

Edgar Filing: AIR INDUSTRIES GROUP, INC. - Form 10QSB

AIR INDUSTRIES GROUP, INC.  
Form 10QSB  
November 14, 2007

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

Form 10-QSB

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

For the quarterly period ended September 30, 2007

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

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

Commission file number 000-29245

AIR INDUSTRIES GROUP, INC.

(Formerly Gales Industries Incorporated).  
(Exact name of small business as specified in its charter)

Delaware 20-4458244  
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification Number)

1479 Clinton Avenue, Bay Shore, New York 11706  
(Address of principal executive offices)

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 69,122,227 shares of Common Stock, \$.001 per share, as of November 9, 2007.

Transitional Small Business Disclosure Format (check one): Yes  No

AIR INDUSTRIES GROUP INC.  
(formerly Gales Industries Incorporated)

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PART I. FINANCIAL INFORMATION  
AIR INDUSTRIES GROUP, INC.  
(formerly Gales Industries Incorporated)  
Condensed Consolidated Balance Sheet

	September 2007 (unaudited)
ASSETS	
Current Assets	
Cash and Cash Equivalents	\$ 760,9
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$304,451 and \$176,458	6,760,3
Inventory	21,457,0
Prepaid Expenses and Other Current Assets	139,3
Deposits	338,6
	-----
Total Current Assets	29,456,3
Property and Equipment, net	4,385,6
Deferred Financing Costs	587,2
Other Assets	406,5
Goodwill	11,553,5
Income Taxes Receivable	127,6
Deposits	471,1

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TOTAL ASSETS	\$ 46,988,0
=====	
LIABILITIES AND STOCKHOLDERS' EQUITY	
Accounts Payable and Accrued Expenses	\$ 5,579,3
Notes Payable - Revolver	10,942,9
Notes Payable - Current Portion	4,627,7
Notes Payable - Sellers - Current Portion	1,066,6
Capital Lease Obligations - Current Portion	283,5
Due to Sellers	
Dividends Payable	120,0
Deferred Gain on Sale - Current Portion	38,0
Income Taxes Payable	
-----	
Total current liabilities	22,658,3
Long term liabilities	
Notes Payable - Net of Current Portion	677,1
Notes Payable - Sellers - Net of Current Portion	2,825,2
Capital Lease Obligations - Net of Current Portion	1,265,0
Deferred Tax Liability	862,2
Deferred Gain on Sale - Net of Current Portion	684,5
Deferred Rent	182,0
-----	
Total liabilities	29,154,6
-----	
Commitments and contingencies	
Stockholders' Equity	
Preferred Stock - Authorized 8,003,716	
Series A Convertible Preferred - \$0.001 Par Value, 1,000 Shares Authorized	
0 shares issued and Outstanding as of September 30, 2007	
and December 31, 2006 respectively	
Series B Convertible Preferred - \$0.001 Par Value, 2,000,000 Shares	
Authorized 802,300 and 0 Shares Issued and Outstanding as of September 30, 2007	
and December 31, 2006 respectively	8
Common Stock - \$0.001 Par, 120,055,746 Shares Authorized	
69,122,227 and 57,269,301 Shares Issued and Outstanding	
as of September 30, 2007 and December 31, 2006 respectively	69,1
Additional Paid-In Capital	18,814,1
Accumulated Deficit	(1,050,61
-----	
Total Stockholders' Equity	17,833,4
-----	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 46,988,0
=====	

See notes to condensed consolidated financial statements

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	Three Months Ended September 30		Nine M Sep
	2007	2006	2007
Net sales	\$ 12,845,821	\$ 7,883,485	\$ 31,323,48
Cost of Sales	9,254,338	6,362,076	24,110,52
Gross profit	3,591,483	1,521,409	7,212,96
Operating costs and expenses:			
Selling and marketing	384,453	175,515	1,005,33
General and administrative	2,232,681	1,108,651	5,069,09
Income from operations	974,349	237,243	1,138,54
Interest and financing costs	478,920	290,853	890,74
Gain on sale of life insurance policy	--	--	--
Gain on Sale of Real Estate	(9,509)	--	(28,52
Other Income	(15,125)	--	(25,01
Other Expenses	50,708	--	76,01
Income (loss) before income taxes	469,355	(53,610)	225,32
(Provision) benefit for income taxes	(46,761)	21,455	(189,66
Net income (loss)	422,594	(32,155)	35,66
Less: Dividend attributable to			
Preferred stockholders	136,578	100,000	247,54
Net income (loss) attributable to common stockholders	\$ 286,016	\$ (132,155)	\$ (211,87
Income (loss) per share (basic)	\$ 0.00	\$ (0.00)	\$ (0.0
Income (loss) per share (diluted)	\$ 0.00	\$ (0.00)	\$ (0.0
Weighted average shares outstanding (basic)	67,838,959	41,545,824	64,149,24
Weighted average shares outstanding (diluted)	70,734,615	41,545,824	64,149,24

See notes to condensed consolidated financial statements

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(Unaudited)

	Nine Months Ended Septe	
	2007	20
Net Income	\$ 35,663	\$ 2
Adjustments to Reconcile Net Income to Net		
Cash Used in Operating Activities, net of effects of acquisitions:		
Depreciation and amortization of property and equipment	568,595	4
Bad Debt Expense	129,111	
Non-Cash Compensation Expense	329,330	1
Warrants issued for services	31,303	
Accrued Interest on Notes Payable-Sellers	16,604	
Amortization of deferred financing costs	99,345	
Gain on Sale of Officer's life insurance policy	--	(
Gain on Sale of Real Estate	(28,527)	
Deferred Taxes	349,271	
Changes in Assets and Liabilities		
(Increase) Decrease in Assets:		
Accounts receivable	(326,626)	(5
Income Taxes Receivable	(127,613)	
Inventory	(2,959,777)	(9
Prepaid expenses and Other Current Assets	138,545	1
Deposits	(156,787)	(
Cash surrender value - officer's life insurance	--	
Other assets	(320,297)	
Increase (Decrease) in Liabilities:		
Accounts payable and accrued expenses	(4,074,252)	(
Income Taxes Payable	(653,426)	
Deferred Rent	142,674	
NET CASH USED IN OPERATING ACTIVITIES	(6,806,864)	(7
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisitions, including transaction costs		
of \$486,200, net of cash acquired of \$94,448	(7,952,547)	
Cash Paid for Deposit on Leasehold Improvements	(24,040)	
Purchase of property and equipment	(187,926)	(2
NET CASH USED IN INVESTING ACTIVITIES	(8,164,513)	(2
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from Private Placement	8,023,000	
Proceeds from sale of officer's life insurance	--	
Payment of Issuance Costs of Private Placement	(698,840)	
Principal payments on capital lease obligations	(84,172)	(2
Repayment of notes payable to Officers and Sellers	(336,913)	(1
Proceeds from notes payable, net	3,231,197	5
Proceeds from Notes Payable-Revolver	5,915,517	
Cash paid for Deferred Financing Costs	(317,500)	
NET CASH PROVIDED BY FINANCING ACTIVITIES	15,732,289	1
Net increase in cash and cash equivalents	760,912	(7
Cash and cash equivalents at the beginning of period	--	1,0
Cash and cash equivalents at the end of period	\$ 760,912	\$ 2

