

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

FORM 10-K/A

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

For the fiscal year ended: December 31, 2017

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

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

Commission File No. 001-35927

**AIR INDUSTRIES GROUP**

(Name of small business issuer in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

80-0948413

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

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

(Address of Principal Executive Offices)

(631) 881-4920

(Registrant's Telephone Number, Including Area Code)

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

Name of Exchange on which Registered

NYSE AMERICAN

Title of Each Class

Common Stock, par value \$0.001

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

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

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

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

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

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

Large Accelerated Filer  Non-Accelerated Filer  Accelerated Filer  Smaller Reporting Company   
Emerging growth 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 Act). Yes  No

As of June 30, 2017, the aggregate market value of our common stock held by non-affiliates was \$ 11,879,537, based on 6,636,613 shares of outstanding common stock held by non-affiliates, and a price of \$1.79 per share, which was the last reported sale price of our common stock on the NYSE American on that date.

There were a total of 25,213,805 shares of the registrant's common stock outstanding as of March 28, 2018.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the registrant's definitive Proxy Statement relating to its 2018 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. Such Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.



### **Explanatory Note**

This amendment is being filed to include the XBRL presentation and to correct certain numbers in Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and certain Notes to the Consolidated Financial Statements, specifically, Note 2. – Discontinued Operations, and Note 3. Summary of Significant Accounting Policies – Credit and Concentration Risks.

Except for the corrections to the foregoing items, amendment speaks as of the original date of the original filing, does not reflect events that may have occurred subsequent to the date of the original filing and does not modify or update in any way any other disclosures made in the original filing.

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## PART II

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

#### Market for Our Common Stock

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

2016:

Quarter Ended March 31, 2016	\$	8.27	\$	5.90
Quarter Ended June 30, 2016	\$	6.18	\$	4.12
Quarter Ended September 30, 2016	\$	5.08	\$	3.85
Quarter Ended December 31, 2016	\$	4.49	\$	2.21

2017:

Quarter Ended March 31, 2017	\$	4.60	\$	2.75
Quarter Ended June 30, 2017	\$	3.60	\$	1.79
Quarter Ended September 30, 2017	\$	1.75	\$	1.20
Quarter Ended December 31, 2017	\$	1.69	\$	1.30

#### Dividend Policy

The declaration and payment of dividends on our common stock is subject to the discretion of our Board of Directors and depends on a number of factors, including future earnings, capital requirements, restrictions under our Loan Facility, financial conditions and future prospects and other factors the Board of Directors may deem relevant.

#### Holders

On March 28, 2018 there were 279 stockholders of record of our common stock. The number of record holders does not include persons who held our Common Stock in nominee or “street name” accounts through brokers.

#### Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes shares of our Common Stock to be issued upon exercise of options and warrants, the weighted-average exercise price of outstanding options and warrants and options available for future issuance pursuant to our equity compensation plans as of December 31, 2017:

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price Of Outstanding Options, Warrants and Rights	Number of Remaining Shares Available for Future Securities Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders	1,048,627	3.20	818,658
Equity compensation plans not approved by security holders	1,704,102	3.62	None
<b>Total</b>	<b>2,752,729</b>		<b>818,658</b>

## Recent Sales of Unregistered Equity Securities

Except as previously reported in our periodic reports filed under the Exchange Act, we did not issue any unregistered equity securities during the fiscal year ended December 31, 2017.

## Purchases of Our Equity Securities

No repurchases of our common stock were made during the fiscal year ended December 31, 2017.

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

*The following discussion of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements for the years ended December 31, 2017 and 2016 and the notes to those statements included elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. You should specifically consider the various risk factors identified in this report that could cause actual results to differ materially from those anticipated in these forward-looking statements.*

### Business Overview

We are an aerospace company operating primarily in the defense industry, though the proportion of our business represented by the commercial 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.
  - 3) 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 (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.
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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. 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.

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.

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.

### **Public Offering**

On July 12, 2017, we sold 5,175,000 shares of common stock at a price of \$1.50 per for gross proceeds of \$7,762,500 in a firm commitment underwritten public offering (the "Public Offering"). We received net proceeds of approximately \$6,819,125 from the sale of our shares in the Public Offering. For additional information concerning the Public Offering and the related restructuring transactions (the "Restructuring Transactions"), see the discussion under the caption "Liquidity," below.

