to 7%.

As of March 31, 2016, 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, 2017 | \$ 1,438,000 |
| March 31, 2018 | 1,438,000 |
| March 31, 2019 | 1,360,000 |
| March 31, 2020 | 1,162,000 |
| March 31, 2021 | 281,000 |
| Thereafter | 5,000 |
| Total future minimum lease payments | 5,684,000 |
| Less: imputed interest | (584,000) |
| Less: current portion | (1,183,000) |
| Total Long Term Portion | \$ 3,917,000 |

Related Party Notes Payable

On September 8, 2015, the Company issued a promissory note (the “Taglich Note A”) to Michael Taglich in the principal amount of \$350,000. The Taglich Note A 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 A is subordinated to its indebtedness to PNC. Interest expense related to the Taglich Note A was \$3,500 for the three months ended March 31, 2016.

Related Party Notes Payable – Subsequent Events

On April 8, 2016, the Company issued a promissory note (the “Taglich Note B”) to Michael Taglich in the principal amount of \$350,000. The Taglich Note B bears interest at the rate of 7% per annum. The principal and interest are due to be paid on June 30, 2016, or earlier upon the Company’s receipt of proceeds from the sale of its equity securities in the aggregate amount of \$1,000,000. The Company's obligation under the Taglich Note B is subordinated to its indebtedness to PNC.

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On April 8, 2016, the Company issued a promissory note (the “Taglich Note C”) to Robert Taglich in the principal amount of \$350,000. The Taglich Note C bears interest at the rate of 7% per annum. The principal and interest are due to be paid on June 30, 2016, or earlier upon the Company’s receipt of proceeds from the sale of its equity securities in the aggregate amount of \$1,000,000. The Company's obligation under the Taglich Note C is subordinated to its indebtedness to PNC.

On May 6, 2016, the Company issued a promissory note (the “Taglich Note D”) to Michael Taglich in the principal amount of \$400,000. The Taglich Note D bears interest at the rate of 7% per annum. The principal and interest are due to be paid on June 30, 2016, or earlier upon the Company’s receipt of proceeds from the sale of its equity securities in the aggregate amount of \$2,000,000. The Company's obligation under the Taglich Note D is subordinated to its indebtedness to PNC.

On May 6, 2016, the Company issued a promissory note (the “Taglich Note E”) to Robert Taglich in the principal amount of \$300,000. The Taglich Note E bears interest at the rate of 7% per annum. The principal and interest are due to be paid on June 30, 2016, or earlier upon the Company’s receipt of proceeds from the sale of its equity securities in the aggregate amount of \$2,000,000. The Company's obligation under the Taglich Note E is subordinated to its indebtedness to PNC.

Note 7. STOCKHOLDERS' EQUITY

Common Stock Issuances

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 was recorded as additional paid in capital at December 31, 2015.

During the three months ended March 31, 2016, 25,000 shares of restricted stock have vested and are included in shares issued and outstanding.

Stock Options

On March 30, 2015, the Board of Directors adopted the Company’s 2015 Equity Incentive Plan (“2015 Plan”) which was approved by affirmative vote of 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 March 31, 2016.

Note 8. INCOME TAXES

The provision for income taxes for the three months ended March 31, 2016 and 2015 is set forth below:

| | 2016 (Unaudited) | 2015 (Unaudited) |
|--------------------------|---------------------|---------------------|
| Current | | |
| Federal | \$ - | \$ 166,000 |
| State | 22,000 | 5,000 |
| Prior Year Under Accrual | | |
| Federal | 13,000 | - |

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| | | | | |
|---|----|-----------|----|------------|
| Total Current Expense | | 35,000 | | 171,000 |
| Deferred Tax (Benefit) | | (691,000) | | (147,000) |
| Net (Benefit from) Provision for Income Taxes | \$ | (656,000) | \$ | 24,000 |

