

AIR INDUSTRIES GROUP
Form 10-Q
May 15, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: March 31, 2018

or

o Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File No. 001-35927

AIR INDUSTRIES GROUP

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

80-0948413

(I.R.S. Employer Identification No.)

360 Motor Parkway, Suite 100, Hauppauge, New York 11788

(Address of principal executive offices)

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(631) 881-4920

(Registrant's telephone number, including area code)

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

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

Large Accelerated Filer

Accelerated Filer (Do not check if smaller reporting company)

Non-Accelerated Filer

Smaller Reporting Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

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

There were a total of 26,205,341 shares of the registrant's common stock outstanding as of May 10, 2018.

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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.

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, 2017, as amended,

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.

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PART I

FINANCIAL INFORMATION

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| | March 31, 2018 | December 31, 2017 |
|---|---------------------------|------------------------------|
| | Unaudited | |
| ASSETS | | |
| Current Assets | | |
| Cash and Cash Equivalents | \$ 1,415,000 | \$ 630,000 |
| Accounts Receivable, Net of Allowance for Doubtful Accounts of \$763,000 and \$494,000, respectively | 6,749,000 | 5,464,000 |
| Inventory | 30,887,000 | 31,141,000 |
| Prepaid Expenses and Other Current Assets | 349,000 | 214,000 |
| Prepaid Taxes | 49,000 | 49,000 |
| Assets Held for Sale | 10,412,000 | 10,082,000 |
| Total Current Assets | 49,861,000 | 47,580,000 |
| Property and Equipment, Net | 9,529,000 | 10,050,000 |
| Capitalized Engineering Costs - Net of Accumulated Amortization of \$5,525,000 and \$5,380,000, respectively | 2,207,000 | 2,188,000 |
| Deferred Financing Costs, Net, Deposits and Other Assets | 737,000 | 665,000 |
| Goodwill | 272,000 | 272,000 |
| TOTAL ASSETS | \$62,606,000 | \$60,755,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Current Portion | \$24,339,000 | \$23,131,000 |
| Notes Payable – Related Party – Current Portion | 1,542,000 | 262,000 |
| Accounts Payable and Accrued Expenses | 10,750,000 | 10,872,000 |
| Deferred Gain on Sale - Current Portion | 38,000 | 38,000 |
| Deferred Revenue | 938,000 | 931,000 |
| Liabilities Directly Associated with Assets Held for Sale | 2,797,000 | 2,795,000 |
| Income Taxes Payable | 20,000 | 20,000 |
| Total Current Liabilities | 40,424,000 | 38,049,000 |
| Long Term Liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Net of Current Portion | 1,533,000 | 1,798,000 |
| Notes Payable – Related Party – Net of Current Portion | 1,616,000 | 1,650,000 |
| Deferred Gain on Sale - Net of Current Portion | 285,000 | 295,000 |
| Deferred Rent | 1,189,000 | 1,197,000 |
| TOTAL LIABILITIES | 45,047,000 | 42,989,000 |
| Commitments and Contingencies | | |
| Stockholders' Equity | | |

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| | | |
|---|--------------|--------------|
| Preferred Stock, par value \$.001 - Authorized 3,000,000 shares, Designated as Series A Convertible Preferred Stock – par value \$0.001, Authorized and outstanding: 0 at March 31, 2018 and December 31, 2017. | — | — |
| Common Stock - Par Value \$.001 - Authorized 50,000,000 Shares, 26,205,341 and 25,213,805 Shares Issued and Outstanding as of March 31, 2018 and December 31, 2017, respectively | 26,000 | 25,000 |
| Additional Paid-In Capital | 72,534,000 | 71,272,000 |
| Accumulated Deficit | (55,001,000) | (53,531,000) |
| TOTAL STOCKHOLDERS' EQUITY | 17,559,000 | 17,766,000 |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$62,606,000 | \$60,755,000 |

See Notes to Condensed Consolidated Financial Statements

Table of Contents**AIR INDUSTRIES GROUP**
Condensed Consolidated Statements of Operations For the Three Months Ended March 31,**(Unaudited)**

| | Three Months Ended March | |
|---|--------------------------|-----------------|
| | 31, | |
| | 2018 | 2017 |
| Net Sales | \$ 12,242,000 | \$12,674,000 |
| Cost of Sales | 10,239,000 | 9,962,000 |
| Gross Profit | 2,003,000 | 2,712,000 |
| Operating Expenses | (2,616,000) | (2,541,000) |
| (Loss) Income from Operations | (613,000) | 171,000 |
| Interest and Financing Costs | (777,000) | (893,000) |
| Gain on Sale of Subsidiary | - | 451,000 |
| Other Income (Expense), Net | 16,000 | (183,000) |
| Loss before Provision for Income Taxes | (1,374,000) | (454,000) |
| Provision for Income Taxes | 2,000 | - |
| Loss from Continuing Operations | (1,376,000) | (454,000) |
| Loss from Discontinued Operations, net of tax | (92,000) | (700,000) |
| Net Loss | \$ (1,468,000) | \$ (1,154,000) |
| Net Loss per share – Basic | | |
| Continuing Operations | \$ 0.05 | \$0.06 |
| Discontinued Operations | \$ (0.00) | \$0.09 |
| Net Loss per share – Diluted | | |
| Continuing Operations | 0.05 | 0.06 |
| Discontinued Operations | \$ (0.00) | \$0.09 |
| Weighted Average Shares Outstanding – Basic | 26,116,262 | 7,650,165 |
| Weighted Average Shares Outstanding – Diluted | 26,116,262 | 7,650,165 |

See Notes to Condensed Consolidated Financial Statements

Table of Contents**AIR INDUSTRIES GROUP****Condensed Consolidated Statements of Cash Flows For the Three Months Ended March 31,****(Unaudited)**

| | 2018 | 2017 |
|---|--------------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Loss | \$(1,468,000) | \$(1,154,000) |
| Adjustments to reconcile net loss to net cash provided by (used in) in operating activities | | |
| Depreciation of property and equipment | 722,000 | 728,000 |
| Amortization of intangible assets | 38,000 | 304,000 |
| Amortization of capitalized engineering costs | 145,000 | 81,000 |
| Bad debt expense (recovery) | 270,000 | (14,000) |
| Non-cash employee compensation expense/(forfeiture of unamortized stock compensation) | 83,000 | (73,000) |
| Amortization of deferred financing costs | 69,000 | 55,000 |
| Deferred gain on sale of real estate | (10,000) | (10,000) |
| (Gain) loss on sale of subsidiary | — | (451,000) |
| Amortization of debt discount on convertible notes payable | 275,000 | 176,000 |
| Changes in Assets and Liabilities | | |
| (Increase) Decrease in Operating Assets: | | |
| Accounts receivable | (1,025,000) | 578,000 |
| Inventory | (733,000) | 1,719,000 |
| Prepaid expenses and other current assets | (103,000) | (102,000) |
| Prepaid taxes | — | 178,000 |
| Deposits and other assets | (124,000) | (276,000) |
| Increase (Decrease) in Operating Liabilities: | | |
| Accounts payable and accrued expense | (97,000) | (621,000) |
| Deferred rent | 1,000 | 6,000 |
| Deferred revenue | 175,000 | (224,000) |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (1,782,000) | 900,000 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capitalized engineering costs | (164,000) | (245,000) |
| Purchase of property and equipment | (144,000) | (89,000) |
| Proceeds from sale of subsidiary | — | 4,260,000 |
| NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES | (308,000) | 3,926,000 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Note payable – revolver – net | 1,489,000 | (5,545,000) |
| Payments of note payable – term notes | (369,000) | (2,069,000) |
| Proceeds from issuance of common stock | 1,065,000 | — |
| Payments of capital lease obligations | (310,000) | (173,000) |

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| | | |
|--|-------------|-------------|
| Proceeds from notes payable issuances– related party | 1,000,000 | 850,000 |
| Proceeds from notes payable issuances - third party | — | 1,850,000 |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 2,875,000 | (5,087,000) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 785,000 | (261,000) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 630,000 | 1,304,000 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$1,415,000 | \$1,043,000 |

See Notes to Condensed Consolidated Financial Statements

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

| | 2018 | 2017 |
|--|-------------|-------------|
| Supplemental cash flow information | | |
| Cash paid during the period for interest | \$390,000 | \$643,000 |
| Cash paid during the period for income taxes | \$2,000 | \$— |
| Supplemental schedule of non-cash investing and financing activities | | |
| Common Stock issued for notes payable - related party | — | — |
| Issuance of Convertible notes payable – related party | \$— | \$382,000 |
| Classification of assets held for sale | \$2,000 | \$— |
| Liabilities directly associated with assets held for sale | \$330,000 | \$— |

See Notes to Condensed Consolidated Financial Statements

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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”), and Compac Development Corporation (“Compac”), (together, the “Company”).

Going Concern

The Company suffered losses from operations of \$613,000 and \$12,758,000 and net losses of \$1,468,000 and \$22,551,000 for the three months ended March 31, 2018 and the year ended December 31, 2017, respectively. The Company also had negative cash flows from operations for the three months ended March 31, 2018 and the years ended December 31, 2017 and 2016. In 2015, the Company ceased paying dividends on its common stock and in 2016 disposed of the real estate on which an operating subsidiary was located through a sale leaseback transaction. Since January 1, 2016, the Company has sold in excess of \$31,000,000 in debt and equity securities to fund its operations. In January 2017, the Company sold one of its operating subsidiaries, AMK Welding Inc. On March 21, 2018, the Company entered into a Stock Purchase Agreement to sell a majority of its Aerostructures & Electronics segment. Furthermore, as of March 31, 2018 and December 31, 2017, the Company was not in compliance with financial covenants under its Amended and Restated Revolving Credit, Term Loan and Security Agreement with PNC Bank (the “Loan Facility”).

The continuation of the Company's business is dependent upon its ability to achieve profitability and positive cash flow and, pending such achievement, future issuances of equity or other financing to fund ongoing operations. The consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

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, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. 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, 2017, as filed with the Securities and Exchange Commission.

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Reclassifications

Certain account balances in 2017 have been reclassified to conform to the current period presentation.

Sale of AMK

On January 27, 2017, the Company sold all of the outstanding shares of AMK to Meyer Tool, Inc., pursuant to a Stock Purchase Agreement dated January 27, 2017 for a purchase price of \$4,500,000, net of a working capital adjustment of (\$163,000), plus additional quarterly payments, not to exceed \$ 1,500,000, equal to five percent (5%) of Net Revenues of AMK commencing April 1, 2017. The Company recorded a \$200,000 gain on the sale of AMK. The gain on sale was the difference between the non-contingent payments and the carrying value of the disposed business. The Company has made an accounting policy decision to record the contingent consideration as it is determined to be realizable.