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Supplemental disclosure of cash flow information:

Cash paid during the period for interest	\$ 646,665	\$ 7
	=====	=====
Cash paid during the period for taxes	\$ 678,729	\$
	=====	=====

Supplemental schedule of noncash financing and investing activities  
Property and Equipment acquired under capital leases

Property and Equipment acquired under capital leases	\$ 673,000	
	=====	
Conversion of Preferred to Common Stock		\$
		=====
Conversion of PIK Dividend to Common Shares		\$ 3
		=====

See notes to condensed consolidated financial statements

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AIR INDUSTRIES GROUP INC.  
(formerly Gales Industries Incorporated)

Condensed Consolidated Statement of Cash Flows (Continued)  
(Unaudited)

Note Payable-Seller and accrued interest  
converted to common stock

\$ 719,773  
=====

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

Fair Value of Tangible Assets acquired	\$ 5,691,777
Goodwill	5,168,319
Cash paid (includes transaction costs of \$280,500)	(4,341,296)
Notes payable issued to Sellers	(1,497,411)
Common stock issued	(1,957,000)
	-----
Liabilities assumed	\$ 3,064,389
	=====

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

Fair Value of Tangible Assets acquired	\$ 1,292,067
Goodwill	5,119,265
Cash paid (includes transaction costs of \$205,700)	(3,705,700)
Notes payable issued to Sellers (net of accredited value of \$140,000)	(1,860,000)
Common stock issued	(566,500)
	-----
Liabilities assumed	\$ 279,132
	=====

See notes to condensed consolidated financial statements

Note 1. FORMATION AND BASIS OF PRESENTATION

On June 26, 2007, we changed our name from Gales Industries Incorporated to Air Industries Group, Inc.

On April 16, 2007, we acquired all of the issued and outstanding capital stock of Sigma Metals, Inc. ("Sigma"), pursuant to a certain Stock Purchase Agreement, dated as of January 2, 2007, from the three shareholders of Sigma (the "Sellers"), in exchange for, \$4,060,796 in cash, three promissory notes, one in favor of each Seller, in the total principal amount of \$1,497,411, and 7,416,082 shares of our Common Stock at \$0.2563 per share equaling \$1,957,000. Soft costs incurred as a result of this acquisition amounted to \$280,500.

Sigma Metals is a specialty distributor of strategic metals, primarily aluminum, stainless steels of various grades, titanium and other exotic end user specified metals. Sigma's products are sold to both aerospace/defense contractors as well as commercial accounts throughout the U.S. and numerous international markets. Customers include the world's largest aircraft manufacturers, subcontractors, original equipment manufacturers and various government agencies.

On August 26, 2007, we acquired all of the issued and outstanding capital stock of Welding Metallurgy, Inc ("Welding Met") pursuant to a certain Stock Purchase Agreement, dated as of March 9, 2007 from the two shareholders of Welding Met (the "Sellers") in exchange for, \$3,500,000 in cash, a promissory note in the principal amount of \$2,000,000 (this note is recorded at \$1,860,000 to reflect the fact that no interest accrues for the first year) (see Note 9) and 2,035,529 shares of our Common Stock at \$0.2702 per share equaling \$566,500. One-half of these shares are held in escrow, as secondary collateral for representations and warranties pursuant to the aforementioned Stock Purchase Agreement. The amount paid to the shareholders of Welding Met is subject to an adjustment for Welding Met's working capital as of the closing date such amount has not yet been finalized. Soft costs incurred as a result of this acquisition amounted to \$205,700.

Welding Metallurgy is a specialty welding and products provider whose significant relationships include the world's largest aircraft manufacturers, subcontractors, and original equipment manufacturers.

Our operating results for the period ended September 30, 2007, include the results of the operations of Sigma beginning on April 17, 2007 and Welding Metallurgy beginning on August 27, 2007. In accordance with Statement of Financial Accounting Standards ("SFAS") 141, Business Combinations, the acquisitions of Sigma and Welding were accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to assets acquired and liabilities assumed based on SFAS No. 141 and are reflected in the balance sheet of the Company as of September 30, 2007 included herein. The Company is in the process of finalizing the allocation of the purchase price to the assets and liabilities based on their relative fair values.

Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Company believes that the disclosures are adequate to make the financial information presented not misleading. These condensed consolidated financial statements should be read in conjunction

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with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2006, filed with the Securities and Exchange Commission on April 2, 2007. All adjustments were of a normal recurring nature unless otherwise disclosed. In the opinion of management, all adjustments necessary for a fair statement of the results of operations for the interim period have been included. The results of operations for such interim periods are not necessarily indicative of the results for the full year.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

### Use of Estimates

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

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### Note 1. FORMATION AND BASIS OF PRESENTATION (Continued)

#### Share-Based Compensation

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 123(R) "Share Based Payments" which is a revision of SFAS No. 123 "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values at the date of grant. The Company recorded in the accompanying statement of operations an expense of \$62,827 and \$42,866 for the three month period ended September 30, 2007 and 2006, respectively and an expense of \$329,330 and \$108,271 for the nine month period ended September 30, 2007 and 2006, respectively, in accordance with the measurement requirements under SFAS No. 123(R) (See Note 4). The Company adopted SFAS No. 123(R), effective in 2005.

#### Taxes

Effective January 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). There were no unrecognized tax benefits as of January 1, 2007 and as of September 30, 2007. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. Management is currently unaware of any issues under review that could result in significant payments, accruals or material deviations from its position. The adoption of the provisions of FIN 48 did not have an impact on the Company's financial position, results of



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operations and cash flows.

### Note 2. CASH SURRENDER VALUE - LIFE INSURANCE

During the quarter ended March 31, 2006, the Company sold one of its key-man life insurance policies. Proceeds from the sale of the insurance policy were \$86,000 which was offset by the cash surrender value of \$32,953. The resulting gain of \$53,047 was recognized as Other Non-Operating Income in the accompanying Statement of Operations for the nine month period ended September 30, 2006.

### Note 3. CONVERSION OF NOTES PAYABLE

On January 26, 2007, two executive officers exercised their right to convert \$665,262 principal amount of our notes plus accrued interest of \$54,511 into an aggregate of 1,799,432 shares of common stock at a conversion price of \$0.40 per share.

### Note 4. SHARE-BASED COMPENSATION ARRANGEMENTS

During 2005, the Company's Board of Directors approved a stock option plan and reserved 10,000,000 shares of its Common Stock for issuance under the plan. The stock option plan permits the Company to grant non-qualified and incentive stock options to employees, directors, and consultants. Awards granted under the Company's plans vest over three, four, five and seven years.

The Company accounts for its stock option plans under the measurement provisions of Statement of Financial Accounting Standards No. 123(R) (revised 2004), Share-Based Payment ("SFAS 123R"). The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. During the nine months ended September 30, 2007, 2,380,000 stock options were granted. No options were granted during the nine months ended September 30, 2006.