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The components of net deferred tax assets as of March 31, 2016 and December 31, 2015 are set forth below:

| | March 31, 2016 (Unaudited) | December 31, 2015 |
|--|----------------------------------|----------------------|
| Deferred tax assets | | |
| Current: | | |
| Net operating losses | \$ 1,055,000 | \$ 462,000 |
| Bad debts | 308,000 | 336,000 |
| Inventory - 263A adjustment | 8,000 | 8,000 |
| Accounts payable, accrued expenses and reserves | 985,000 | 919,000 |
| Total current deferred tax assets before valuation allowance | 2,356,000 | 1,725,000 |
| Valuation allowance | - | - |
| Total current deferred tax assets after valuation allowance | 2,356,000 | 1,725,000 |
| Non-current: | | |
| Section 1231 loss carry forward | 4,000 | 4,000 |
| Stock based compensation - options and restricted stock | 88,000 | 79,000 |
| Capitalized engineering costs | 432,000 | 432,000 |
| Deferred rent | 410,000 | 410,000 |
| Amortization - NTW Transaction | 845,000 | 789,000 |
| Inventory reserves | 727,000 | 680,000 |
| Deferred gain on sale of real estate | 123,000 | 126,000 |
| Other | 148,000 | 257,000 |
| Total non-current deferred tax assets before valuation allowance | 2,777,000 | 2,777,000 |
| Valuation allowance | (4,000) | (4,000) |
| Total non-current deferred tax assets after valuation allowance | 2,773,000 | 2,773,000 |
| Deferred tax liabilities: | | |
| Property and equipment | (2,041,000) | (2,091,000) |
| Amortization - NTW Goodwill | (14,000) | (13,000) |
| Amortization - AMK Goodwill | (22,000) | (18,000) |
| Amortization - Welding Transaction | (298,000) | (313,000) |
| Total non-current deferred tax liabilities | (2,375,000) | (2,435,000) |
| Net non-current deferred tax asset | \$ 398,000 | \$ 338,000 |

During the year ended December 31, 2015, the Company provided a valuation allowance on the deferred tax assets related to capital loss and section 1231 loss carryforwards. The valuation allowance at both March 31, 2016 and December 31, 2015 amounted to \$4,000. Management believes that the remainder of the net deferred tax assets are more likely than not to be realized.

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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, ECC and Compac; and Turbine Engine Components which consists of AMK and Sterling.

The accounting policies of each segment 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.

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Financial information about the Company's operating segments for the three months ended March 31, 2016 and 2015 are as follows:

| | Three Months Ended March 31, | |
|---|------------------------------|---------------------|
| | 2016 (Unaudited) | 2015 (Unaudited) |
| COMPLEX MACHINING | | |
| Net Sales | \$ 7,467,000 | \$ 9,064,000 |
| Gross Profit | 1,858,000 | 2,091,000 |
| Pre (Loss) Income | (400,000) | (180,000) |
| Assets | 51,076,000 | 40,205,000 |
| AEROSTRUCTURES & ELECTRONICS | | |
| Net Sales | 5,160,000 | 5,782,000 |
| Gross Profit | 948,000 | 2,162,000 |
| Pre Tax (Loss) Income | (772,000) | 770,000 |
| Assets | 19,263,000 | 18,141,000 |
| TURBINE ENGINE COMPONENTS | | |
| Net Sales | 2,557,000 | 1,965,000 |
| Gross Profit | 15,000 | 116,000 |
| Pre Tax (Loss) Income | (914,000) | (462,000) |
| Assets | 17,247,000 | 18,188,000 |
| CORPORATE | | |
| Net Sales | - | - |
| Gross Profit | - | - |
| Pre Tax (Loss) Income | - | - |
| Assets | 534,000 | 1,279,000 |
| CONSOLIDATED | | |
| Net Sales | 15,184,000 | 16,811,000 |
| Gross Profit | 2,821,000 | 4,369,000 |
| Pre Tax (Loss) Income | (2,086,000) | 128,000 |
| Benefit from (Provision for) Income Taxes | 656,000 | (24,000) |
| Net (Loss) Income | (1,430,000) | 104,000 |
| Assets | \$ 88,120,000 | \$ 77,813,000 |