The proceeds of the sale of AMK were applied as follows: \$1,700,000 to the payment of the Term Loan (as defined in the PNC Loan Agreement), \$1,800,000 to the payment of outstanding Revolving Advances (as defined in the PNC Loan Agreement), and \$500,000 to the payment of existing accounts payable. The remaining \$500,000 was applied to outstanding accounts payable and reduced the amount of the Revolving Advance.

Sale of Welding Metallurgy Inc.

On March 21, 2018, the Company signed an agreement to sell all of the outstanding shares of WMI including its wholly owned subsidiaries Miller Stuart, Woodbine, Decimal and Compac Development Corp to CPI Aerostructures, Inc., pursuant to a Stock Purchase Agreement (SPA) for a purchase price of \$9,000,000, subject to a customary working capital adjustment. The SPA also provides for contingent payments of up to an aggregate of \$1,000,000 if WMI enters into specified agreements, long-term agreements with certain customers, by May 31, 2018 and July 31, 2018, respectively (the "Specified Dates"), which contingent payments are subject to reduction if subsequent to the Specified Dates WMI enters into those specified agreements by \$100,000 for each calendar month after the Specified Date. The sale is subject to certain conditions, including CPI obtaining financing for the amount of the purchase price, and requires an escrow deposit of \$2,000,000 to cover the working capital adjustment and our obligation to indemnify CPI against damages arising out of the breach of our representations and warranties and obligations under the SPA. It is anticipated that the sale will occur in May or June of 2018.

Subsequent Events

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

Note 2. — DISCONTINUED OPERATIONS

As discussed above, in March 2018, the Company entered into an agreement to sell WMI, Miller Stuart, WPI and Compac. As such, these businesses are reported as discontinued operations for the three months ended March 31, 2018 and 2017. As required, the Company has retrospectively recast its consolidated statements of operations and balance sheets for all periods presented. The Company has not segregated the cash flows of these businesses in the consolidated statements of cash flows. Management was also required to make certain assumptions and apply judgment to determine historical expenses related to the discontinued operations presented in prior periods. Unless noted otherwise, discussion in the Notes to Consolidated Financial Statements refers to the Company's continuing operations.

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At December 31, 2017, the Company has recorded a loss on impairment on intangible assets of \$1,085,000 and a loss on assets held for sale of \$1,563,000.

The following table presents a reconciliation of the major financial lines constituting the results of operations for discontinued operations to the net loss from discontinued operations presented separately in the consolidated statement of operations for the three months ended March 31, 2018 and March 31, 2017:

| | Three Months Ended | |
|---|----------------------------------|---------------------|
| | March 31, 2018 (unaudited) | 2017 (unaudited) |
| Net revenue | \$2,543,000 | \$3,479,000 |
| Cost of goods sold | 2,151,000 | 3,489,000 |
| Gross profit | 392,000 | (10,000) |
| Operating expenses: | | |
| Selling, general and administrative | 485,000 | 680,000 |
| Total operating expenses | (93,000) | (690,000) |
| Interest expense | — | (10,000) |
| Other income (expense) | 1,000 | — |
| Loss from discontinued operations before income taxes | (92,000) | (700,000) |
| Provision for income taxes | — | — |
| Net loss from discontinued operations | \$(92,000) | \$(700,000) |

Non-cash operating amounts for discontinued operations for the three months ended March 31, 2018 include depreciation of \$42,000 and amortization of \$38,000. Capital expenditures were \$1,000. There were no other significant non-cash operating amounts or investing items of the discontinued operations for the period.

Non-cash operating amounts for discontinued operations for the three months ended March 31, 2017 include depreciation of \$45,000 and amortization of \$55,000. Capital expenditures were \$-0-. There were no other significant non-cash operating amounts or investing items of the discontinued operations for the period.

See Note 6 for a reconciliation of the carrying amounts of major classes of assets and liabilities of the discontinued operations to the total assets and liabilities of the disposal group classified as held for sale that are presented separately in the consolidated balance sheets.

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 Metallurgy 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. 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. 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.

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If the sale of WMI closes, the Company will be more focused on complex machined products for aircraft landing gear and jet turbines.

Inventory Valuation

For annual periods, the Company values inventory at the lower of cost on a first-in-first out basis or market. The Company does not take physical inventories at interim quarterly reporting periods. As such, approximately 50% of the inventory value at March 31, 2018 has been estimated using a gross profit percentage based on sales of previous periods to the net sales of the current period, as management believes that the gross profit percentage on these items are materially consistent from period to period. The remainder of the inventory value at March 31, 2018 is estimated based on the Company's standard cost perpetual inventory system, as management believes the perpetual system computed value for these items provides a better estimate of value for that inventory. Adjustments to reconcile the annual physical inventory to the Company's books are treated as changes in accounting estimates and are recorded in the fourth quarter. Inventories consist of the following at:

| | March 31, 2018 (unaudited) | December 31, 2017 |
|-------------------|----------------------------------|-------------------------|
| Raw Materials | \$5,290,000 | \$5,346,000 |
| Work In Progress | 19,065,000 | 19,947,000 |
| Finished Goods | 10,930,000 | 10,122,000 |
| Inventory Reserve | (4,398,000) | (4,274,000) |
| Total Inventory | \$30,887,000 | \$31,141,000 |

Credit and Concentration Risks

There were three customers that represented 73.1% of total sales, and three customers that represented 60.3% of total sales for the three months ended March 31, 2018 and 2017, respectively. This is set forth in the table below.

| Customer | Percentage of Sales | |
|----------|---------------------------|---------------------------|
| | March 2018 (Unaudited) | March 2017 (Unaudited) |
| 1 | 34.5 | 18.9 |
| 2 | 28.6 | 21.5 |
| 3 | 10.0 | * |
| 4 | ** | 19.9 |

* Customer was less than 10% of sales at March 31, 2017.

** Customer was less than 10% of sales at March 31, 2018.

There were three customers that represented 71.9% of gross accounts receivable and three customers that represented 68.7% of gross accounts receivable at March 31, 2018 and December 31, 2017, respectively. This is set forth in the table below.

| Customer | Percentage of Receivables | |
|----------|---------------------------|---------------|
| | March 2018 | December 2017 |
| | (Unaudited) | |
| 1 | 43.2 | 41.9 |
| 2 | 16.3 | 14.6 |
| 3 | 12.4 | * |
| 4 | ** | 12.2 |

* Customer was less than 10% of gross accounts receivable at December 31, 2017.

** Customer was less than 10% of gross accounts receivable at March 31, 2018.

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

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

Earnings per share

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

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

| | Three Months Ended | |
|---|----------------------------------|----------------------------------|
| | March 31, 2018 (Unaudited) | March 31, 2017 (Unaudited) |
| Weighted average shares outstanding used to compute basic earnings per share | 26,116,262 | 7,650,165 |
| Effect of dilutive stock options and warrants | — | — |
| Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share | 26,116,262 | 7,650,165 |

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

| Three Months Ended | |
|--------------------|-------------------|
| March 31, 2018 | March 31, 2017 |
| | |

| | (Unaudited) | (Unaudited) |
|---------------|-------------|-------------|
| Stock Options | 354,000 | 513,000 |
| Warrants | 1,480,000 | 520,000 |
| | 1,834,000 | 1,033,000 |

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

| | March 31, 2018 (Unaudited) | March 31, 2017 (Unaudited) |
|-----------------------------|----------------------------------|----------------------------------|
| Convertible Preferred Stock | — | 2,517,000 |
| Stock Options | 695,000 | 3,000 |
| Warrants | 480,000 | 321,000 |
| | 1,175,000 | 2,841,000 |

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 \$83,000 and \$73,000 for the three months ended March 31, 2018 and 2017, respectively, and was included in operating expenses on the accompanying Condensed Consolidated Statements of Income.

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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 \$272,000 at March 31, 2018 and December 31, 2017 relates to the acquisitions of NTW \$163,000 and ECC \$109,000.

Goodwill is not amortized, but is tested at least annually for impairment, or if circumstances occur that more likely than not reduce the fair value of the reporting unit below its carrying amount.

The Company has determined that there has been no impairment of goodwill at March 31, 2018.

Recently Issued Accounting Pronouncements

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. ASU 2014-09 supersedes existing revenue recognition guidance, including ASC 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts, and outlines a single set of comprehensive principles for recognizing revenue under U.S. GAAP. Among other things, it requires companies to identify contractual performance obligations and determine whether revenue should be recognized at a point in time or over time. On July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017. We intend to adopt the New Revenue Standard effective January 1, 2018.

The new guidance allows for two transition methods in application - (i) retrospective to each prior reporting period presented, or (ii) prospective with the cumulative effect of adoption recognized on January 1, 2018 (also known as the modified retrospective approach). The Company is still assessing which transition method to adopt. This guidance requires additional disclosures of the amount by which each financial statement line item affected in the current reporting period during 2019 as compared to the guidance that was in effect before the change, and an explanation of the reasons for the significant changes.

The Company currently recognizes the majority of its revenues based on shipment of products (at a point in time). Currently, some contracts the Company enters into with customers are accounted for on a percentage of completion basis. For contracts with a significant amount of development and/or requiring the delivery of a minimal number of units, revenue and profit are recognized using the percentage-of-completion cost-to-cost method to measure progress. For contracts that require the Company to produce a substantial number of similar items without a significant level of

development, the Company currently records revenue and profit using the percentage-of-completion units-of-delivery method as the basis for measuring progress on the contract.

Under ASC 606, revenue will be recognized as the customer obtains control of the goods and services promised in the contract (i.e., performance obligations). We may also have more performance obligations in our contracts under ASC 606, which may impact the timing of recording sales and operating profit, including those where sales recognition is deferred pending the incurrence of costs.

The Company has not completed its assessment of the effects of the new revenue standard, and has not determined whether adopting ASU 2014-09 will have a material effect on its consolidated financial statements.

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In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements. The Company has been gathering the lease agreement data and has begun to analyze the financial impact to the 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.