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

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### Note 4. SHARE-BASED COMPENSATION ARRANGEMENTS (Continued)

At September 30, 2007 and 2006, 2,496,666 and 1,580,000 options are vested and exercisable, respectively. The weighted average exercise price of exercisable options at September 30, 2007 was \$0.43 per share.

During the quarter ended March 31, 2007, the Company issued warrants to purchase an aggregate of 20,833 shares to a consultant for services rendered. These warrants have a term of five years and an exercise price equal to 120% of the average closing price of the Company's Common Stock during the month immediately preceding the date of issuance. These warrants have a cashless exercise feature. The warrants were valued using the Black-Scholes model and the Company recorded an expense of \$5,514 in its consolidated statement of operations for the nine months ended September 30, 2007. The Company's agreement with this consultant was

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terminated during the first week of September 2006.

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

The Company issued to Taglich Brothers, Inc., placement agent for the private offering of the Company's Series B Convertible Preferred Stock described in Note 5, warrants to purchase 2,900,578 shares of Common Stock at a per share exercise price of \$0.305 in addition to other consideration. These warrants have a term of five-years and a cashless exercise feature. These warrants were valued at \$32,000 using the Black-Scholes model and the value of such warrants was deducted from the additional paid in capital resulting from the offering.

### Note 5. ISSUANCE OF SERIES B PREFERRED STOCK

To finance the acquisition of Sigma and provide us with additional working capital, we completed a private placement of our Series B Convertible Preferred Stock, par value \$0.001 per share ("Series B Preferred Stock") in which we raised gross proceeds of \$8,023,000.

The Company issued to Taglich Brothers, Inc. placement agent for the private offering of the Company's Series B Convertible Preferred Stock: (i) a sales commission of \$641,840 or 8% of the gross proceeds of the offering, (ii) \$25,000 as reimbursement of its actual and reasonable out-of-pocket expenses incurred in connection with offering, including fees and expenses of its counsel, and (iii) warrants to purchase 2,900,578 shares of Common Stock at a per share exercise price of \$0.305. These warrants have a term of five-years and a "cashless exercise" feature. The preferred stock contains a 7% cumulative non-declared dividend which amounted to \$247,542 for the nine months ended September 30, 2007.

### Note 6. AMENDMENT OF CREDIT FACILITY

On April 19, 2007, in connection with the acquisition of Sigma Metals, the Company entered into a Third Amendment to the Revolving Credit, Term Loan, Equipment Line of Credit and Security Agreement with PNC Bank. The amendment cost \$42,500 and modified the terms of the Loan Facility with PNC to allow for Sigma to become a borrower under the Loan Facility. This cost is being amortized over the remaining term of the credit facility. As a result of Sigma becoming a borrower under the Loan Facility, Sigma pledged all of its assets and properties to PNC to secure its obligations under the Loan Facility. In addition, the termination date of the Loan Facility was extended to April 30, 2010 and the maximum revolving advance amount was increased by \$2,000,000, from \$9,000,000 to \$11,000,000. The Company remains in compliance with its Debt covenants.

In connection with the acquisition of Welding Metallurgy, we also amended and modified the terms of the Loan Facility with PNC to allow for Welding Metallurgy, Inc., and Air Industries Group, Inc., to become parties to the Loan Facility. In connection with such amendment, Welding Metallurgy pledged all of its assets to secure amounts due under the Loan Facility. The maximum revolving advance amount was increased by \$3,000,000 from \$11,000,000 to \$14,000,000.

Note 6. AMENDMENT OF CREDIT FACILITY (Continued)

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

Note 7. CASHLESS EXERCISE OF OPTIONS TO FORMER CHARIMAN

On May 17, 2007, the former Executive Chairman converted 250,000 of his options into 90,580 shares of Company Common Stock pursuant to the cashless exercise feature contained in his option agreement.

Note 8. CONTINGENCIES

We are a defendant in an action by our former investor relations firm filed on September 18, 2007 in the Supreme Court of the State of New York, New York County captioned Porter, Levay & Rose, Inc. against Air Industries Group, Inc. et al. (Index No. 003104/07). The complaint alleges breach of contract and seeks compensatory damages of approximately \$211,347 for services rendered and an order directing us to deliver to plaintiff warrants to purchase 125,000 shares of our common stock, containing a cashless exercise feature. The complaint also seeks punitive damages unspecified in amount. The case is in its early stages. We previously issued approximately 41,668 of the warrants sought by the plaintiff. We anticipate this action will be settled for approximately \$30,000 and have accrued an expense in such amount.

Note 9. SELLERS NOTES

In connection with the acquisition of Sigma Metals, we incurred notes payable obligations to the former shareholders of Sigma Metals in the aggregate principal amount of \$1,497,411. The principal balance of the remaining balance is \$1,346,826 and is repayable by us in equal monthly installments of \$43,446 principal, plus interest.

In connection with the acquisition of Welding Metallurgy, we incurred notes payable obligations to the former shareholders of Welding Metallurgy in the aggregate principal amount of \$2,000,000, which bear no interest until August 24, 2008, and bear interest thereafter at 7% per annum. To reflect that fact that this note does not bear interest for the first year, we have discounted the value of the note in our accompanying balance sheet to \$1,860,000, and will expense the imputed interest on a monthly basis and accrete up the value of the note to its face value of \$2,000,000. The indebtedness evidenced by this note is subordinate to our indebtedness to PNC and SCCF and is payable in one installment in the principal amount of \$500,000 due on August 24, 2008 and twelve consecutive quarterly installments of principal in the amount of one-hundred

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twenty-five thousand dollars, plus accrued interest commencing on November 30, 2008 and continuing through August 31, 2011.

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### Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion of our results of operations constitutes management's review of the factors that affected our financial and operating performance for the three and nine months ended September 30, 2007 and 2006. This discussion should be read in conjunction with the financial statements and notes thereto contained elsewhere in this report and in our Form 10-KSB, for the year ended December 31, 2006.

#### General

We manufacture aircraft structural parts and assemblies principally for prime defense contractors in the aerospace industry. During 2006, approximately 85% of our revenues were derived from sales of parts and assemblies directed toward military applications, although direct sales to the military (U.S. and NATO) constituted less than 8.5% of our revenues. We have evolved from being an individual parts manufacturer to being a manufacturer of subassemblies (i.e. being an assembly constructor) and being an engineering integrator. We currently produce over 2,400 individual products (SKU's) that are assembled by a skilled labor force into electromechanical devices, mixer assemblies, rotor-hub components, rocket launching systems, arresting gear, vibration absorbing assemblies, landing gear components and many other subassembly packages.

As a result of acquisitions we completed in the second and third quarters as part of our plan to capitalize on our relationships in the aerospace industry, we have become a specialty distributor of strategic metals, primarily aluminum, stainless steels of various grades, titanium and other exotic end user specified materials sourced from suppliers throughout the world, and a provider of specialty welding services and metal products. Our metals products are sold throughout the world to prime contractors in the defense and commercial aerospace industries, aerospace engine manufacturers and various subcontractors to aerospace manufacturers. Our welding services and products are provided to similar customers in the United States.