### **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.

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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**

### **Years ended December 31, 2017 and 2016:**

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:**

	<b>2017</b>	<b>2016</b>
Net sales	\$ 49,869,000	\$ 51,321,000
Cost of sales	45,002,000	47,052,000
Gross profit	4,867,000	4,269,000
Operating expenses and interest and financing costs	14,808,000	16,904,000
Other income (expense) net	(22,000)	(131,000)
(Benefit from) provision for income taxes	(197,000)	2,101,000
Net loss from continuing operations	\$ (15,873,000)	\$ (14,867,000)

### **Balance Sheet Data:**

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Cash and cash equivalents	\$ 630,000	\$ 1,304,000
Working capital	9,531,000	8,562,000
Total assets	60,755,000	82,800,000
Total stockholders' equity	\$ 17,766,000	\$ 24,890,000

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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:

	Year Ended December 31,	
	2017	2016
<b>COMPLEX MACHINING</b>		
Net Sales	\$ 38,489,000	\$ 37,124,000
Gross Profit	4,906,000	4,382,000
Pre Tax Loss	(2,839,000)	(5,432,000)
Assets	43,207,000	45,073,000
<b>AEROSTRUCTURES &amp; ELECTRONICS</b>		
Net Sales	4,574,000	3,224,000
Gross Profit	507,000	38,000
Pre Tax Loss	(4,233,000)	(3,240,000)
Assets	1,021,000	4,596,000
<b>TURBINE ENGINE COMPONENTS</b>		
Net Sales	6,806,000	10,973,000
Gross Profit	(546,000)	(151,000)
Pre Tax Loss	(7,599,000)	(4,084,000)
Assets	6,157,000	17,235,000
<b>CORPORATE</b>		
Net Sales	—	—
Gross Profit	—	—
Pre Tax Loss	(1,399,000)	(10,000)
Assets	288,000	649,000
<b>CONSOLIDATED</b>		
Net Sales	49,869,000	51,321,000
Gross Profit	4,867,000	4,269,000
Pre Tax Loss	(16,070,000)	(12,766,000)
(Benefit from) provision for Income Taxes	(197,000)	2,101,000
Loss from Discontinued Operations	(6,678,000)	(756,000)
Assets Held for Sale	10,082,000	15,247,000
Net Loss	(22,551,000)	(15,623,000)
Assets	\$ 60,755,000	\$ 82,800,000

**Net Sales:**

Consolidated net sales for the year ended December 31, 2017 were \$49,869,000, a decrease of \$1,452,000, or 2.8%, compared with \$51,321,000 for the year ended December 31, 2016. Net sales of our Complex Machining segment were \$38,489,000, an increase of \$1,365,000, or 3.7%, from \$37,124,000 in the prior year. Net sales of our Aerostructures & Electronics segment, after elimination of discontinued operations, were \$4,574,000, an increase of \$1,350,000, or 41.9%, from \$3,224,000 in the prior year. This increase can be attributed to increased volume at EUR-PAC. Net sales in our Turbine Engine Components segment were \$6,806,000, a decrease of \$4,167,000, compared with \$10,973,000 for the year ended December 31, 2016. This decrease was due almost entirely to the sale of AMK in January 2017 which had sales of \$4,511,000 in 2016 and \$417,000 in 2017. Excluding the results of AMK in both annual periods, consolidated net sales would have been \$49,452,000 in 2017 or an increase of 5.6% as compared to \$46,810,000 in 2016.

As indicated in the table below, three customers represented 62.0% and three customers represented 52.3% of total sales for the years ended December 31, 2017 and 2016, respectively.

Customer	Percentage of Sales	
	2017	2016
Sikorsky Aircraft	25.5%	21.3%
Goodrich Landing Gear Systems	20.5%	14.6%
United States Department of Defense	16.0%	16.4%



As indicated in the table below, three customers represented 68.7% and two customers represented 35.3% of gross accounts receivable at December 31, 2017 and 2016, respectively.

Customer	Percentage of Receivables	
	2017	2016
Goodrich Landing Gear Systems	41.9%	24.1%
Rohr	14.6%	11.2*
Sikorsky Aircraft	12.2%	*

\* Customer was less than 10% of Gross Accounts Receivable at December 31, 2016.