In May 2016, the FASB issued Accounting Standards Update No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow -Scope Improvements and Practical Expedients. The amendments do not change the core revenue recognition principle in Topic 606. The amendments provide clarifying guidance in certain narrow areas and add some practical expedients. These amendments are effective at the same date that Topic 606 is effective. Topic 606 is effective for public entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein (i.e., January 1, 2018, for a calendar year entity). Topic 606 is effective for nonpublic entities one year later. The Company is currently assessing the impact of the adoption of the amendments to Topic 606 and these amendments on its consolidated financial statements.

In September 2017, the FASB issued ASU 2017-13, “Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842),” which provides additional implementation guidance on the previously issued ASU 2016-02 Leases (Topic 842). The revenue standard is effective for annual periods beginning after December 15, 2017. ASU 2016-02 requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective for fiscal years, and

interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. The Company is currently assessing the impact of the adoption of this guidance on its consolidated financial statements.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This update will be effective for all interim and annual reporting periods beginning after December 15, 2018. The Company is currently assessing the impact of the adoption of these amendments on its consolidated financial statements.

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In March 2018, the FASB issued Accounting Standards Update No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (“ASU 2018-05”). ASU 2018-05 adds various SEC paragraphs pursuant to the issuance of the December 2017 SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB No. 118”), which was effective immediately. SAB No.118 provides for a provisional one year measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act. The adoption of ASU 2018-05 had no material impact on the Company’s consolidated financial statements as of and for the three months ended March 31, 2018. See Note 10, Income Taxes, for disclosures related to this amended guidance.

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.

Note 4. PROPERTY AND EQUIPMENT

The components of property and equipment at March 31, 2018 and December 31, 2017 consisted of the following:

| | March 31, 2018 | December 31, 2017 | |
|---------------------------------------|---------------------------|------------------------------|---------------|
| Land | \$300,000 | \$300,000 | |
| Buildings and Improvements | 1,650,000 | 1,650,000 | 31.5 years |
| Machinery and Equipment | 11,570,000 | 11,554,000 | 5 - 8 years |
| Capital Lease Machinery and Equipment | 6,534,000 | 6,534,000 | 5 - 8 years |
| Tools and Instruments | 8,677,000 | 8,538,000 | 1.5 - 7 years |
| Automotive Equipment | 172,000 | 172,000 | 5 years |
| Furniture and Fixtures | 316,000 | 311,000 | 5 - 8 years |
| Leasehold Improvements | 528,000 | 528,000 | Term of Lease |
| Computers and Software | 406,000 | 406,000 | 4 - 6 years |
| Total Property and Equipment | 30,153,000 | 29,993,000 | |
| Less: Accumulated Depreciation | (20,624,000) | (19,943,000) | |
| Property and Equipment, net | \$9,529,000 | \$10,050,000 | |

Depreciation expense for the three months ended March 31, 2018 and 2017 was approximately \$681,000 and \$722,000, respectively.

Assets held under capitalized lease obligations are depreciated over the shorter of their related lease terms or their estimated productive lives. Depreciation of assets under capital leases is included in depreciation expense for 2018 and 2017. Accumulated depreciation on these assets was approximately \$3,919,000 and \$3,595,000 as of March 31, 2018 and December 31, 2017, respectively.

Note 5. INTANGIBLE ASSETS

The expense for amortization of the intangibles for the three months ended March 31, 2017 was approximately \$254,000. As of December 31, 2017 Intangible Assets had been fully amortized.

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As discussed in Note 1, on March 21, 2018, the Company signed a Stock Purchase Agreement to sell all of the outstanding shares of WMI to CPI for a purchase price of \$9,000,000, subject to a working capital adjustment, and a contingent payment of \$1,000,000. At March 31, 2018 and December 31, 2017, the Company reclassified its assets held for sale and the liabilities directly associated to these assets. The components of these assets and liabilities are as follows:

Components of Assets Held for Sale and Liabilities Directly Associated

| | March 31, 2018 | December 31, 2017 |
|---|-------------------|----------------------|
| Assets Held for Sale | | |
| Accounts Receivable, net of allowance for doubtful accounts | \$1,687,000 | \$2,217,000 |
| Inventory, net of reserves | 9,052,000 | 8,065,000 |
| Prepaid and other assets | 436,000 | 485,000 |
| Property and equipment, net of accumulated depreciation | 837,000 | 878,000 |
| Impairment of Assets Held for Sale | (1,600,000) | (1,563,000) |
| Assets Held for Sale | \$10,412,000 | \$10,082,000 |
| Accounts payable and accrued expenses | 1,966,000 | 2,138,000 |
| Deferred Revenue | 689,000 | 521,000 |
| Notes Payable & Capital lease obligations | 8,000 | 11,000 |
| Deferred rent | 134,000 | 125,000 |
| Liabilities directly associated to Assets Held for Sale | \$2,797,000 | \$2,795,000 |

Additionally, WMI's operations were previously reported in the Company's Aerostructures & Electronics segment. The amounts below represent WMI's operations that have been excluded from this segment for the three months ended March 31, 2018 and 2017, respectively:

| <u>Segment Data</u> | | |
|------------------------------|-------------|-------------|
| Aerostructures & Electronics | 2018 | 2017 |
| Net Sales | \$2,543,000 | \$3,479,000 |

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| | | |
|-----------------------|------------|------------|
| Gross Profit (Loss) | 392,000 | (10,000) |
| Pre Tax (Loss) Income | (92,000) | (700,000) |
| Assets | 10,412,000 | 15,409,000 |

Note 7. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

| | March 31, 2018 (unaudited) | December 31, 2017 |
|---|----------------------------------|----------------------|
| Revolving credit note payable to PNC Bank N.A. ("PNC") | \$17,944,000 | \$16,455,000 |
| Term loans, PNC | 3,102,000 | 3,471,000 |
| Capital lease obligations | 2,763,000 | 3,073,000 |
| Related party notes payable, net of debt discount | 3,158,000 | 1,912,000 |
| Convertible notes payable-third parties, net of debt discount | 2,063,000 | 1,930,000 |
| Subtotal | 29,030,000 | 26,841,000 |
| Less: Current portion of notes and capital obligations | (25,881,000) | (23,393,000) |
| Notes payable and capital lease obligations, net of current portion | \$3,149,000 | \$3,448,000 |

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PNC Bank N.A. ("PNC")

The Company has a Loan Facility with PNC secured by substantially all of its assets. The Loan Facility, which was to have expired on April 30, 2018, has been extended until May 31, 2018, and the Company is in negotiations with PNC for a further extension which the Company expects will include certain modifications to the terms of the Loan Facility.

The Loan Facility has been amended many times during its term. The Loan Facility was amended in June 2016 (the "Twelfth Amendment") and September 2016 (the "Thirteenth Amendment"). In connection with the Twelfth Amendment, the Company paid PNC a fee of \$100,000 and reimbursed it for the fees and expenses of its counsel. The Twelfth Amendment provides for a \$33,000,000 revolving loan. In addition, in the Twelfth Amendment the four term loans (Term Loan A, Term Loan B, Term Loan C and Term Loan D) then outstanding were consolidated into a single term loan with the initial principal amount of \$7,387,854. Further, in the Twelfth Amendment the Company acknowledged that there were then outstanding excess advances under the revolving loan in the amount of \$12,500,000.

Under the terms of the Loan Facility, as amended, the revolving loan now bears interest at (a) the sum of the Alternate Base Rate plus one and three-quarters of one percent (1.75%) with respect to Domestic Rate Loans; and (b) the sum of the LIBOR Rate plus four and one-half of one percent (4.50%) with respect to LIBOR Rate Loans. The amount outstanding under the revolving loan, inclusive of the excess advance, was \$17,944,000 and \$16,455,000, as of March 31, 2018 and December 31, 2017, respectively. Because the revolving loans contain a subjective acceleration clause which could permit PNC to require repayment prior to maturity, all of the loans outstanding with PNC are classified with the current portion of notes and capital lease obligations.

The Loan Facility was further amended pursuant to the Thirteenth Amendment, to modify the advance rate with respect to our inventory to be the lesser of (i) 75% of the eligible inventory, an increase from 50%, and (ii) 90% of the liquidation value of the eligible inventory, an increase from 85%, subject to the inventory sublimit of \$12,500,000 and such reserves as PNC may deem proper. In addition, in the Thirteenth Amendment the lender waived any default resulting from the Company's obligation to comply with the minimum EBITDA (as defined in the Loan Facility) covenant for the period ended June 30, 2016, consented to the issuance of the Company's 12% Subordinated Convertible Notes and the amendment to the Company's Articles of Incorporation to increase the authorized number of shares of Preferred Stock and Series A Preferred Stock.

The repayment terms of the Term Loan provided for in the Twelfth Amendment consist of sixty (60) consecutive monthly principal installments, the first fifty-nine (59) of which shall be in the amount of \$123,133 commencing on the first business day of July, 2016, and continuing on the first business day of each month thereafter, with a sixtieth (60th) and final payment of any unpaid balance of principal and interest payable on the last business day of June, 2021.

At the closing of the Twelfth Amendment, the Company paid \$1,500,000 to reduce the outstanding excess under the revolving loan from \$12,500,000 to \$11,000,000. It also agreed that the excess advances will be paid down by \$100,000 each week commencing the second week after the closing of the Twelfth Amendment.

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

The terms of the Loan Facility require that among other things, the Company maintain a specified Fixed Charge Coverage Ratio and maintain a minimum EBITDA. In addition, the Company is limited in the amount of capital expenditures it can make. The Company also is limited as to the amount of dividends it can pay its shareholders, as defined in the Loan Facility.

On June 19, 2017, we entered into the Fifteenth Amendment to the Loan Facility, which waived the failure to comply with the minimum EBITDA covenant for the periods ended December 31, 2016 and March 31, 2017 and the Capital Expenditures covenant for the period ended December 31, 2016. The amendment also requires that we maintain at all times a Fixed Charge Coverage Ratio, tested quarterly on a consolidated basis beginning September 30, 2017, as follows: (i) 1.00 to 1.00 for the quarter ending September 30, 2017, tested based upon the prior three (3) months, (ii) 1.05 to 1.00 for the quarter ending December 31, 2017, tested based upon the prior six (6) months and (iii) 1.05 to 1.00 for the quarter ending March 31, 2018, tested based upon the prior nine months and that we maintain EBITDA of not less than \$345,000 for the period ending September 30, 2017. The amendment also provided that we were not required to maintain a Fixed Charge Coverage Ratio and that no testing was required to the Fixed Charge Coverage Ratio for the periods ending December 31, 2016 and June 30, 2017 and that we are not required to maintain a Fixed Charge Coverage Ratio and that no testing will be required of the Fixed Charge Coverage Ratio for the period ending June 30, 2017. On March 31, 2018 and December 31, 2017, the Company was not in compliance with our Fixed Charge Coverage Ratio covenant. The failure to satisfy the foregoing covenants would constitute a default under the Loan Facility and PNC at its option could give notice to the Company that all amounts under the Loan Facility are immediately due and payable, and accordingly all amounts due under the loan facility have been classified as current, as of March 31, 2018 and December 31, 2017. In addition, the amendment reduced the weekly payments we are required to make to reduce our \$2,244,071 over-advance under the revolving credit facility as of June 19, 2017 from \$100,000 to \$25,000 per week during the period commencing May 22, 2017 through and including July 10, 2017. At December 31, 2017, the over-advance had been paid in full. We paid \$50,000 to PNC in connection with the amendment and reimbursed PNC's counsel fees.