Sales of parts and services to one customer accounted for approximately 41.7% of our consolidated revenue in the third quarter of 2007, and 49.2% of our consolidated revenue in the nine months ended September 30, 2007 and are subject to General Ordering Agreements which extend through 2013.

#### Results of Operations

We completed the acquisition of our metals distribution operations on April 16, 2007, and the acquisition of our welding operations on August 26, 2007, consequently, the results of such operations from April 17, 2007, and August 27, 2007, respectively, are included in our financial statements for the period ended September 30, 2007, and reflected in the discussion below.

#### Results of Operations

Three months ended September 30, 2007 compared with three months ended September 30, 2006

Net Sales. Net sales were \$12,845,821 for the three months ended September 30, 2007 ("Third Quarter 2007"), increased by \$4,962,336 or 62.95% from net sales of \$7,883,485 for the three months ended September 30, 2006 ("Third

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Quarter 2006"). The increase in net sales was attributable primarily to the acquisition of our metals distribution and welding operations which generated net sales during the quarter of \$3,905,260 supplemented by an increase in net sales of our preexisting operations of \$1,057,076 over net sales for such operations during the Third Quarter 2006.

**Gross Profit.** In the Third Quarter 2007, gross profit increased by \$2,070,074 or 136.1%, to \$3,591,483 or 27.95% of net sales, compared to gross profit of \$1,521,409 or 19.6% of net sales in Third Quarter 2006. This increase in gross profit reflects the contribution of \$1,402,493 from our newly acquired metals distribution and welding operations, and the \$667,581 increase in the gross profit of our pre-existing operations from the gross profit recorded in the Third Quarter 2006. The increase in gross profit margin reflects the higher margins of our metals distributions and welding operations which generated gross profit margins of 34.4% and 46.0%, respectively, during the Third Quarter 2007, as compared to our pre-existing operations which generated gross profit margins of 24.48% during the Third Quarter 2007. The year over year improvement in the gross profit margin of our pre-existing operations was primarily attributable to a shift in production to higher margin products.

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**Selling and Marketing Expenses.** Selling and marketing expenses were \$384,453 in Third Quarter 2007, an increase of \$208,938 or 119.04% from selling and marketing expenses of \$175,515 in Third Quarter 2006. The increase in selling and marketing expenses is attributable to expenses associated with our recently acquired metals distribution and welding operations slightly offset by a reduction of \$29,189 in selling and marketing expenses of our pre-existing operations.

**General and Administrative Expenses.** General and administrative expenses were \$2,232,681 in Third Quarter 2007, an increase of \$1,124,030 or 101.4% from general and administrative expenses of \$1,108,651 in Third Quarter 2006. The increase reflects the general and administrative expenses of our metals distribution and welding operations, costs related to the integration of the operating and financial systems of our metals distribution and welding operations into our general systems, costs of upgrading our financial reporting systems to accommodate future acquisitions, and the expense of preparing to comply with Section 404 of the Sarbanes-Oxley Act of 2002.

**Interest and Financing Costs.** Interest and financing costs were \$478,920 in Third Quarter 2007, an increase of \$188,067 or 64.7% from interest and financing costs of \$290,853 in Third Quarter 2006. The increase in interest and financing costs resulted from the incurrence of debt during 2007 to acquire our metals distribution and welding operations which offset the savings from the sale and leaseback of our headquarters in October 2006

**Gain on sale of real estate.** We are required to defer recognition of a portion of the gain on the sale of our headquarters in the fourth quarter of 2006. This gain is being recognized ratably over the twenty year term of our lease for this real estate. Accordingly, we recognized \$9,509 during the Third Quarter of 2007.

**Income (Loss) before Income Taxes.** Income before the impact of income taxes was \$469,355 in Third Quarter 2007 compared to a loss before the provision for income taxes of (\$53,610) in Third Quarter 2006, an increase of \$522,965. The increase in income resulted primarily from the contributions of our metals distribution and welding operations, which generated income before taxes during the Third Quarter 2007 of \$368,495 and \$150,407, respectively, offset by a loss at our pre-existing operations as we continued to recover from the disruption

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caused by a decision in the Third Quarter 2006 of our major customer to defer shipments in order to recover from its operating difficulties.

**Net Income (Loss).** Net income for the Third Quarter of 2007 was \$422,594, as compared to a net loss of (\$32,155) for the Third Quarter 2006. This increase was primarily attributable to the contributions from our metals distribution and welding operation and the improved performance of our pre-existing operations as described above.

**Net Income (Loss) Attributable to Common Stockholders.** The dividend payable on the our Series A preferred stock in the Third Quarter 2006 exceeded our net loss during such period, resulting in a net loss attributable to common stockholders of (\$132,155). Our Series A preferred stock was converted into common stock in August 2006. In April and May of 2007, we issued shares of our Series B Preferred Stock. The dividend attributable to our Series B Preferred Stock during the Third Quarter 2007 reduced our net income attributable to common stockholders for the quarter to \$286,016.

Nine months ended September 30, 2007 compared with nine months ended September 30, 2006

**Net Sales.** Net sales were \$31,323,487 for the nine months ended September 30, 2007, increased by \$5,321,565 or 20.5% from net sales of \$26,001,922 for the nine months ended September 30, 2006. The increase in net sales was attributable to the consolidation of \$6,689,684 of net sales from the metals distribution and welding operations acquired on April 16, 2007 and August 27, 2007, respectively, offset in part by a reduction in net sales of our pre-existing operations during the period of approximately \$1,368,119. The reduction in sales at our pre-existing operations during the period reflects the lower sales during the first six months of 2007 as a result of a decision in the third quarter of 2006 of our largest customer to delay acceptance of products manufactured as it attempted to recover from its operating difficulties. Management believes that we have now adjusted our manufacturing schedules and, absent further disruptions, should no longer be adversely impacted by the disruption to our largest customer's operations during 2006.

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**Gross Profit.** In the nine months ended September 30, 2007, gross profit increased by \$2,426,013 or 50.68%, to \$7,212,967 or 23.03% of net sales, compared to gross profit of \$4,786,954 or 18.41% of net sales in nine months ended September 30, 2006. This increase in gross profit reflects the contribution of our metals distribution and welding operations supplemented by the improvement in the gross profit at our pre-existing operations during 2007. The increase in gross profit margin reflects the higher margins of our metals distributions and welding operations which generated gross profit margins of 29.0% and 46.0%, respectively, since the acquisition of those operations, as compared to our pre-existing operations which generated gross profit margins of 21.1% during the first nine months of 2007.

**Selling and Marketing Expenses.** Selling and marketing expenses were \$1,005,331 in the nine months ended September 30, 2007, an increase of \$531,571 or 112.20% from selling and marketing expenses of \$473,760 in the nine months ended 2006. The increase in selling and marketing expenses is attributable to expenses of our metals distribution and welding operations. Our pre-existing operations selling and marketing expenses decreased year over year for the period by \$115,533, or 24.4%, due to lower sales and a reduction in market efforts.