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 the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015. This discussion contains forward-looking statements that involve risks and uncertainties. You should specifically consider the various risk factors identified in our report on Form 10-K for the year ended December 31, 2015, which was filed on April 4, 2016, 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 and industrial 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, and other components. We also provide sheet metal fabrication of aerostructures, tube bending, welding and kitting services. Our Turbine Engine Components segment makes components and provides services for jet engines and ground-power 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, the US Navy F-18 and USAF F-16 fighter aircraft, Boeing's 777 and Airbus' 380 commercial airliners. Our Turbine Engine segment makes components for jet engines that are used on the USAF F-15 and F-16, the Airbus A-330 and A-380, and the Boeing 777, in addition to a number of ground-power turbine applications.

Air Industries Machining, Corp. ("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 provided 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 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. Sterling's results are reported as part of our Turbine Engine Components segment. In September 2015 we acquired the business and operations of Compac Development Corporation ("Compac") in an asset acquisition. Compac specializes in the manufacture of RFI/EMI (Radio Frequency Interference – Electro-Magnetic Interference) shielded enclosures for electronic components. Its results are reported as part of our Aerostructures and Electronics segment.

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.

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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 and decreased usage of aircraft 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" ("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.

We currently divide our operations into three operating segments: Complex Machining; Aerostructures and Electronics; and Turbine Engine Components. We separately report our corporate overhead (which was comprised of certain operating costs that were not directly attributable to a particular segment). Effective January 1, 2015, all operating costs are allocated to the Company's three operating segments. 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, 2016 and 2015. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report. 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, 2016 and 2015: | |
|---|--|---------------------|
| | 2016 (Unaudited) | 2015 (Unaudited) |
| Net sales | \$ 15,184,000 | \$ 16,811,000 |
| Cost of sales | 12,363,000 | 12,442,000 |
| Gross profit | 2,821,000 | 4,369,000 |
| Operating expenses and interest costs | (4,917,000) | (4,249,000) |
| Other income, net | 10,000 | 8,000 |
| Benefit from (provision for) income taxes | 656,000 | (24,000) |
| Net (loss) income | \$ (1,430,000) | \$ 104,000 |

Balance Sheet Data:

| | March 31, 2016 (Unaudited) | December 31, 2015 |
|----------------------------|-------------------------------|----------------------|
| Cash and cash equivalents | \$ 369,000 | \$ 529,000 |
| Working capital | 1,081,000 | 2,166,000 |
| Total assets | 88,120,000 | 88,250,000 |
| Total stockholders' equity | \$ 27,402,000 | \$ 28,805,000 |

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, | |
|---|------------------------------|---------------------|
| | 2016 (Unaudited) | 2015 (Unaudited) |
| COMPLEX MACHINING | | |
| Net Sales | \$ 7,467,000 | \$ 9,064,000 |
| Gross Profit | 1,858,000 | 2,091,000 |
| Pre (Loss) Income | (400,000) | (180,000) |
| Assets | 51,076,000 | 40,205,000 |
| AEROSTRUCTURES & ELECTRONICS | | |
| Net Sales | 5,160,000 | 5,782,000 |
| Gross Profit | 948,000 | 2,162,000 |
| Pre Tax (Loss) Income | (772,000) | 770,000 |
| Assets | 19,263,000 | 18,141,000 |
| TURBINE ENGINE COMPONENTS | | |
| Net Sales | 2,557,000 | 1,965,000 |
| Gross Profit | 15,000 | 116,000 |
| Pre Tax (Loss) Income | (914,000) | (462,000) |
| Assets | 17,247,000 | 18,188,000 |
| CORPORATE | | |
| Net Sales | - | - |
| Gross Profit | - | - |
| Pre Tax (Loss) Income | - | - |
| Assets | 534,000 | 1,279,000 |
| CONSOLIDATED | | |
| Net Sales | 15,184,000 | 16,811,000 |
| Gross Profit | 2,821,000 | 4,369,000 |
| Pre Tax (Loss) Income | (2,086,000) | 128,000 |
| Benefit from (Provision for) Income Taxes | 656,000 | (24,000) |
| Net (Loss) Income | (1,430,000) | 104,000 |
| Assets | \$ 88,120,000 | \$ 77,813,000 |