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As of March 31, 2018, our debt to PNC in the amount of \$21,046,000 consisted of the revolving credit loan in the amount of \$17,944,000 and the term loan in the amount of \$3,102,000. As of December 31, 2017, our debt to PNC in the amount of \$19,926,000 consisted of the revolving credit note due to PNC in the amount of \$16,455,000 and the term loan due to PNC in the amount of \$3,471,000.

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 formula. 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, 2018 the future minimum principal payments for the term loans are as follows:

| <u>For the twelve months ending</u> | Amount |
|-------------------------------------|-------------|
| March 31, 2019 | \$1,478,000 |
| March 31, 2020 | 1,478,000 |
| March 31, 2021 | 146,000 |
| March 31, 2022 | — |
| March 31, 2023 | — |
| Thereafter | — |
| | |
| PNC Term Loans payable | 3,102,000 |
| Less: Current portion | (3,102,000) |
| Long-term portion | \$— |

Interest expense related to these credit facilities amounted to approximately \$342,000 and \$720,000 for the three months ended March 31, 2018 and 2017, respectively.

Capital Leases Payable – Equipment

The Company is committed under several capital leases for manufacturing and computer equipment. All leases have bargain purchase options exercisable at the termination of each lease. Capital lease obligations totaled \$2,763,000 and \$3,073,000 as of March 31, 2018 and December 31, 2017, respectively, with various interest rates ranging from approximately 4% to 14%.

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As of March 31, 2018, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

| <u>For the twelve months ending</u> | Amount |
|-------------------------------------|-------------|
| March 31, 2019 | \$1,392,000 |
| March 31, 2020 | 1,193,000 |
| March 31, 2021 | 316,000 |
| March 31, 2022 | 36,000 |
| March 31, 2023 | 1,000 |
| Thereafter | — |
| Total future minimum lease payments | 2,938,000 |
| Less: imputed interest | (175,000) |
| Less: current portion | (1,274,000) |
| Total Long Term Portion | \$1,489,000 |

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Related Party Notes Payable

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

Taglich Brothers, Inc. has acted as placement agent for various debt and equity financing transactions and has received cash and equity compensation for their services. In addition, Michael and Robert Taglich have also invested in the Company through various debt and equity financings.

From November 23, 2016 through March 21, 2017, the Company received gross proceeds of \$1,950,000 from Robert and Michael Taglich, from the sale of an equal principal amount of our 8% Subordinated Convertible Notes (the “8% Notes”). See “Private Placements of 8% Subordinated Convertible Notes” below.

In November 2017, Michael Taglich and Robert Taglich purchased 144,927 shares and 72,463 shares, respectively, of common stock, together with warrants to purchase an additional 48,000 shares and 24,000 shares, respectively, of common stock, for a purchase price of \$200,000 and \$100,000, respectively, in a private placement of the Company’s equity securities completed in January 2018 from which the Company received gross proceeds of \$2,000,000. Taglich Brothers, Inc., which as placement agent for the sale of the shares and warrants, received a placement agent fee equal to \$160,000 (8% of the amounts invested), payable at the Company’s option, in cash or additional shares of common stock and warrants having the same terms and conditions as the shares and warrants issued in the offering. See Note 8 below.

On March 29, 2018 and April 4, 2018, Michael Taglich and Robert Taglich advanced \$1,000,000 and \$100,000, respectively, to the Company. The terms of such advances require approval of PNC. Subject to the consent of PNC and completion of documentation, the Company agreed with Michael and Robert Taglich that each of them will receive a promissory note with a principal amount equal to the amount advanced to the Company (a “Note”) bearing interest, payable monthly, at the rate of 1% per month, except that interest accrued prior to the sale of WMI may be paid in kind. The Note and all interest accrued will be payable on June 1, 2019. The Company will exercise reasonable efforts to cause the Notes to be secured by a lien on its assets and, in all events, repayment of the Notes will be subordinate to our obligations to PNC. In addition to his Note, each of Michael and Robert Taglich will receive a number of shares equal to the result obtained by dividing .3 times the amount advanced by the closing price of the Company’s common stock immediately prior to the documentation of this transaction. Taglich Brothers has acted as placement agent in connection with the investment of \$1,100,000 by Michael and Robert Taglich and may seek additional investors for up to \$150,000 on the terms set forth above. For such services they are to be paid a commission in the aggregate amount of 3% of the amount invested which may be paid in kind.

Related party advances and notes payable, net of debt discounts to Michael and Robert Taglich, and their affiliated entities, totaled \$3,158,000 and \$1,912,000, as of March 31, 2018 and December 31, 2017, respectively.

Private Placements of 8% Subordinated Convertible Notes

From November 23, 2016 through March 21, 2017, the Company received gross proceeds of \$4,775,000, of which \$1,950,000 were received from Robert and Michael Taglich, from the sale of an equal principal amount of our 8% Subordinated Convertible Notes (the "8% Notes"), together with warrants to purchase a total of 383,080 shares of our common stock, in private placement transactions with accredited investors (the "8% Note Offerings"). In connection with the offering of the 8% Notes, the Company issued 8% Notes in the aggregate principal amount of \$382,000 to Taglich Brothers, Inc., placement agent for the 8% Note Offerings, in lieu of payment of cash compensation for sales commissions, together with warrants to purchase a total of 180,977 shares of our common stock. Payment of the principal and accrued interest on the 8% Notes are junior and subordinate in right of payment to our indebtedness under the Loan Facility.

Interest on the 2018 Notes is payable on the outstanding principal amount thereof at the annual rate of 8%, payable quarterly commencing February 28, 2017, in cash, or at our option, in additional 2018 Notes, provided that if accrued interest payable on \$1,269,000 principal amount of the 2018 Notes issued in December 2016 is paid in additional 2018 Notes, interest for that quarterly interest payment shall be calculated at the rate of 12% per annum. Upon the occurrence and continuation of an event of default, interest shall accrue at the rate of 12% per annum.

During the three months ended March 31, 2018, we issued \$97,920 principal amount of 8% Notes in lieu of cash payment of accrued interest. As of March 31, 2018, we had outstanding \$5,254,000 principal amount of 8% Notes, of which \$2,847,000 principal amount is due on November 30, 2018 and \$2,407,000 principal amount is due on February 28, 2019.

The outstanding principal amount plus accrued interest on the 8% Notes is convertible at the option of the holder into shares of common stock conversion prices ranging from \$2.25 to \$4.45 per share, subject to certain anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as mergers and other business combinations.

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An event of default under the 8% Notes will occur (i) if the Company fails to make any payment under the 8% Notes within ten days after the date first due, or (ii) if the Company files a petition in bankruptcy or under any similar insolvency law, makes an assignment for the benefit of its creditors, or if any voluntary petition in bankruptcy or under any similar insolvency law is filed against the Company and such petition is not dismissed within sixty (60) days after the filing thereof. Upon the occurrence and continuation of an event of default, holders of a majority of the outstanding principal amount of the 8% Notes then outstanding, upon notice to the Company and the holders of the Senior Indebtedness (as defined in the 8% Notes), may demand immediate payment of the unpaid principal amount of the 8% Notes, together with accrued interest thereon and all other amounts payable under the 8% Notes, subject to the subordination provisions of the 8% Notes.

The exercise price of the warrants issued in connection with the 8% Note Offerings ranges from \$3.00 to \$4.53 per share, subject to certain anti-dilution and other adjustments, including stock splits, distributions in respect of the common stock and in the event of certain fundamental transactions such as mergers and other business combinations, and may be exercised on a cashless basis for a lesser number of shares depending upon prevailing market prices at the time of exercise. Of these warrants, 320,702 warrants may be exercised until November 30, 2021 and 243,307 warrants may be exercised until January 31, 2022.

Note 8. STOCKHOLDERS' EQUITY

Common Stock -- Sale of Unregistered Equity Securities

On November 29, 2017, Air Industries Group (the "Company") entered into a Placement Agency Agreement with Taglich Brothers, Inc. as placement agent (the "Placement Agent"), pursuant to which the Placement Agent agreed to offer on behalf of the Company, on a best efforts basis, up to 1,600,000 shares of the Company's common stock (the "Shares") to accredited investors (the "Offering"), together with five-year warrants to purchase 24,000 shares of common stock (the "Warrants") for each \$100,000 of shares purchased, in a private placement exempt from the registration requirements of the Securities Act.

On January 9, 2018 the Company issued and sold to 35 accredited investors an aggregate of 852,000 Shares and Warrants to purchase an additional 255,600 shares of common stock, for gross proceeds of \$1,065,000 pursuant to the Offering. The purchase price for the Shares and Warrants was \$1.25 per Share. The Company had previously sold a total of 725,390 Shares and Warrants to purchase an additional 224,400 shares of common stock for gross proceeds of \$935,000 on November 29, 2017, December 5, 2017 and December 29, 2017 pursuant to the Offering.

The Warrants have an exercise price of \$1.50 per share, subject to certain anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as mergers and other business combinations, and may be exercised on a cashless basis for a lesser number of shares depending upon prevailing market prices at the time of exercise. The Warrants may be exercised until November 30, 2022.

In connection with the Offering, Taglich Brothers, Inc., a related party, which acted as placement agent for the sale of the Shares and Warrants, is entitled to a placement agent fee equal to \$104,000 (8% of the amounts invested), payable at the Company's option, in cash or additional shares of common stock and warrants having the same terms and conditions as the Shares and Warrants. Michael Taglich and Robert Taglich, directors of the Company, are principals of Taglich Brothers, Inc. The placement agent fee was \$85,200 and \$0 for the three months ended March 31, 2018 and 2017, respectively.