**General and Administrative Expenses.** General and administrative expenses

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were \$5,069,093 in the first nine months of 2007, an increase of \$2,086,509 or 69.96% from general and administrative expenses of \$2,982,584 in the nine months ended September 30, 2006. The increase primarily reflects the effects of the expenses for our metals distribution and welding operations of \$831,755 during the period coupled with the general and administrative expenses incurred to acquire such operations and integrate them into our pre-existing operations. In addition, we incurred costs related to upgrading our financial reporting systems to accommodate future acquisitions and preparing to comply with Section 404 of the Sarbanes-Oxley Act of 2002.

**Interest and Financing Costs.** Interest and financing costs were \$890,743 in the nine months ended September 30, 2007, a decrease of \$87,286 or 8.92% from interest and financing costs of \$978,029 for the nine months ended 2006. The decrease in interest and financing costs resulted from the decrease in the levels of our outstanding debt as a result of the sale leaseback of our headquarters in October 2006, partially offset by the increase in debt associated with the acquisitions of our metals distribution and welding operations.

**Gain on sale of real estate.** We were required to defer recognition of a portion of the gain on the sale of our headquarters in the fourth quarter of 2006. This gain is being recognized ratably over the twenty year term of the lease for this real estate. Accordingly, we recognized \$28,527 during the nine months ended September 30, 2007.

**Income before Income Taxes.** Income before the impact of income taxes was \$225,327 in the nine months ended September 30, 2007 as compared to pre-tax income in the same period for the prior year of \$406,431, a decrease of \$181,104. This was a function of lower sales primarily during the first six months of 2007 at our pre-existing operations. Sales at our pre-existing operations for the nine months ended September 30, 2007, were down by \$1,368,119 or 5.3% from the prior year's \$26,001,922, primarily for the reasons discussed above, after having been down by \$2,425,195 or 13% in the first six months of 2007 as compared to the first six months of 2006. This decrease in income at our pre-existing operations was partially offset by the contributions of our metals distributions and welding operations, which generated income before taxes of \$482,326 during the nine months ended September 30, 2007. Management believes that we have now adjusted our manufacturing schedules and overcome the difficulties caused by the disruption to our largest customer's operations during 2006.

**Net Income.** Net income decreased from \$243,777 in the nine months ended September 30, 2006 to net income of \$35,663 in the first nine months of 2007. The decrease in net income was attributable to the factors discussed above as well as the effect of the FAS 109, income tax expense.

**Net (Loss) Attributable to Common Stockholders.** The dividend payable on our Series A preferred stock in the nine months ended September 30, 2006 exceeded our net income during such period, resulting in a net loss attributable to common stockholders of (\$216,223). Our Series A preferred stock was converted into common stock in August 2006. Similarly, the dividend related to our Series B preferred stock during the nine months ended September 30, 2007 exceeded our net income during the period resulting in a net loss attributable to common stockholders of (\$211,879). Our Series B preferred stock accrues dividends at a rate of 7% per annum.

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

### Liquidity and Capital Resources

At September 30, 2007, we had cash or cash equivalents of \$760,912 as compared to \$0 at December 31, 2006. The Loan Facility provided by PNC requires that all cash at our operating subsidiaries be swept on a daily basis to our loan accounts. The \$760,912 currently on hand represents the portion of the proceeds of our private placement completed in the second quarter of 2007, that has yet to be applied to operations. At September 30, 2007, we had working capital of \$6,798,007 as compared to working capital of \$4,911,354 as of December 31, 2006. This increase in working capital reflects the proceeds of the placement of our Series B Preferred Stock, offset by the cost of acquiring our metals distribution and welding operations and our negative cash flows from operations during the first nine months of 2007. It should be noted that included in current liabilities is an aggregate of \$15,570,756 due PNC (\$10,942,980) and SCCF (\$4,500,000). Under the terms of our loan agreements these amounts are not due to be repaid until April 30, 2010 and August 24, 2010, but have been included in current liabilities due to the right of the banks to demand immediate repayment upon the occurrence of certain events which management believes are not likely to occur, combined with the existence of a lockbox arrangement. We believe that our cash requirements for operations in the next twelve months will be met by revenues from operations, cash reserves, and amounts available under the Loan Facility.

We used \$6,806,864 in operations during the nine months ended September 30, 2007. The use of cash in operations reflects an increase in inventory of \$2,959,777 at our pre-existing operations, an increase in our deposits with vendors of \$156,787, a decrease in prepaid expenses of \$138,545, a decrease in our accounts payable and accrued expenses of \$4,039,254, and an increase in the accounts receivable associated with our pre-existing operations of \$454,618. The increase in our inventory and decrease in our accounts payable noted above are those associated with our pre-existing operations and do not reflect the changes resulting from the acquisitions of our metals distribution and welding operations. The increase in inventory reflected on our balance sheets included herein resulted primarily from the acquisition of our metals and welding operations and, in part, from work flow disruptions at our principal customer which prevented us from shipping all of the inventory originally anticipated. The increase in deposits with vendors and decrease in accounts payable are due to advanced payment requirements imposed by certain suppliers of our pre-existing operations. As a result of efforts to reduce amounts due these suppliers, we anticipate that they may not require prepayments in the immediate future.

In connection with the acquisition of Air Industries Machining Corp., we incurred notes payable obligations to the sellers in the aggregate principal amount of \$1,627,262, of which \$665,262 were in the form of convertible promissory notes which were converted by the holders into 1,799,432 shares of common stock at a conversion price of \$0.40 per share on January 26, 2007. The remaining principal amount, \$673,400, and payable in equal quarterly installments of \$48,100 principal, plus interest.

In connection with the acquisition of Sigma Metals, in addition to the issuance of Preferred Stock and incurrence of debt discussed below, we incurred notes payable obligations to the former shareholders of Sigma Metals in the aggregate principal amount of \$1,497,411. The remaining principal balance, \$1,346,826, is payable in equal monthly installments of \$43,446 of principal plus interest.

In connection with the acquisition of Welding Metallurgy, we incurred a notes payable obligation to the former shareholders of Welding Metallurgy in the aggregate principal amount of \$2,000,000, which bears no interest until August



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24, 2008, and bears interest thereafter at 7% per annum. To reflect the fact that this note does not bear interest for the first year, we have discounted the value of the note in our accompanying balance sheet to \$1,860,000, and will expense the imputed interest on a monthly basis and accrete up the value of the note to its face value of \$2,000,000. The indebtedness evidenced by this note is subordinate to our indebtedness to PNC and SCCF and is payable in one installment in the principal amount of \$500,000 due on August 24, 2008 and twelve consecutive quarterly installments of principal in the amount of one-hundred twenty-five thousand dollars, plus accrued interest commencing on November 30, 2008 and continuing through August 31, 2011.

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The terms of the PNC Loan Facility are set forth in our Consolidated Financial Statements included in our Annual Report on Form 10-KSB for the year ended December 31, 2006 and the amendments there have been discussed in our previously filed reports on Form 8-K. Under the PNC Loan Facility, as of September 30, 2007, we had revolving loan balances of \$10,942,980, a term loan balance of \$266,402, an equipment loan balance of \$411,200, and an outstanding stand-by letter of credit in the amount of \$127,500. In addition, as of September 30, 2007 we had capital lease obligations to other parties totaling \$1,548,645.