Net Sales:

Consolidated net sales for the three months ended March 31, 2016 were approximately \$15,184,000, a decrease of \$(1,627,000), or (9.6)%, compared with \$16,811,000 for the three months ended March 31, 2015. The decrease in sales resulted from declines in our Complex Machining and Aerostructure & Electronics segments totaling approximately \$(1,597,000) and \$(622,000), respectively. These declines in sales were partially offset by increases in our Turbine Engine Components segment of approximately \$ 592,000. The increase in sales of our Turbine Engine Components segment in 2016 reflects the inclusion of three months of sales of Sterling, as opposed to the one month of sales included in the March 31, 2015 period.

As indicated in the table below, four customers represented 58.4% and two customers represented 41.3% of total sales for the three months ended March 31, 2016 and 2014, respectively.

| Customer | Percentage of Sales | |
|-------------------------------------|---------------------|------|
| | 2016 | 2015 |
| Sikorsky Aircraft | 23.2 | 23.2 |
| United States Department of Defense | 12.7 | * |
| Goodrich Landing Gear Systems | 11.9 | 18.1 |
| Northrop Grumman Corporation | 10.6 | * |

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

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, 2016 was \$2,821,000 a decrease of approximately \$(1,548,000), or (35.4%), as compared to gross profit of \$4,369,000 for the three months ended March 31, 2015. Consolidated gross profit as a percentage of sales was 18.6% and 26.0 % for the three months ended March 31, 2016 and 2015, respectively. Gross profit from operations in our Complex Machining segment declined by approximately \$(233,000) accounting for 15% of the decline in consolidated gross profit. Gross profit from operations in our Aerostructures & Electronics segment declined by approximately \$(1,214,000) accounting for 78% of the decline in consolidated gross profit. Gross profit from operations in our Turbine Engine Component segment declined by approximately \$(101,000) accounting for 6% of the decline in consolidated gross profit.

Operating Expenses:

Consolidated Operating Expenses for the three months ended March 31, 2016 were \$4,412,000 and increased by \$509,000, or 13.04%, compared to \$3,903,000 for the three months ended March 31, 2015. The increase reflects approximately \$148,000 resulting from the Sterling Engineering and Compac Development acquisitions completed on March 1, 2015 and September 1, 2015, respectively.

Interest and financing costs for the three months ended March 31, 2016 were approximately \$494,000 an increase of approximately \$148,000, or 42.8% compared to \$346,000 for the three months ended March 31, 2015. The increase results from additional amounts of debt outstanding due to acquisitions and increases in inventory.

Loss before income taxes for the three months ended March 31, 2016 was \$(2,086,000), a decrease of \$(2,214,000) compared to income before income taxes of \$128,000 for the three months ended March 31, 2015. All three segments operated at a loss for the quarter. Our Complex Machining segment experienced a loss of approximately \$(400,000)

accounting for 19.2% of the consolidated loss. Our Aerostructures & Electronics segment experienced a loss of approximately \$(772,000) accounting for 37% of the consolidated loss. Our Turbine & Engine segment experienced a loss of approximately \$(914,000) accounting for 43.8% of the consolidated loss.