If prior to July 1, 2018, the Company should complete a placement of shares of its common stock or securities convertible into or exercisable for shares of its common stock at an effective price or conversion rate (the "Subsequent Price") less than \$1.25 per share of common stock, there shall be issued to the purchasers in the Offering, such additional number of shares of common stock as would have been received had the Purchase Price thereunder been equal to the greater of the Subsequent Price and \$1.00 per share, provided further that no adjustment shall be made for those subscribers who are officers, directors or otherwise deemed to be affiliates of the Company under the rules of the NYSE American. If the Company shall complete more than one placements of shares of its common stock or securities convertible into or exercisable for shares of its common stock prior to July 1, 2018, the Subsequent Price will be the lowest of the prices at which such offerings are completed.

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The Offering commenced November 29, 2017 and was completed in four closings for gross proceeds of \$2,000,000 as follows:

| Date | Total Investment | Shares | | Warrants | |
|----------------|------------------|-------------|--------|---------------|----------|
| | | # of shares | Price | # of warrants | Ex Price |
| 11/29/2017 | \$300,000 | 217,390 | \$1.38 | 72,000 | \$1.50 |
| 12/5/2017 | 400,000 | 320,000 | \$1.25 | 96,000 | \$1.50 |
| 12/29/2017 | 235,000 | 188,000 | \$1.25 | 56,400 | \$1.50 |
| Subtotal- 2017 | 935,000 | 725,390 | | 224,400 | |
| 1/9/2018 | 1,065,000 | 852,000 | \$1.25 | 255,600 | \$1.50 |
| Total Offering | \$2,000,000 | 1,577,390 | | 480,000 | |

During the three months ended March 31, 2018, the Company issued 123,456 shares of common stock in lieu of cash payment for various services provided to the Company.

Note 9. COMMITMENTS AND CONTINGENCIES**Loss Contingencies**

During 2016, a number of actions were commenced against the Company by vendors, landlords and former landlords, including a third party claim as a result of an injury suffered on a portion of a leased property not occupied by the Company. As certain of these claims represent amounts included in accounts payable they are not specifically discussed herein.

Westbury Park Associates, LLC commenced an action on or about January 11, 2017 against Air Industries Group in the NYS Supreme Court, County of Suffolk, seeking the recovery of approximately \$31,000 for past rent arrears, and for an unidentified sum representing all additional rent due under an alleged commercial lease through the end of its term, plus attorney's fees. The Company believes that it has a meritorious defense, and there was no lease on the property and that its subsidiary Compac Development Corp was a hold-over tenant occupying the space on month-to-month tenancy.

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An employee of the Company commenced an action against, among others, Rechler Equity B-2, LLC and Air Industries Group, in the Supreme Court State of New York, Suffolk County, seeking compensation in an undetermined amount for injuries suffered while leaving the premises occupied by Welding Metallurgy, Inc. Rechler Equity B-2, LLC, has served a Third Party Complaint in this action against Air Industries Group, Inc. and Welding Metallurgy, Inc. The action remains in the early pleading stage. The Company believes it is not liable to the employee and any amount it might have to pay would be covered by insurance.

An employee of the Company commenced an action against, among others, Sterling Engineering and Air Industries Group, in Connecticut Commission on Human Rights and Opportunities, seeking lost wages in an undetermined amount for the employee's termination. The action remains in the early pleading stage. The Company believes it is not liable to the employee and any amount it might have to pay would be covered by insurance.

Table of Contents**Note 10. INCOME TAXES**

The Tax Cuts and Jobs Act (the "Tax Act") was enacted on December 22, 2017, and permanently reduces the U.S. federal corporate rate from 35% to 21%, effective January 1, 2018.

SAB No. 118 allows a company to record a provisional amount when it does not have the necessary information available, prepared, or analyzed in reasonable detail to complete its accounting for the change in the tax law during the measurement period. As of March 31, 2018, the Company has not completed its accounting for the tax effects of the enactment of the Tax Act; however, the Company has made a reasonable estimate of the effects on its existing deferred tax balances. The Company is still analyzing the Tax Act and refining its calculations, which could potentially impact the measurement of its tax balances. The Company expects to complete its analysis within the measurement period.

The Company recorded no Federal income tax benefit for the three months ended March 31, 2018. A tax benefit of approximately \$407,000 would have been recorded for the three months ended March 31, 2018, had there not been a full valuation allowance recorded against incremental deferred tax assets created during the period. In determining the estimated annual effective income tax rate, the Company analyzes various factors, including projections of our annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, their ability to use tax credits and net operating loss carry forwards, and available tax planning alternatives. As of March 31, 2018 and December 31, 2017, the Company provided a valuation allowance against its net deferred tax assets since the Company believes it is more likely than not that its deferred tax assets will not be realized.

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

| | 2018 (unaudited) | 2017 (unaudited) |
|---|---------------------|---------------------|
| Current | | |
| Federal | \$— | \$— |
| State | 2,000 | — |
| Prior Year Under accrual | | |
| Federal | — | — |
| State | — | — |
| Total Current Expense | 2,000 | — |
| Deferred Tax Benefit | — | — |
| Valuation Allowance | — | — |
| Net Provision for (Benefit from) Income Taxes | \$2,000 | \$— |

Table of Contents**Note 11. SEGMENT REPORTING**

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

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

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

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

Given the pending sale of WMI, in the future, the Company may change its reportable operating segments.

Financial information about the Company's reporting segments for the three months ended March 31, 2018 and 2017 are as follows:

| | Three Months Ended March | |
|--------------------------|--------------------------|--------------|
| | 31, | |
| | 2018 | 2017 |
| COMPLEX MACHINING | | |
| Net Sales | \$ 10,627,000 | \$ 9,891,000 |

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| | | |
|----------------|------------|------------|
| Gross Profit | 2,023,000 | 2,900,000 |
| Pre Tax Income | 116,000 | 1,085,000 |
| Assets | 45,014,000 | 41,940,000 |

AEROSTRUCTURES & ELECTRONICS

| | | |
|--------------|------------|------------|
| Net Sales | 333,000 | 841,000 |
| Gross Profit | 28,000 | 36,000 |
| Pre Tax Loss | (472,000) | (579,000) |
| Assets | 930,000 | 4,260,000 |

TURBINE ENGINE COMPONENTS

| | | |
|--------------|------------|------------|
| Net Sales | 1,282,000 | 1,942,000 |
| Gross Loss | (48,000) | (224,000) |
| Pre Tax Loss | (457,000) | (827,000) |
| Assets | 6,009,000 | 11,233,000 |

CORPORATE

| | | |
|--------------|------------|------------|
| Net Sales | — | — |
| Gross Profit | — | — |
| Pre Tax Loss | (561,000) | (133,000) |
| Assets | 241,000 | 785,000 |

CONSOLIDATED

| | | |
|-----------------------------------|--------------|--------------|
| Net Sales | 12,242,000 | 12,674,000 |
| Gross Profit | 2,003,000 | 2,712,000 |
| Pre Tax Loss | (1,374,000) | (454,000) |
| Provision for Income Taxes | 2,000 | — |
| Loss from Discontinued Operations | (92,000) | (700,000) |
| Assets Held for Sale | 10,412,000 | 15,409,000 |
| Net Loss | (1,468,000) | (1,154,000) |
| Assets | \$62,606,000 | \$73,627,000 |

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

The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements and notes to those statements included elsewhere in the is 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, 2017 (the "2017 Form 10-K"). This discussion contains forward-looking statements that involve risks and uncertainties. You should specifically consider the various risk factors identified in this report that could cause actual results to differ materially from those anticipated in these forward-looking statements.

Business Overview

We are an aerospace company operating primarily in the defense industry, though the proportion of our business represented by the commercial 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. 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 commercial aerospace businesses which have enabled us to broaden the range of products and services beyond those which were provided by AIM.

In response to recent operating losses and lack of adequate working capital, we have and continue to reposition our business including:

- 1) In January 2017 we sold AMK Welding, Inc., for \$4.5 million, net of a working capital adjustment of (\$163,000) plus additional payments based on net revenue not to exceed \$1.5 million.

- 2) In November 2017 we hired a new CEO, Lou Melluzzo, and increased our focus on reducing costs and achieving profitability.

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On March 21, 2018, we entered into an SPA for the sale of WMI and related operations for a purchase price of \$9,000,000, subject to a working capital adjustment. The SPA also provides for contingent payments of up to an aggregate of \$1,000,000 if WMI enters into specified agreements by May 31, 2018 and July 31, 2018, respectively 3)(the “Specified Dates”), which contingent payments are subject to reduction by \$100,000 for each calendar month after the Specified Dates which passes before WMI enters into the specified agreements. It is anticipated that the sale will occur in May or June of 2018. Once the sale of WMI is complete, we will be more focused on the production of complex, machined products for aircraft landing gear and jet engines.

During the three months ended March 31, 2018, we issued and sold to 35 accredited investors an aggregate of 852,000 shares of its common stock and warrants to purchase an additional 255,600 shares of common stock, for 4)gross proceeds of \$1,065,000 pursuant to a private placement offering. In addition, we borrowed an aggregate of \$1,100,000 from Michael Taglich and Robert Taglich, directors of the Company and principals of Taglich Brothers, Inc. who assisted us with the private placement offering.

In addition to repositioning our business to obtain profitability and positive cash flow, we remain resolute on meeting customers’ needs and have and continue to align production schedules to meet the needs of customers in our Complex Machining and Turbine Engine segments. We believe that an unyielding focus on our customers will allow us to execute on our existing backlog in a timely fashion and take on additional commitments. We are pleased with our progress and the positive responses received from our customers. As we focused on and devoted our finances to our customers in our Complex Machining and Turbine Engine segments, we inadvertently failed to timely perform under various contracts undertaken by our Eur-Pac subsidiary. As a result, we recently received a Notice of Proposed Debarment which, if granted, would prevent Eur-Pac from bidding on Federal Government contracts. We have a period of time in which to contest the proposed debarment and will likely do so unless we determine that it would be more in our interests to devote our funds to our larger business segments.

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

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

While our revenues are largely determined by the number of contracts we are awarded, the volume of product delivered and price of product under each contract, our costs are determined by a number of factors. The principal factors impacting our costs are the cost of materials and supplies, labor, financing and the efficiency at which we can produce our products. The cost of materials used in the aerospace industry is highly volatile. In addition, the market for the skilled labor we require to operate our plants is highly competitive. The profit margin of the various products we sell varies based upon a number of factors, including the complexity of the product, the intensity of the competition for such product and, in some cases, the ability to deliver replacement parts on short notice. Thus, in assessing our performance from one period to another, a reader must understand that changes in profit margin can be the result of shifts in the mix of products sold. Many of our operations have a large percentage of fixed factory overhead. As a result our profit margins are also highly variable with sales volumes as under-absorption of factory overhead can decrease profits.