To finance the acquisition of Sigma and provide us with additional working capital, we completed a private placement of our Series B Convertible Preferred Stock, par value \$0.001 per share ("Series B Preferred Stock") in which we raised gross proceeds of \$8,023,000. A first closing, in which we received gross proceeds of \$4,955,000 occurred simultaneously with the acquisition of Sigma and was entirely devoted to the acquisition. A second closing occurred on May 3, 2007, in which we received gross proceeds of \$3,068,000. The holders of the Series B Preferred Stock are entitled to a cumulative annual dividend of 7% per annum which under certain circumstances, is payable in shares of the Company's stock. The shares of Series B Preferred Stock issued in the offering are initially convertible into approximately 29,005,785 shares of the Company's common stock.

In connection with the acquisition of Sigma, we also amended and modified the terms of the Loan Facility with PNC to allow for Sigma to become a borrower under the Loan Facility. The cost of this amendment was \$42,500 and is being amortized over the remaining term of the Credit Facility. As part of the amendment, Sigma Metals' pledged all of its assets and to PNC to secure the payment of its obligations under the Loan Facility. In addition to the foregoing the termination date of the Loan Facility was extended to April 30, 2010 and the maximum revolving advance amount was increased by \$2,000,000, from \$9,000,000 to \$11,000,000.

In connection with the acquisition of Welding Metallurgy, we amended and modified the terms of the Loan Facility with PNC to allow Welding Metallurgy and Air Industries Group to be added as guarantors of amounts due under the Loan Facility. In connection with such amendment Welding Metallurgy pledged all of its assets and properties to PNC to secure its obligations under the Loan Facility. The maximum revolving advance amount was increased by an additional \$3,000,000 from \$11,000,000 to \$14,000,000.

Additionally, in connection with the Welding Metallurgy acquisition, Steel City Capital Funding LLC ("SCCF") ("Term B Lender") provided a Term Loan of \$4,500,000. The Term Loan is payable on August 24, 2010. Borrowings under the SCCF Loan Agreement bear interest, payable monthly, generally at a rate of 6% over the base commercial lending rate of PNC Bank as publicly announced to be in effect from time to time. Under the terms of our loan agreements these amounts

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are not due to be repaid until August 24, 2010, but have been included in current liabilities due to the right of the banks to demand immediate repayment upon the occurrence of certain events (subjective acceleration clause) which management believes are not likely to occur, combined with the existence of a lockbox arrangement. In addition, to secure the obligations due SCCF, we pledged to SCCF the capital stock of Air Industries Machining Corp, Sigma Metals, and Welding Metallurgy, and each of those entities granted to SCCF a security interest on all of their assets.

As of September 30, 2007, one customer accounted for approximately 22.1% of our accounts receivable. In addition, this customer accounted for approximately 41.7% of net sales for the quarter ended September 30, 2007, and 49.2% of our Consolidated revenue in the nine months ended September 30, 2007. In the event such customer is unable or unwilling to pay amounts due or in the event our relationship with such customer is severed or negatively affected, our results of operations will be materially adversely affected and we may not have the resources to meet our capital obligations.

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### Cautionary Note Regarding Forward-Looking Statements

Our disclosure and analysis in this report contains some forward-looking statements. Certain of the matters discussed concerning our operations, cash flows, financial position, economic performance and financial condition, including, in particular, future sales, product demand, competition and the effect of economic conditions include forward-looking statements within the meaning of section 27A of the Securities Act and Section 21E of the Securities Exchange Act.

Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions are forward-looking statements. Although we believe that these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital, capital expenditures, distribution channels, profitability, new products, adequacy of funds from operations, these statements and other projections and statements contained herein expressing general optimism about future operating results and non-historical information, are subject to several risks and uncertainties, and therefore, we can give no assurance that these statements will be achieved.

Investors are cautioned that our forward-looking statements are not guarantees of future performance and actual results or developments may differ materially from the expectations expressed in the forward-looking statements.

As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainty of estimates, forecasts and projections and may be better or worse than projected. Given these uncertainties, you should not place any reliance on these forward-looking statements. These forward-looking statements also represent our estimates and assumptions only as of the date that they were made. We expressly disclaim a duty to provide updates to these forward-looking statements, and the estimates and assumptions associated with them, after the date of this filing to reflect events or changes in circumstances or changes in expectations or the occurrence of anticipated events.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise.

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You are advised, however, to consult any additional disclosures we make in our Form 10-KSB, Form 10-QSB and Form 8-K reports to the SEC. Also note that we provide a cautionary discussion of risk and uncertainties under the caption "Risk Factors" in this report. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed here could also adversely affect us. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

### Risk Factors

The purchase of our common stock involves a high degree of risk. Before you invest you should carefully consider the risks and uncertainties described below, as well as in

- o the section of our prospectus dated July 27, 2007 captioned "Risk Factors"
- o our Annual Report on Form 10-KSB for the fiscal year ended December 31, 2006, or our "2006 Form 10-KSB," under the caption "Risk Factors"
- o our Management's Discussion and Analysis of Financial Condition and results of Operations set forth in Item 2 of Part I of this report
- o our consolidated financial statements and related notes included in Item 1 of Part I of this report
- o our consolidated financial statements and related notes, our Management's Discussion and Analysis of Financial Condition and Results of Operations and the other information in our 2006 Form 10-KSB.

If any of the events described below or in the portions of this report or our 2006 Form 10-KSB referred to above actually occurs, our financial condition or operating results may be materially and adversely affected, our business may be severely impaired, and the price of our common stock may decline, perhaps significantly. This means you could lose all or a part of your investment.

We cannot assure you that any business we acquire will benefit from its acquisition by us.

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We cannot assure you that any benefits to the business of AIM, Sigma Metals, Welding Metallurgy or any other entities that we acquire will be achieved from their acquisition by us or by our status as a public company, or that the results of operations of AIM, Sigma Metals, Welding Metallurgy or such other acquired entities will not be adversely impacted by their acquisition by us. The process of combining the organizations of private companies into a public company such as ours may cause fundamental changes to their businesses or in their operations.

The past performance and results of operations of AIM, Sigma Metals, Welding Metallurgy or any other entity that we acquire are not necessarily indicative of our future performance or results of operations. Future performance may be adversely affected as a result of the integration of the acquired business into our organization and the significant increase in expenses relating to financial statement preparation and compliance with controls and procedures standards established by the Sarbanes-Oxley Act of 2002.

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

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We expect to experience growth in the number of employees and the scope of our operations as a result of internal growth and acquisitions. These activities could result in increased responsibilities for management.

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

Our future success also depends on our ability to address potential market opportunities and to manage expenses to match our ability to finance operations. The need to control our expenses will place a significant strain on our management and operational resources. If we are unable to control our expenses effectively, our business, results of operations and financial condition may be adversely affected.

The unsuccessful integration of a business or business segment we acquire could have a material adverse effect on our results.