### **Gross Profit:**

Consolidated gross profit from operations for the year ended December 31, 2017 was \$4,867,000, an increase of \$598,000, or 14.0%, as compared to gross profit of \$4,269,000 for the year ended December 31, 2016. Consolidated gross profit as a percentage of sales was 9.8% and 8.3% for the years ended December 31, 2017 and 2016, respectively. Gross profit from operations for AMK, which was sold in January 2017, for the year ended December 31, 2016 was approximately \$169,000. Excluding AMK from the Company's 2016 results would result in gross profit of \$4,100,000 or 8.8% of sales of \$46,810,000. The increase in gross profit from 8.8% to 9.8% after removing results of AMK was due to the implementation of cost reduction and productivity improvement initiatives.

### **Interest and Financing Costs**

Our interest and financing costs increased from \$2,500,000 in 2016 to \$3,378,000 in 2017.

### **Impairment Charges**

In fiscal 2017, we recorded a goodwill impairment charge of \$6,195,000 and a loss on assets held for sale of \$1,563,000, each of which amounts are included in the loss from continuing operations. In addition, in connection with the sale of WMI, we recorded a goodwill impairment charge of \$3,417,000 and an impairment of intangible asset write-down of \$1,085,000, both of these amounts are included in the loss from discontinued operations.

### **Operating Expense**

Consolidated operating expenses for the year ended December 31, 2017 totaled \$11,430,000 and decreased by \$2,974,000 or 20.6% compared to \$14,404,000 for the year ended December 31, 2016. The decrease in operating expenses is primarily due to staff reduction measures and cost reduction initiatives.

### **Net Loss**

Net loss for the year ended December 31, 2017 was \$22,551,000, an increase of \$6,928,000, compared to a net loss \$15,623,000 for the year ended December 31, 2016, for the reasons discussed above. Our net loss in 2017 and 2016 includes a net loss from the discontinued operations of WMI and related operations of \$6,678,000 and \$756,000, respectively. In addition, our net loss for 2017 includes an impairment charge related to ongoing operations of approximately \$6,195,000. Excluding such amounts, our net loss in 2017 would have been \$9,678,000 and in 2016 would have been \$14,867,000.

### **Impact of Inflation**

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

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## **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. 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.

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 \$16,455,000 and \$24,393,000, as of December 31, 2017 and 2016 (including excess advances at December 31, 2016), 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.

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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. We paid \$50,000 to PNC in connection with the amendment and reimbursed PNC's counsel fees.

As of December 31, 2017, we were not in compliance with our Fixed Charge Coverage Ratio covenant.

As of December 31, 2017, our outstanding indebtedness to PNC was \$19,926,000 and consisted of revolving loans in the amount of \$16,455,000 and the term loan of \$3,471,000, as compared to December 31, 2016, when our debt to PNC was \$31,042,000 and consisted of revolving loans of \$24,393,000 and the term loan of \$6,649,000. In addition, as of December 31, 2017 we had capitalized lease obligations to third parties of \$3,073,000, as compared to capitalized lease obligations of \$4,215,000 as of December 31, 2016.

## **Significant Transactions Since January 1, 2017 Which Have Impacted Our Liquidity**

### ***Dispositions***

On January 27, 2017, we 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. In June 2017, we agreed to a final working capital adjustment with the buyer reducing the gain on sale from \$451,000 to \$200,000. 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 were applied in accordance with the terms of the Fourteenth Amendment to the Loan Facility, as discussed above.

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.

### ***Series A Preferred Stock***

Pursuant to the restructuring completed in connection with our July 2017 public offering, all outstanding shares of Series A Preferred Stock were converted into 8,629,606 shares of our common stock.

### ***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.

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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 year ended December 31, 2017, we issued \$354,238 principal amount of 8% Notes in lieu of cash payment of accrued interest. As of December 31, 2017, we had outstanding \$5,525,000 principal amount of 8% Notes, of which \$3,003,000 principal amount is due on November 30, 2018 and \$2,522,000 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***

Related party notes payable to Michael and Robert Taglich, and their affiliated entities, totaled \$2,126,000 and \$1,086,000, as of December 31, 2017 and December 31, 2016, respectively.