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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. ASC 280 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. In light of the pending sale of WMI and our focus on complex, machined parts to achieve profitability and growth, in the future we may change our reportable operating segments.

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-CONTINUING OPERATIONS

In March 2018, we announced our intention to divest WMI and related operations. These operations are part of our Aerostructures & Electronics operating segment. Once the sale is completed, our Company will be more focused on complex, machined products for aircraft landing gear and jet turbine applications. Although WMI and the related operations have been classified as a discontinued operation, we will continue to operate these businesses until the sale is closed which is anticipated to occur in May or June 2018. We anticipate that from January 2018 through the closing date, these operations will generate a net loss. For purposes of the following discussion of our selected financial information and operating results, we have presented our financial information based on our continuing operations unless otherwise noted.

Selected Financial Information:

| | <u>For the Three Months</u> | |
|---|-----------------------------|--------------|
| | <u>Ended March 31,</u> | |
| | 2018 | 2017 |
| | (unaudited) | (unaudited) |
| Net sales | \$12,242,000 | \$12,674,000 |
| Cost of sales | 10,239,000 | 9,962,000 |
| Gross profit | 2,003,000 | 2,712,000 |
| Operating expenses and interest and financing costs | 3,393,000 | 3,434,000 |
| Other income (expense) net | 16,000 | (183,000) |
| Provision for income taxes | 2,000 | - |
| Net loss from continuing operations | \$(1,376,000) | \$(454,000) |

Balance Sheet Data:

| | March 31, 2018 | December 31, 2017 |
|----------------------------|-------------------|-------------------------|
| | (unaudited) | |
| Cash and cash equivalents | \$1,415,000 | \$630,000 |
| Working capital | 9,437,000 | 9,531,000 |
| Total assets | 62,606,000 | 60,755,000 |
| Total stockholders' equity | \$17,559,000 | \$17,766,000 |

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

| | <u>For the Three Months</u> | |
|---|-----------------------------|---------------|
| | <u>Ended March 31,</u> | |
| | 2018 | 2017 |
| | (unaudited) | (unaudited) |
| COMPLEX MACHINING | | |
| Net Sales | \$ 10,627,000 | \$ 9,891,000 |
| Gross Profit | 2,023,000 | 2,900,000 |
| Pre Tax Loss | 116,000 | 1,085,000 |
| Assets | 45,014,000 | 41,940,000 |
| AEROSTRUCTURES & ELECTRONICS | | |
| Net Sales | 333,000 | 841,000 |
| Gross Profit | 28,000 | 36,000 |
| Pre Tax Loss | (472,000) | (579,000) |
| Assets | 930,000 | 4,260,000 |
| TURBINE ENGINE COMPONENTS | | |
| Net Sales | 1,282,000 | 1,942,000 |
| Gross Profit | (48,000) | (224,000) |
| Pre Tax Loss | (457,000) | (827,000) |
| Assets | 6,009,000 | 11,233,000 |
| CORPORATE | | |
| Net Sales | — | — |
| Gross Profit | — | — |
| Pre Tax Loss | (561,000) | (133,000) |
| Assets | 241,000 | 785,000 |
| CONSOLIDATED | | |
| Net Sales | 12,242,000 | 12,674,000 |
| Gross Profit | 2,003,000 | 2,712,000 |
| Pre Tax Loss | (1,374,000) | (454,000) |
| Provision for Income Taxes | 2,000 | — |
| Loss from Discontinued Operations | (92,000) | (700,000) |
| Assets Held for Sale | 10,412,000 | 15,409,000 |
| Net Loss | (1,468,000) | (1,154,000) |
| Assets | \$ 62,606,000 | \$ 73,627,000 |

Net Sales:

Consolidated net sales for the three months ended March 31, 2018 were \$12,242,000, a decrease of \$432,000, or 3.4%, compared with \$12,674,000 for the three months ended March 31, 2017. Net sales of our Complex Machining segment were \$10,627,000, an increase of \$736,000, or 7.4%, from \$9,891,000 in the prior year. Net sales of our Aerostructures & Electronics segment were \$333,000, a decrease of \$508,000, or 60.4%, from \$841,000 in the prior year. This decrease can be attributed to decreased volume at EUR-PAC. Net sales in our Turbine Engine Components segment were \$1,282,000, a decrease of \$660,000, compared with \$1,942,000 for the three months ended March 31, 2017. This decrease was primarily due to the sale of AMK in January 2017, which had sales of \$417,000 in 2017. Excluding the results of AMK in both periods, comparative consolidated net sales would have been similar.

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As indicated in the table below, three customers represented 73.1% and three customers represented 60.3% of total sales for the three months ended March 31, 2018 and March 31, 2017, respectively.

| Customer | Percentage of Sales | | |
|-------------------------------------|---------------------|-------------|---|
| | 2018 | 2017 | |
| | (unaudited) | (unaudited) | |
| Goodrich Landing Gear Systems | 34.5% | 18.9% | % |
| Sikorsky Aircraft | 28.6% | 21.5% | % |
| Rohr Inc. | 10.0% | * | |
| United States Department of Defense | ** | 19.9% | % |

* Customer was less than 10% of sales at March 31, 2017.

** Customer was less than 10% of sales at March 31, 2018.

Gross Profit:

Consolidated gross profit from operations for the three months ended March 31, 2018 was \$2,003,000, a decrease of \$709,000, or 26.1%, as compared to gross profit of \$2,712,000 for the three months ended March 31, 2017.

Consolidated gross profit as a percentage of sales was 16.4% and 21.4% for the three months ended March 31, 2018 and 2017, respectively. Our gross profit percentage during the three months ended was most notably impacted by lower gross margins in our Complex Machine segment due to different product mix. We believe in future periods, we can improve our gross margins as compared to our most recent period.

Interest and Financing Costs

Interest and financing costs for the three months ended March 31, 2018 were \$777,000 a decrease of \$116,000 or 13.0% compared to \$893,000 for the three months ended March 31, 2017.

Operating Expense

Consolidated operating expenses for the three months ended March 31, 2018 totaled \$2,616,000 and increased by \$75,000 or 3.0% compared to \$2,541,000 for the three months ended March 31, 2017. The increase in operating expenses is primarily due to professional and insurance expenses.

Net Loss

Net loss for the three months ended March 31, 2018 was \$1,468,000, a loss increase of \$314,000, compared to a net loss \$1,154,000 for the three months ended March 31, 2017, for the reasons discussed above. Our net loss in 2018 and 2017 includes a net loss from the discontinued operations of WMI and related operations of \$92,000 and \$700,000, respectively. Excluding such amounts, our net loss in 2018 would have been \$1,376,000 and in 2017 would have been \$454,000.

LIQUIDITY AND CAPITAL RESOURCES

We are highly leveraged and rely upon our ability to continue to borrow under our Loan Facility with PNC or to raise debt and equity from our principal stockholders and third parties to support operations and acquisitions. Substantially all of our assets are pledged as collateral under our Loan Facility. The Loan Facility, which was to have expired on April 30, 2018, has been extended until May 31, 2018, and we are in negotiations with PNC for a further extension which we expect will include certain modifications to the terms of the Loan Facility.

We are required to maintain a lockbox account with PNC, into which substantially all of our cash receipts are paid. If PNC were to cease providing revolving loans to us under the Loan Facility, we would lack funds to continue our operations. Over the past eighteen months we have also relied upon our ability to borrow money from certain stockholders and raise debt and equity capital to support our operations. Should we continue to need to borrow funds from our principal stockholders or raise debt or equity, there is no assurance that we will be able to do so or that the terms on which we borrow funds or raise equity will be favorable to us or our existing shareholders.

The Loan Facility has been amended many times during its term, most recently in January 2017 (the "Fourteenth Amendment") and June 2017 (the "Fifteenth Amendment").

The Loan Facility provides for a \$33,000,000 revolving loan and a term loan with the initial principal amount of \$7,387,854.

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Under the terms of the Loan Facility, as amended, the revolving loan bears 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 four and one-half of one percent (4.50%) with respect to LIBOR Rate Loans. The advance rate with respect to our inventory is an amount equal to the lesser of (i) 75% of the eligible inventory, an increase from 50%, and (ii) 90% of the liquidation value of the eligible inventory, subject to the inventory sublimit of \$12,500,000 and such reserves as PNC may deem proper.

The amount outstanding under the revolving loan was \$17,944,000 and \$16,455,000, as of March 31, 2018 and December 31, 2017, respectively.

The repayment terms of the Term Loan provide for monthly principal installments in the amount of \$123,133 payable on the first business day of each month, with a final payment of any unpaid balance of principal and interest payable on the last business day of June, 2021.

The terms of the Loan Facility require that, among other things, we maintain a specified Fixed Charge Coverage Ratio and maintain a minimum EBITDA (as defined in the Loan Facility) for specified periods. In addition, we are limited in the amount of Capital Expenditures we can make. We are also limited to the amount of dividends we can pay our shareholders as defined in the Loan Facility.

In connection with the sale of AMK to Meyer Tool, Inc., on January 27, 2017 we, together with our wholly-owned subsidiaries, entered into the Fourteenth Amendment to the Loan Facility which amended certain terms and conditions of the Loan Facility and released AMK from its obligations under the Loan Facility.

The proceeds of the sale of AMK, net of a working adjustment in the amount of (\$163,000), were applied as follows: \$1,700,000 to the payment of the Term Loan, \$1,800,000 to the payment of outstanding revolving loans, and \$500,000 to the payment of existing accounts payable. The remaining \$500,000 will be applied to outstanding accounts payable on a future date to be determined by PNC or used to reduce the revolving loans. The Fourteenth Amendment to the Loan Facility required that we maintain a Fixed Charge Coverage Ratio of not less than 1.25 to 1.00, tested quarterly on a consolidated rolling twelve (12) month basis however, for the quarter ending June 30, 2017, which was to be tested based upon the prior six (6) months, we were required to maintain a Fixed Charge Coverage Ratio of not less than 1.00 to 1.00 and for the quarter ending September 30, 2017, which was to be tested based upon the prior nine (9) months, we were required to maintain a Fixed Charge Coverage Ratio of not less than 1.10 to 1.00. The amendment also reduced the amount to be paid weekly in repayment of excess advances under the revolving credit facility from \$100,000 to \$50,000 for each Monday during the months of January, February and March of 2017. Thereafter, the weekly payments were to return to \$100,000 until such excess advances were repaid in full.