As part of our business strategy, we expect to acquire assets and businesses relating to or complementary to our operations. These acquisitions will involve risks commonly encountered in acquisitions. These risks include, among other things, exposure to unknown liabilities of the acquired companies, additional acquisition costs and unanticipated expenses. Our quarterly and annual operating results will fluctuate due to the costs and expenses of acquiring and integrating new businesses. We may also experience difficulties in assimilating the operations and personnel of acquired businesses. Our ongoing business may be disrupted and our management's time and attention diverted from existing operations. Our acquisition strategy will likely require additional debt or equity financing, resulting in additional leverage or dilution of ownership. We cannot assure you that any future acquisition will be consummated, or that if consummated, that we will be able to integrate such acquisition successfully.

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

There are risks associated with programs that are subject to appropriation by Congress, which could be potential targets for reductions in funding to pay for other programs. Future reductions in United States Government spending on defense or future changes in the kind of defense products required by United States Government agencies could limit demand for our products, which would have a materially adverse effect on our operating results and financial condition.

In addition, potential shifts in responsibilities and functions within the defense and intelligence communities could result in a reduction of orders for defense products by segments of the defense industry that have historically been our major customers. As a result, demand for our products could decline, resulting in a decrease in revenues and materially adversely affecting our operating results and financial condition.

We depend on revenues from a few significant relationships, in particular with Sikorsky Aircraft, and any loss, cancellation, reduction, or interruption in these relationships could harm our business.

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In general, we have derived a material portion of our revenues from one or a limited number of customers. We expect that in future periods we may enter into contracts with customers which represent a significant concentration of our revenues. If such contracts were terminated, our revenues and net income could significantly decline. Our success will depend on our continued ability to develop and manage relationships with significant customers. One customer accounted for approximately 49.2% of our consolidated sales during the nine months ended September 30, 2007. Any adverse change in our relationship with Sikorsky could have a material adverse effect on our business. Although we are attempting to expand our customer base, we expect that our customer concentration will not change significantly in the near future. The markets in which we sell our products are dominated by a relatively small number of customers who have contracts with United States governmental agencies, thereby limiting the number of potential customers. We cannot be sure that we will be able to retain our largest customers or that we will be able to attract additional customers, or that our customers will continue to buy our products in the same amounts as in prior years. The loss of one or more of our largest customers, any reduction or interruption in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may have to make, could significantly harm our business.

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

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

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

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

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

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conditions, may adversely affect the future market price of our common stock, as well as our overall operating results.

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

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

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

Our future success depends to a significant extent upon the continued service of our executive officers and other key management and technical personnel and on our ability to continue to attract, retain and motivate executive and other key employees, including those in managerial, technical, marketing and information technology support positions. Attracting and retaining skilled workers and qualified sales representatives is also critical to us. Experienced management and technical, marketing and support personnel in the defense and aerospace industries are in demand and competition for their talents is intense. The loss of the services of one or more of our key employees or our failure to attract, retain and motivate qualified personnel could have a material adverse effect on our business, financial condition and results of operations.

Our indebtedness may affect operations.

As described under the caption "Management's Discussion and Analysis or Plan of Operation - Liquidity and Capital Resources", we have significant indebtedness. We are significantly leveraged and our indebtedness is substantial in relation to our stockholders' equity. Our ability to make principal and interest payments will depend on future performance, which is subject to many factors, some of which are outside our control. In addition, our Loan Facility is secured by substantially all of our assets. In the case of a continuing default under our Loan Facility, the lender will have the right to foreclose on our assets, which would have a material adverse effect on our business. Payment of principal and interest on the Loan Facility may limit our ability to pay cash dividends to our stockholders and the documents governing the Loan Facility prohibit the payment of cash dividends in certain situations. Our leverage may also adversely affect our ability to finance future operations and capital needs, may limit our ability to pursue business opportunities and may make our results of operations more susceptible to adverse economic conditions.

We may issue shares of our capital stock or debt securities to complete an acquisition, which would reduce the equity interest of our stockholders.

We may issue our securities to acquire companies or businesses. Most likely, we will issue additional shares of our common stock or preferred stock, or both, to complete acquisitions. If we issue additional shares of our common stock or shares of our preferred stock, the equity interest of our existing stockholders may be reduced significantly, and the market price of our common stock may decrease. The shares of preferred stock we issue are likely to provide holders with dividend, liquidation and voting rights, and may include

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participation rights, senior to, and more favorable than, the rights and powers of holders of our common stock.

If we issue debt securities as part of an acquisition, and we are unable to generate sufficient operating revenues to pay the principal amount and accrued interest on that debt, we may be forced to sell all or a significant portion of our assets to satisfy our debt service obligations, unless we are able to refinance or negotiate an extension of our payment obligation. Even if we are able to meet our debt service obligations as they become due, the holders of that debt may accelerate payment if we fail to comply with, and/or are unable to obtain waivers of, covenants that require us to maintain certain financial ratios or reserves or satisfy certain other financial restrictions. In addition, the covenants in the loan agreements may restrict our ability to obtain additional financing and our flexibility in operating our business.

We have a limited number of shares available for future issuance and will need approval by our current shareholders to authorize more shares for issuance.

We are authorized to issue 120,055,746 shares of common stock. As of November 9, 2007, we had outstanding or commitments to issue 112,126,835 shares of common stock after giving effect to the conversion of our series B convertible preferred stock and the exercise of all outstanding options and warrants. Restrictions in our credit facility require that we pay dividends on our series B convertible preferred stock by issuing shares of our common stock. We are authorized to issue 8,003,716 shares of blank check preferred stock of which 2,000,000 shares have been designated series B convertible preferred stock. To facilitate the raising of additional capital or the completion of acquisitions, it is likely that we will seek shareholder approval to increase the number of shares of common stock we are authorized to issue.

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Because of our limited resources and the significant competition for acquisitions, we may not be able to consummate an acquisition with growth potential, if at all.

We expect to encounter intense competition from other entities having a business objective similar to ours, including venture capital funds, leveraged buyout funds and operating businesses competing for acquisitions. Many of these entities are well established and have extensive experience in identifying and effecting business combinations. Many of these competitors possess greater technical, human and other resources than we do and our financial resources will be relatively limited when contrasted with those of many of these competitors. While we believe that there are numerous potential target businesses that we could acquire, our ability to compete in acquiring certain target businesses will be limited by our available financial resources. This inherent competitive limitation gives others an advantage in pursuing the acquisition of certain target businesses.

We may be unable to obtain financing, if required, to complete an acquisition or to fund the operations and growth of any business acquired, which could compel us to abandon a particular prospective acquisition.

If we require financing to complete an acquisition, that financing may not be available in amounts and on terms acceptable to us, if at all. To the extent that financing proves to be unavailable when needed to consummate a particular acquisition, we would be compelled to restructure the transaction or abandon that particular acquisition. In addition, if we consummate an acquisition, we may require financing to fund the operations or growth of the business acquired. Our inability to secure additional financing could have a material adverse

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effect on the continued development or growth of our business.

### Item 3. Controls and Procedures

SEC Release 33-8760 provides that non-accelerated filers such as us are not required to include management's evaluation of controls and procedures under this Item until our Annual Report for the fiscal year ended December 31, 2007.