The Company recognized a benefit from taxes of \$656,000 for three months ended March 31, 2016 compared to a provision for taxes of approximately \$24,000 for three months ended March 31, 2015, an increase of \$680,000. The income tax benefit in 2016 resulted primarily from the net operating losses generated by the Company of approximately \$1.7 million, or \$593,000, of deferred tax benefit.

Net loss for the three months ended March 31, 2016 was \$(1,430,000), a decrease of \$(1,534,000), or 11.3%, compared to net income of \$104,000 for the three months ended March 31, 2015 for the reasons discussed above.

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 our cash receipts are paid. If PNC were to cease lending, we would lack funds to continue its operations.

The Loan Facility with PNC has been amended many times during its term. The Company entered into an amendment to the Loan Facility in February 2016 and paid an amendment fee of \$75,000. At March 31, 2016, the Loan Facility consisted of a \$37,500,000 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, 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.

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 March 31, 2016 and December 31, 2015, the balance due under Term Loan A was \$1,943,000 and \$2,039,000, 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 March 31, 2016 and December 31, 2015, the balance due under Term Loan B was \$2,567,000 and \$2,742,000, 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 March 31, 2016 and December 31, 2015, the balance due under Term Loan C was \$2,014,000 and \$2,118,000, 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 March 31, 2016 and December 31, 2015, the balance due under Term Loan D was \$2,746,000 and \$2,934,000, respectively.

To the extent that the Company disposes of collateral used to secure the Loan Facility, other than inventory, the Company must promptly repay the draws on the credit facility in 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 March 31, 2016 and 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. As of March 31, 2016 and December 31, 2015, the Company was in compliance with all other terms of the Loan Facility.

We are currently in discussions with PNC and have reached an agreement in principle regarding a twelfth amendment of our Loan Facility. As part of this Amendment, the bank will extend the maturity date of the revolving portion of the Loan Facility to April 30, 2018. In addition, we have acknowledged that there are currently outstanding excess advances of approximately \$6,500,000 and that such over advances shall be repaid by the payment of \$1,500,000 on the closing date of the twelfth amendment and by the payment of \$100,000 on each Monday thereafter beginning on the second Monday following the closing date. So long as they are outstanding, the over advances shall bear interest at a per annum rate equal to the LIBOR rate plus 4.5%. We will pay the bank a fee of \$100,000 on the first Monday after the closing of the twelfth amendment and reimburse it for all expenses incurred in connection with entering into the amendment. Further, as part of the amendment the bank will waive our failure to comply with the Fixed Charge Ratio covenant contained in the Loan Facility for the period from December 31, 2015 to March 31, 2016.

As of March 31, 2016, our debt for borrowed monies in the amount of \$44,782,000 consisted of the revolving credit note due to PNC in the amount of \$30,062,000, the term loans due to PNC in the amount of \$9,270,000, a note in the amount of \$350,000, and capitalized lease obligations of \$5,100,000. This represents a decrease of \$23,000 in our debt for borrowed monies from December 31, 2015 of \$44,805,000, when the revolving note due to PNC was \$29,604,000, the term loans due to PNC were \$9,833,000, and we had a note in the amount of \$350,000, and capitalized lease obligations were \$5,018,000.

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.

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, 2016 (Unaudited) | Three Months Ended March 31, 2015 (Unaudited) |
|----------------------------|---|---|
| Cash provided by (used in) | | |
| Operating activities | \$ 900,000 | \$ 988,000 |
| Investing activities | (567,000) | (5,117,000) |
| Financing activities | (493,000) | 5,169,000 |

| | | | | |
|--|----|-----------|----|-----------|
| Net (decrease) increase in cash and cash equivalents | \$ | (160,000) | \$ | 1,040,000 |
|--|----|-----------|----|-----------|