On June 19, 2017, we entered into the Fifteenth Amendment to the Loan Facility, which waived the failure to comply with the minimum EBITDA covenant for the periods ended December 31, 2016 and March 31, 2017 and the Capital Expenditures covenant for the period ended December 31, 2016. The amendment also requires that we maintain at all times a Fixed Charge Coverage Ratio, tested quarterly on a consolidated basis beginning September 30, 2017, as follows: (i) 1.00 to 1.00 for the quarter ending September 30, 2017, tested based upon the prior three (3) months, (ii) 1.05 to 1.00 for the quarter ending December 31, 2017, tested based upon the prior six (6) months and (iii) 1.05 to 1.00 for the quarter ending March 31, 2018, tested based upon the prior nine (9) months and that we maintain EBITDA of not less than \$345,000 for the period ending June 30, 2017. The amendment also provided that we were not required to maintain a Fixed Charge Coverage Ratio and that no testing was required to the Fixed Charge Coverage Ratio for the periods ending December 31, 2016 and March 31, 2017 and that we were not required to maintain a Fixed Charge Coverage Ratio and no testing was required of the Fixed Charge Coverage Ratio for the period ending June 30, 2017. In addition, the amendment reduces the weekly payments we are required to make to reduce our \$2,244,071 over-advance under the revolving credit facility as of June 19, 2017 from \$100,000 to \$25,000 per week during the period commencing May 22, 2017 through and including July 10, 2017. At December 31, 2017, the over-advance had been paid in full. We paid \$50,000 to PNC in connection with the amendment and reimbursed PNC's counsel fees.

As of March 31, 2018 and December 31, 2017, we were not in compliance with our Fixed Charge Coverage Ratio covenant. The failure to satisfy the foregoing covenants would constitute a default under the Loan Facility and PNC at its option could give us notice that all amounts under the Loan Facility are immediately due and payable, and accordingly all amounts due under the loan facility have been classified as current, as of March 31, 2018 and December 31, 2017.

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As of March 21, 2018, our outstanding indebtedness to PNC was \$21,046,000 and consisted of revolving loans in the amount of \$17,944,000 and the term loan of \$3,102,000, as compared to December 31, 2017, when our debt to PNC was \$19,926,000 and consisted of revolving loans of \$16,455,000 and the term loan of \$3,471,000. In addition, as of March 31, 2018 we had capitalized lease obligations to third parties of \$2,763,000, as compared to capitalized lease obligations to third parties of \$3,073,000 as of December 31, 2017.

Significant Transactions Since January 1, 2018 Which Have Impacted Our Liquidity

Dispositions

On March 21, 2018, we entered into a Stock Purchase Agreement (“SPA”) for the sale of WMI and related operations, for a purchase price of \$9,000,000, subject to a working capital adjustment. The SPA also provides for contingent payments of up to an aggregate of \$1,000,000 if WMI enters into specified agreements by May 31, 2018 and July 31, 2018, respectively (the “Specified Dates”), which contingent payments are subject to reduction by \$100,000 for each calendar month after the Specified Dates which passes before WMI enters into the specified agreements. The sale is subject to certain conditions, including the buyer obtaining financing for the amount of the purchase price, and requires an escrow deposit of \$2,000,000 to cover the working capital adjustment and our obligation to indemnify the buyer against damages arising out of the breach of our representations and warranties and obligations under the SPA. It is anticipated that the sale will occur in May or June of 2018.

Private Placements of 8% Subordinated Convertible Notes

From November 23, 2016 through March 21, 2017, we received gross proceeds of \$4,775,000 from the sale of our 8% Notes, together with warrants to purchase a total of 383,080 shares of our common stock, in private placement transactions with accredited investors (the “8% Note Offerings”). In connection with the 8% Notes offerings, we issued 8% Notes in the aggregate principal amount of \$382,000 to Taglich Brothers, placement agent for the 8% Note Offerings, in lieu of payment of cash compensation for sales commissions, together with warrants to purchase a total of 180,977 shares of our common stock. Payment of the principal and accrued interest on the 8% Notes are junior and subordinate in right of payment to our indebtedness under the Loan Facility.

Interest on the outstanding principal of the 8% Notes is payable quarterly at the annual rate of 8%, in cash, or if we are prohibited by applicable law or PNC, our principal lender under our Loan Facility, from paying interest in cash, or we otherwise elect to do so, we may pay accrued interest, in additional 8% Notes (“PIK Notes”), provided that if accrued interest with respect to the 8% Notes is paid in additional 8% Notes, interest for that quarterly interest payment will be calculated at the rate of 12% per annum. Upon the occurrence and continuation of an event of default, interest shall

accrue at the rate of 12% per annum.

During the three months ended March 31, 2018, we issued \$97,920 principal amount of 8% Notes in lieu of cash payment of accrued interest. As of March 31, 2018, we had outstanding \$5,254,000 principal amount of 8% Notes, of which \$2,847,000 principal amount is due on November 30, 2018 and \$2,407,000 principal amount is due on February 28, 2019.

The outstanding principal amount plus accrued interest on the 8% Notes is convertible at the option of the holder into shares of common stock at conversion prices ranging from \$2.25 to \$4.00 per share, subject to certain anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as mergers and other business combinations.

The exercise price of the warrants issued in connection with the 8% Note Offerings ranges from \$3.00 to \$4.45 per share, subject to certain anti-dilution and other adjustments, including stock splits, distributions in respect of the common stock and in the event of certain fundamental transactions such as mergers and other business combinations, and may be exercised on a cashless basis for a lesser number of shares depending upon prevailing market prices at the time of exercise. Of these warrants, 320,702 warrants may be exercised until November 30, 2021 and 243,307 warrants may be exercised until January 31, 2022.

Loans from Principal Stockholders

On March 29, 2018 and April 4, 2018, Michael Taglich and Robert Taglich advanced \$1,000,000 and \$100,000, respectively, to the Company. The terms of such advances require approval of PNC. Subject to the consent of PNC and completion of documentation, we agreed with Michael and Robert Taglich that each of them will receive a promissory note with a principal amount equal to the amount advanced to us (a "Note") bearing interest, payable monthly, at the rate of 1% per month, except that interest accrued prior to the sale of WMI may be paid in kind. The Note and all interest accrued will be payable on June 1, 2019. We will exercise reasonable efforts to cause the Notes to be secured by a lien on our assets and, in all events, repayment of the Notes will be subordinate to our obligations to PNC. In addition to his Note, each of Michael and Robert Taglich will receive a number of shares equal to the result obtained by dividing .3 times the amount advanced by the closing price of our common stock immediately prior to the documentation of this transaction.

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Taglich Brothers has acted as placement agent in connection with the investment of \$1,100,000 by Michael and Robert Taglich and may seek additional investors for up to \$150,000 on the terms set forth above. For such services they are to be paid a commission in the aggregate amount of 3% of the amount invested which may be paid in kind.

Related party notes payable to Michael and Robert Taglich, and their affiliated entities, totaled \$3,158,000 and \$1,912,000, as of March 31, 2018 and December 31, 2017, respectively.

Equity Private Placement

On November 29, 2017, December 5, 2017, December 29, 2017 and January 9, 2018, we issued and sold to 44 accredited investors, including Michael Taglich and Robert Taglich, an aggregate of 1,577,390 shares of common stock and warrants to purchase an additional 480,000 shares of common stock, for gross proceeds of \$2,000,000, in a private placement exempt from the registration requirements of the Securities Act. Michael Taglich and Robert Taglich purchased 144,927 shares and 72,463 shares, respectively, together with warrants to purchase an additional 48,000 shares and 24,000 shares, respectively, of common stock, for a purchase price of \$200,000 and \$100,000, respectively. The purchase price for the shares and warrants was \$1.25 per share, except that the purchase price paid by Michael Taglich and Robert Taglich was \$1.38 per share, the closing price of a share of common stock immediately prior to the purchase. The warrants have an exercise price of \$1.50 per share, subject to certain anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as mergers and other business combinations, and may be exercised on a cashless basis for a lesser number of shares depending upon prevailing market prices at the time of exercise. The warrants may be exercised until November 30, 2022.

If prior to July 1, 2018, we complete a placement of shares of our common stock or securities convertible into or exercisable for shares of our common stock at an effective price or conversion rate (the "Subsequent Price") less than \$1.25 per share of common stock, we have agreed to issue to the purchasers of the shares and warrants (other than Michael Taglich and Robert Taglich), such additional number of shares of common stock as would have been received had the purchase price been equal to the greater of the Subsequent Price and \$1.00 per share. If we complete more than one placement of shares of common stock or securities convertible into or exercisable for shares of common stock prior to July 1, 2018, the Subsequent Price will be the lowest of the prices at which such offerings are completed.

Taglich Brothers, Inc., of which Michael Taglich and Robert Taglich are principals, acted as placement agent for the sale of the shares and warrants received a placement agent fee equal to \$160,000 (8% of the amounts invested), payable at the Company's option, in cash or additional shares of common stock and warrants having the same terms and conditions as the shares and warrants issued in the offering.

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, | |
| | 2018 | 2017 |
| | (unaudited) | (unaudited) |
| Cash provided by (used in) | | |
| Operating activities | \$(1,782,000) | 900,000 |
| Investing activities | (308,000) | 3,926,000 |
| Financing activities | 2,875,000 | (5,087,000) |
| Net increase (decrease) in cash and cash equivalents | \$785,000 | (261,000) |

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Cash Provided By (Used in) Operating Activities

Cash used in operating activities primarily consists of our net loss adjusted for certain non-cash items and changes to working capital items.

For the three months ended March 31, 2018, net cash was impacted by a net loss of \$1,468,000, offset by \$1,592,000 of non-cash items consisting of depreciation of property and equipment of \$722,000, amortization of convertible notes payable of \$275,000, amortization of capitalized engineering costs of \$145,000, compensation expense of \$83,000 and other non-cash items totaling \$367,000.

Operating assets and liabilities further used cash in the net amount of \$1,906,000 consisting primarily of the net increases in accounts receivable, inventory and deposits and other assets in the amounts of \$1,025,000, \$733,000 and \$227,000 respectively, partially offset by decreases in accounts payable and accrued expenses in the amount \$97,000 and an increase in deferred revenue and rent in the amount of \$176,000.