On March 17, 2017, we borrowed \$200,000 and \$300,000 from each of Michael Taglich and Robert Taglich, respectively, and issued promissory notes in the principal amounts of \$200,000 and \$300,000 to Michael Taglich and Robert Taglich, respectively (the "Taglich Notes"). The Taglich Notes bore interest at the rate of 7% per annum. Pursuant to the restructuring completed in connection with our July 2017 public offering, the Taglich Notes have been converted into 346,992 shares of common stock.

On May 2, and May 10, 2017, we borrowed an aggregate of \$750,000 from each of Michael Taglich and Robert Taglich. This indebtedness, together with accrued interest, were converted into May 2018 Notes on May 12, 2017.

In April 2018, Michael and Robert Taglich advanced an aggregate of \$1,150,000 which funds are to be applied to a private placement on terms yet to be determined.

Taglich Brothers acted as a placement agent in connection with the sale of the May 2018 Notes and warrants discussed below for which they are to be paid commissions in the aggregate amount of \$176,000.

As compensation for its services as placement agent for the offering of the 12% Notes discussed below, we paid Taglich Brothers a fee of \$295,400 and issued to Taglich Brothers five-year warrants to purchase 68,617 shares of common stock at an initial exercise price of \$6.15, subject to certain anti-dilution and other adjustments.

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## ***May Note Financing***

On May 12 and May 19, 2017, we issued and sold to 17 accredited investors (including Michael N. Taglich and Robert F. Taglich individually and a partnership of which they are partners), our “May 2018 Notes” in the aggregate principal amount of \$4,158,624, together with warrants to purchase an aggregate of 501,039 shares of common stock, for gross proceeds (net of the exchange of indebtedness totaling \$1,503,288 due to Michael N. Taglich and Robert F. Taglich of \$2,534,196, Roth Capital LLC and Taglich Brothers acted as placement agents in connection with the sale of the May 2018 Notes and warrants for which they are to be paid commissions in the aggregate amount of \$191,155.

The May 2018 Notes and warrants were issued for a purchase price equal to 97% of the principal amount of the May 2018 Notes purchased. The conversion price of the May 2018 Notes was originally \$2.49 per share. In connection with our July public offering, approximately \$1,754,215 principal amount of the May 2018 Notes were converted into 1,240,605 shares of common stock at a conversion price of \$1.50 per share, the public offering price of the shares sold in the Public Offering, and \$463,501 principal amount of May 2018 Notes were redeemed. The balance of the May 2018 Notes were converted into 1,222,809 shares of common stock at \$1.50 per share, the public offering price of the shares sold in the Public Offering, pursuant to the restructuring approved by our stockholders at our Annual Meeting on October 3, 2017. Consequently, no May 2018 Notes remain outstanding.

We issued warrants to purchase 501,039 shares of common stock as part of the private placement of the May 2018 Notes. The warrants, when issued, were exercisable at an initial exercise price of \$2.49 per share until May 12, 2022, and may be exercised on a cashless basis for a lesser number of shares based upon prevailing market prices when exercised. The exercise price of the warrants is subject to anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as recapitalizations, mergers and other business combination transactions. In accordance with the terms of the warrants, the exercise price was reduced to \$1.50 per share, the public offering price of the shares of common stock sold in the Public Offering.

We early adopted the provisions of ASU 2017-11 in recognizing the warrants. As a result, the exercise price reset provisions were excluded from the assessment of whether the warrants are considered indexed to our own stock. The warrants otherwise meet the requirements for equity classification, as such were initially classified in Stockholders’ Equity. We will recognize the value of the exercise price reset provision if and when it becomes triggered, by recognizing the value of the effect of the exercise price reset as a deemed dividend and a reduction of income available to common shareholders in computing basic earnings per share.

The proceeds received upon issuing the May 2018 Notes and warrants was allocated to each instrument on a relative fair value basis. The allocation resulted in an effective conversion price for the May 2018 Notes that was below the quoted market price of our common stock. As such, we recognized a beneficial conversion feature equal to the intrinsic value of the conversion feature on each issuance date, resulting in an additional discount to the initial carrying value of the May 2018 Notes with a corresponding credit to additional paid-in capital.