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## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

At the time we acquired our metals distribution business it was a defendant in an action by a former employee filed on November 3, 2006 in the Supreme Court of the State of New York, Nassau County captioned Philip Karmel against Sigma Metals, Inc. (Index No. 06-018054) seeking damages as a result of the termination of employment. This litigation was settled on or about September 20, 2007 for the amount of \$18,846.

We are a defendant in an action by our former investor relations firm filed on September 18, 2007 in the Supreme Court of the State of New York, New York County captioned Porter, Levay & Rose, Inc. against Air Industries Group, Inc. et al. (Index No. 003104/07). The complaint alleges breach of contract and seeks compensatory damages of approximately \$211,347 for services rendered and an order directing us to deliver to plaintiff warrants to purchase 125,000 shares of our common stock, containing a cashless exercise feature. The complaint also seeks punitive damages unspecified in amount. The case is in its early stages. We previously issued approximately 41,668 of the warrants sought by the plaintiff. We anticipate this action will be settled for approximately \$30,000 and have accrued an expense in such amount.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On or about October 1, 2007, the Company issued to the former shareholders of Sigma Metals, Inc. the 7,416,082 shares of the Company's Common Stock, \$.001 par value per share (the "Shares") due as a result of our acquisition of Sigma as previously reported. The issuance and sale of the shares to the former shareholders of Sigma Metals, Inc. was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of the Securities Act and Regulation D promulgated thereunder. No underwriting discounts or commissions were paid in connection with the issuance of these shares.

Except as stated above, information concerning unregistered sales of our equity securities during the fiscal quarter ended September 30, 2007 has previously been disclosed in our Current Reports on Form 8-K.

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#### Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit No.	Description
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- 3.1 Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K report, filed February 15, 2006).
- 3.2 Certificate of Amendment to Certificate of Incorporation (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K report, filed July 2, 2007).
- 3.3 By-Laws of the Registrant (incorporated by reference to Exhibit 3.2 of the Registrant's Form 8-K report, filed February 15, 2006).
- 4.1 Certificate of Designation (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 4.2 Convertible Promissory Note, dated November 30, 2005, in the amount of \$332,631, from Gales Industries Incorporated (and assumed by the Registrant) to Dario Peragallo (incorporated by reference to Exhibit 4.2 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.3 Form of Warrant issued by the Registrant to GunnAllen Financial, Inc. (incorporated by reference to Exhibit 4.3 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.4 Form of Warrant issued by Original Gales to Atlas Private Equity, LLC (and assumed by the Registrant) (Incorporated by reference to Exhibit 4.4 of the Registrants Form 10-KSB, filed April 17, 2006).
- 4.5 Form of Warrant issued by Gales Industries Incorporated (and assumed by the Registrant) to investors in the \$45,000 Bridge Financing in or about August 2005 (incorporated by reference to Exhibit 4.5 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.6 Form of Warrant issued by Gales Industries Incorporated (and assumed by the Registrant) to investors in the \$105,000 Bridge Financing in or about September, 2005 (incorporated by reference to Exhibit 4.6 of the Registrant's Form 8-K report, filed December 6, 2005).
- 4.7 Form of Warrant issued to Porter, LeVay & Rose, Inc. (incorporated herein by reference to Exhibit 4.7 to Registrant's Amendment No. 1 on Form SB-2/A, filed June 16, 2006).
- 10.1 Form of Subscription Agreement for series B convertible preferred stock (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.2 Stock Purchase Agreement, dated January 2, 2007, between the Registrant, Sigma Metals, Inc. and the shareholders of Sigma Metals, Inc. (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 3, 2007).
- 10.3 Form of Promissory Note issued to the former shareholders of Sigma Metals, Inc. (incorporated by reference from Exhibit 10.2 to the Registrant's Current report on Form 8-K filed on April 18, 2007).
- 10.4 Employment Agreement by and between the Registrant and George Elkins, dated as of April 12, 2007 (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.5 Employment Agreement by and between the Registrant and Carole Tate, dated as of April 12, 2007 (incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.6 Employment Agreement by and between the Registrant and Joseph Coonan, dated as of April 12, 2007 (incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed with the SEC on April 18, 2007).
- 10.7 Letter of Clarification between the Registrant and Michael A. Gales dated May 11, 2007 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-QSB for the fiscal quarter ended March 31, 2007).

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- 10.8 Stock Purchase Agreement, dated March 9, 2007, between the Registrant and the shareholders of Welding Metallurgy, Inc. (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 15, 2007).
- 10.9 Amendment No 1. to Stock Purchase Agreement, dated August 2, 2007, between the Registrant and the shareholders of Welding Metallurgy, Inc. (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8- K/A filed on August 3, 2007).
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- 10.10 7% Promissory Note of Registrant in the principal amount of \$2,000,000 in favor of John and Lugenia Gantt (incorporated by reference from Exhibit 10.1 to the Registrant's Form 8-K report, filed August 28, 2007).
- 10.11 Consulting Agreement by and among Welding Metallurgy, Inc., Gantt Associates Ltd. And John Gantt, dated as of August 24, 2007 (incorporated by reference from Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.12 Escrow Agreement dated as of August 24,2007 by and among the Registrant John Gantt and Eaton & Van Winkle LLP, as escrow agent (incorporated by reference from Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.13 Registration Rights Agreement dated as of August 24, 2007 by and among the Registrant and John and Lugenia Gantt (incorporated by reference from Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.14 Fourth Amendment to the Revolving Credit, Term Loan and Security Agreement dated as of November 10, 2005 (the "PNC Bank Credit Facility") with the financial institutions named therein (the "Lenders") and PNC Bank N.A., as agent for the Lenders, as amended, dated as of August 24, 2007 (incorporated by reference from Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.15 Loan and Security Agreement dated as of August 24, 2007 by and among Air Industries Machining, Corp., Sigma Metals, Inc., Welding Metallurgy, Inc. and Steel City Capital Funding LLC (incorporated by reference from Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.16 Pledge Agreement dated as of August 24, 2007 by and among Air Industries Machining, Corp., Sigma Metals, Inc., as pledgors, and Steel City Capital Funding LLC, as pledge (incorporated by reference from Exhibit 10.7 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.17 Pledge Agreement dated as of August 24, 2007 by and among Air Industries Machining, Corp., Sigma Metals, Inc. as pledgors and John and Lugenia Gantt, as pledges (incorporated by reference from Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.18 Pledge Agreement dated as of August 24, 2007 by and between Air Industries Group, Inc., as pledgor, and Steel City Capital Funding LLC, as pledge (incorporated by reference from Exhibit 10.9 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 10.19 Guarantor Suretyship Agreement dated as of August 24, 2007 between the Registrant and Steel City Capital Fundung LLC(incorporated by reference from Exhibit 10.10 to the Registrant's Current Report on Form 8-K filed on August 24, 2007).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

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- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

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SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: November 14, 2007

AIR INDUSTRIES GROUP INC.  
(formerly Gales Industries Incorporated)

By: /s/ Peter D. Rettaliata

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Peter D. Rettaliata  
President and Chief Executive Officer

/s/ Louis A. Giusto

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Louis A. Giusto  
Vice Chairman, Chief Financial Officer  
and Treasurer (Principal Financial and  
Accounting Officer)

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