Cash Provided By (Used in) Investing Activities

For the three months ended March 31, 2018, cash used in investing activities was \$308,000. This was comprised of \$164,000 for capitalized engineering costs and \$144,000 for the purchase of property and equipment.

Cash provided by investing activities for the three months ended March 31, 2017 consists of the cash received from the sale of one of our businesses in the amount of \$4,260,000, reduced by capitalized engineering costs and by capital expenditures for property and equipment in the amounts of \$245,000 and \$89,000, respectively. 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, 2017.

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 the proceeds from the sale of our equity.

For the three months ended March 31, 2018, cash provided by financing activities was \$2,875,000. This was comprised of proceeds from the issuance of common stock of \$1,065,000, note payable of \$1,000,000, and by proceeds from our revolving loans in the amount of \$1,489,000, partially offset by repayments of \$369,000 on our term loan and \$310,000 on our capital lease obligations,

Going Concern

The Company suffered losses from operations of \$613,000 and \$12,758,000 and net losses of \$1,468,000 and \$22,551,000 for the three months ended March 31, 2018 and the year ended December 31, 2017. The Company also had negative cash flows from operations for the three months ended March 31, 2018 and the years ended December 31, 2017 and 2016. In 2015, the Company ceased paying dividends on its common stock and in 2016 disposed of the real estate on which an operating subsidiary was located through a sale leaseback transaction. Since January 1, 2016, the Company has sold in excess of \$31,000,000 in debt and equity securities to fund its operations. In January 2017, the Company sold one of its operating subsidiaries, AMK Welding Inc. On March 21, 2018, the Company entered into a Stock Purchase Agreement to sell a majority of its Aerostructures & Electronics segment. Furthermore, as of March 31, 2018 and December 31, 2017, the Company was not in compliance with financial covenants under its Amended and Restated Revolving Credit, Term Loan and Security Agreement with PNC Bank.

The continuation of the Company's business is dependent upon its ability to achieve profitability and positive cash flow and, pending such achievement, future issuances of equity or other financing to fund ongoing operations.

OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of March 31, 2018.

Critical Accounting Policies

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

Inventory Valuation

The Company does not take physical inventories at interim quarterly reporting periods. The majority of the inventory been estimated using a gross profit percentage based on sales of previous periods to the net sales of the current period, as management believes that the gross profit percentage on these items are materially consistent from period to period.

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The remainder of the inventory value is estimated based on the Company's standard cost perpetual inventory system, as management believes the perpetual system computed value for these items provides a better estimate of value for that inventory.

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.

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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. As of December 31, 2017, the intangible assets have been fully amortized and there has been no impairment.

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Recently Issued Accounting Pronouncements

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. ASU 2014-09 supersedes existing revenue recognition guidance, including ASC 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts, and outlines a single set of comprehensive principles for recognizing revenue under U.S. GAAP. Among other things, it requires companies to identify contractual performance obligations and determine whether revenue should be recognized at a point in time or over time. On July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017. We intend to adopt the New Revenue Standard effective January 1, 2018.

The new guidance allows for two transition methods in application - (i) retrospective to each prior reporting period presented, or (ii) prospective with the cumulative effect of adoption recognized on January 1, 2018 (also known as the modified retrospective approach). The Company is still assessing which transition method to adopt. This guidance requires additional disclosures of the amount by which each financial statement line item affected in the current reporting period during 2019 as compared to the guidance that was in effect before the change, and an explanation of the reasons for the significant changes.

The Company currently recognizes the majority of its revenues based on shipment of products (at a point in time). Currently, some contracts the Company enters into with customers are accounted for on a percentage of completion basis. For contracts with a significant amount of development and/or requiring the delivery of a minimal number of units, revenue and profit are recognized using the percentage-of-completion cost-to-cost method to measure progress. For contracts that require the Company to produce a substantial number of similar items without a significant level of development, the Company currently records revenue and profit using the percentage-of-completion units-of-delivery method as the basis for measuring progress on the contract.

Under ASC 606, revenue will be recognized as the customer obtains control of the goods and services promised in the contract (i.e., performance obligations). We may also have more performance obligations in our contracts under ASC 606, which may impact the timing of recording sales and operating profit, including those where sales recognition is deferred pending the incurrence of costs.

The Company has not completed its assessment of the effects of the new revenue standard, and has not determined whether adopting ASU 2014-09 will have a material effect on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term

leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements. The Company has been gathering the lease agreement data and has begun to analyze the financial impact to the consolidated financial statements.

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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.

In May 2016, the FASB issued Accounting Standards Update No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow -Scope Improvements and Practical Expedients. The amendments do not change the core revenue recognition principle in Topic 606. The amendments provide clarifying guidance in certain narrow areas and add some practical expedients. These amendments are effective at the same date that Topic 606 is effective. Topic 606 is effective for public entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein (i.e., January 1, 2018, for a calendar year entity). Topic 606 is effective for nonpublic entities one year later. The Company is currently assessing the impact of the adoption of the amendments to Topic 606 and these amendments on its consolidated financial statements.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This update will be effective for all interim and annual reporting periods beginning after December 15, 2018. The Company is currently assessing the impact of the adoption of these amendments on its consolidated financial statements.

In September 2017, the FASB issued ASU 2017-13, “Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842),” which provides additional implementation guidance on the previously issued ASU 2016-02 Leases (Topic 842). The revenue standard is effective for annual periods beginning after December 15, 2017. ASU 2016-02 requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. The Company is currently assessing the impact of the adoption of this guidance on its consolidated financial statements.

In March 2018, the FASB issued Accounting Standards Update No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (“ASU 2018-05”). ASU 2018-05 adds various SEC paragraphs pursuant to the issuance of the December 2017 SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB No. 118”), which was effective immediately. SAB No.118 provides for a provisional one year measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act. The adoption of ASU 2018-05 had no material impact

on the Company's consolidated financial statements as of and for the three months ended March 31, 2018. See Note 10, Income Taxes, for disclosures related to this amended guidance.

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.

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JOBS Act

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision of and with the participation of management, including our Chief Executive Officer and our Chief Financial 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. This was due to certain deficiencies in our controls over financial reporting, described below. In particular, certain portions of our inventory control system have not been integrated into the system used by the balance of the Company which could result in a failure to properly account for

the costs associated with work in process, slow moving inventory and the value of inventory on hand and the enterprise reporting system used to track employee hours and, hence, costs to be included in work in process, is not sufficiently automated to ensure compliance at all times. In addition, our Chief Executive Officer and Chief Financial Officer concluded that our quarterly closing process was deficient at our subsidiaries and that our consolidating process and period end reporting and disclosure procedures were materially weak. They also concluded that our system for administering and disclosing stock compensation was deficient and that we lacked the accounting personnel necessary to account for complex accounting matters and unusual and non-standard transactions and were deficient in supervision and internal control monitoring.

To remedy these weaknesses, when financially able, we plan to supplement our accounting staff with additional experienced financial professionals, redefining and realigning responsibilities and by defining additional controls, reporting processes and procedures to address the accounting requirements and disclosures for non-standard and unusual transactions. In addition, until we locate and engage appropriate accounting personnel, we will engage third party consultants to assist in accounting for non-recurring complex transactions.

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

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Changes in Internal Control over Financial Reporting

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

PART II

OTHER INFORMATION

Item 1A. Risk Factors.

Reference is made to the risks and uncertainties disclosed in Item 1A (“Risk Factors”) of our Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Form 10-K”), which section is incorporated by reference into this report. Prospective investors are encouraged to consider the risks described in our 2017 Form 10-K, our Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in this Report and other information publicly disclosed or contained in documents we file with the Securities and Exchange Commission before purchasing our securities.

Item 2. Sales of Unregistered Equity Securities

Except as previously disclosed on our Exchange Act reports, we did not issue or sell any unregistered equity securities during the period covered by this Report.

Item 6. Exhibits

| <u>Exhibit</u> <u>No.</u> | <u>Description</u> |
|------------------------------|--------------------|
|------------------------------|--------------------|

- 2.1 Agreement and Plan of Merger dated July 29, 2013 between Air Industries Group, Inc. and Air Industries Group (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed August 30, 2013).
- 2.2 Articles of Merger between Air Industries Group and Air Industries Group, Inc. filed with the Secretary of State of Nevada on August 28, 2013 (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed August 30, 2013).
- 2.3 Certificate of Merger between Air Industries Group and Air Industries Group, Inc. filed with the Secretary of State of Nevada on August 29, 2013 (incorporated herein by reference to Exhibit 3.3 to the Company's Current Report on Form 8-K filed August 30, 2013).
- 3.1 Articles of Incorporation of Air Industries Group (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed August 30, 2013).
- 3.2 Certificate of Designation authorizing the issuance of the Series A Preferred Stock (incorporated herein by reference to exhibit 3.1 to the Company's Current Report on Form 8-K filed on June 1, 2016).
- 3.3 Certificate of Amendment increasing number of authorized shares of preferred stock and Series A Preferred Stock (incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2016 filed on April 19, 2017).
- 3.4 Amendment to Certificate of Designation (incorporated herein by reference to the Company's Registration Statement on Form S-1 (Amendment No. 2) filed on June 19, 2017 declared effective on July 6, 2017).
- 3.5 Amended and Restated By-Laws of the Company (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2014 filed on March 31, 2015).
- 10.32 Stock Purchase Agreement dated March 21, 2018 with CPI Aerostructures, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 23, 2018).
- 14.1 Code of Ethics (incorporated herein by reference to Exhibit 14.1 to the Company's Annual Report on Form 10-K/A (Amendment No.2) for the year ended December 31, 2017 filed on April 30, 2018).

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Certifications

- 31.1 Certification of principal executive officer pursuant to Rule 13a-14 or Rule 15d-14 of Securities Exchange Act of 1934.
- 31.2 Certification of principal financial officer pursuant to Rule 13a-14 or Rule 15d-14 of the Exchange Act of 1934.
- 32.1 Certification of principal executive officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
- 32.2 Certification of principal financial officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

XBRL Presentation

- 101.SCH XBRL Taxonomy Extension Schema Document
101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF XBRL Taxonomy Extension Definition Linkbase Document
101.LAB XBRL Taxonomy Extension Label Linkbase Document
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

Dated: May 15, 2018

AIR INDUSTRIES GROUP

By: /s/ Michael Recca
Michael Recca

Chief Financial Officer

(principal financial and accounting officer)