Cash Provided By Operating Activities

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

For the three months ended March 31, 2016, our net cash provided by operating activities of \$900,000 was comprised of a net loss of \$1,430,000 offset by \$1,505,000 of cash provided by changes in operating assets and liabilities, plus adjustments for non-cash items of \$825,000. Adjustments for non-cash items consisted primarily of depreciation of property and equipment of \$904,000, amortization of capitalized engineering costs, intangibles and other items of \$595,000, and non-cash compensation of \$27,000. These non-cash items were offset by \$10,000 of deferred gain on the sale of real estate and \$691,000 of deferred income taxes. The net increase in operating assets and liabilities consisted of a net decrease in operating assets of \$198,000 and a net increase in operating liabilities of \$1,307,000. The net decrease in operating assets was comprised of a decrease in accounts receivable of \$3,850,000 due to the timing of shipments to and cash receipts from customers, a decrease in prepaid expenses and other assets of \$139,000, a decrease in deposits and other assets of \$35,000, partially offset by an increase in inventory of \$3,826,000. The net increase in operating liabilities was comprised of increases in accounts payable and accrued expenses of \$941,000 due to the timing of the receipt and payment of invoices, an increase in income taxes payable of \$11,000, and increases in deferred rent of \$3,000 and deferred revenue of \$352,000.

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 acquired. A description of capitalized engineering costs can be found below and in Note 3 Summary of Significant Accounting Policies in our Consolidated Financial Statements for the year ended December 31, 2015.

For the three months ended March 31, 2016, cash used in investing activities was \$567,000. This was comprised of \$212,000 for capitalized engineering costs and \$355,000 for the purchase of property and equipment.

Cash Provided By (Used In) Financing Activities

Cash provided by (used in) financing activities consists of the 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, 2016, cash used in financing activities was \$493,000. This was comprised of repayments of \$563,000 on our term loans, \$313,000 on our capital lease obligations, and \$75,000 of deferred financing costs, partially offset by additional borrowings of \$458,000 under our revolving credit facility.

OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of March 31, 2016.

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, 2016 and December 31, 2015.

Recently Issued Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)” (“ASU 2016-01”). The main objective of ASU 2016-01 is enhancing the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect the adoption of this amended to have a significant impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The main objective of ASU 2016-02 is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. To meet that objective, the FASB is amending the FASB Accounting Standards Codification and creating Topic 842, Leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company does not expect the adoption of this amended to have a significant impact on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation—Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment” (“ASU 2016-09”). ASU 2016-09 is part of the FASB Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. ASU 2016-09 will affect all entities that issue share-based payment awards to their employees. The areas for simplification involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning

after December 15, 2016, and interim periods within those annual periods. The Company does not expect the adoption of this amended to have a significant impact on its consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2016-10”). The core principle of the guidance in Topic 606 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU 2016-10 affect the guidance in ASU 2014-09, “Revenue from Contracts with Customers”, which is not yet effective. The effective date and transition requirements of ASU 2016-10 are the same as the effective date and transition requirements of ASU 2014-09. They are effective prospectively for reporting periods beginning after December 15, 2017 and early adoption is not permitted. The Company is currently assessing the impact of the adoption of these amendments 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.

When we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2015, our Chief Executive Officer and our Chief Accounting Officer concluded that as of such date, our disclosure controls and procedures were not effective due to a material weakness related to (i) 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 and (ii) 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 an effort to eliminate such weakness, we have added Marianne Giglio to our accounting department and entered into an agreement with Chord Advisors, LLC, an advisory firm that provides financial accounting and advisory services to public companies, to assist our internal accounting staff in determining the appropriate tax and financial accounting treatment of our significant transactions and in connection with such other financial reporting matters as our management deems appropriate. Given that such actions were taken recently, they have yet to have a significant impact on the effectiveness of our disclosure controls and procedures.

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 as of the end of the period covered by this Report. 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 not effective.

(b) Changes in Internal Control over Financial Reporting

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

SIGNATURES

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 16, 2016

AIR INDUSTRIES GROUP

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

By: /s/ Marianne Giglio
Marianne Giglio
Chief Accounting Officer
(Principal Financial Officer)