We recognized an aggregate debt discount on the May 2018 Notes of approximately \$2.5 million, comprised of the allocation of proceeds to the warrants and recognition of the beneficial conversion feature. The debt discount is presented net of the May 2018 Note balance in the Condensed Consolidated Balance Sheets and is amortized to interest expense over the term of the May 2018 Notes using the effective interest method. We amortized approximately \$739,000 to interest expense in the year ended December 31, 2017.

## ***Public Offering and Restructuring***

On July 12, 2017, we sold 5,175,000 shares of common stock at a price of \$1.50 per for gross proceeds of \$7,762,500 in the Public Offering. We received net proceeds of approximately \$6,819,125 of which approximately \$4,000,000 was used to pay outstanding trade payable, \$463,501 was used to redeem an equal principal amount of May 2018 Notes at a redemption price of 100% of the principal amount thereof and approximately \$2,355,624 was added to our working capital.

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In connection with the Public Offering, approximately \$1,860,908 aggregate principal amount of the May 2018 Notes were converted into an aggregate of 1,240,605 shares of our common stock at a conversion price of \$1.50 per share, the public offering price of the shares sold in the Public Offering.

In addition, we issued shares of common stock in connection with the Restructuring Transactions, described below, contemplated by the Public Offering, at a conversion price of \$1.50 per share, upon obtaining stockholder approval at our Annual Meeting of Stockholders on October 3, 2017:

- May 2018 Notes in the aggregate principal amount of \$1,834,214 were converted into 1,222,809 shares.
- All of the outstanding 1,294,441 shares of Series A Preferred Stock were converted into 8,629,606 shares.
- The Taglich Notes in the principal amount of \$500,000, together with accrued interest thereon, were converted into 346,992 shares.

### **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 \$56,000 (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.

After giving effect to the foregoing transactions, we had outstanding approximately 25,034,084 shares of common stock and no shares of preferred stock. In addition, other than the indebtedness under our Loan Facility and the indebtedness represented by our 8% Notes, our only other indebtedness for money borrowed was the \$1,150,000 advanced by Michael and Robert Taglich on terms to be determined.

### **Cash Flow**

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

	<b>Year Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
Cash provided by (used in)		
Operating activities	\$ (3,986)	(692)
Investing activities	1,761	(924)
Financing activities	1,551	2,391
Net (decrease) increase in cash and cash equivalents	\$ (674)	775

### ***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 year ended December 31, 2017, net cash was impacted by a net loss of \$22,551,000, offset by \$19,172,000 of non-cash items consisting primarily of goodwill impairment of \$9,612,000, depreciation of property and equipment of \$2,723,000, amortization of debt discount on convertible notes payable of \$2,301,000, amortization of capitalized engineering costs and intangibles of \$1,096,000. Operating assets and liabilities further used cash in the net amount of \$607,000 consisting primarily of the net decrease of accounts payable and accrued expenses in the amount \$3,527,000 and a decrease in accounts receivable of \$1,004,000, partially offset primarily by decreases in inventory of \$905,000 prepaid taxes of \$360,000 and an increase in deferred revenue of \$410,000.

For the year ended December 31, 2016, our net cash used in operating activities of \$692,000 was comprised of a net loss of \$15,623,000 plus \$6,712,000 of cash provided by changes in operating assets and liabilities plus adjustments for non-cash items of \$8,219,000. Adjustments for non-cash items consisted primarily of depreciation of property and equipment of \$3,347,000, amortization of capitalized engineering costs, intangibles and other items of \$2,229,000, bad debt expense of \$274,000, representing amounts reserved for as potentially uncollectible, and non-cash compensation of \$167,000, deferred income taxes of \$2,063,000, loss on sale of fixed assets held for sale of \$5,000, loss on extinguishment of debt of \$172,000, and prepaid taxes of \$126,000. These non-cash items were offset by \$38,000 of deferred gain on the sale of real estate. The increase in operating assets and liabilities consisted of a net decrease in Operating Assets of \$2,045,000 and a net increase in Operating Liabilities of \$4,667,000. The increase in Operating Assets was comprised of an increase in inventory of \$2,902,000, and a net decrease in prepaid expenses and other current assets, and deposits and other assets of \$394,000, partially offset by a decrease in accounts receivable of \$4,616,000. The net increase in Operating Liabilities was comprised of increases in accounts payable and accrued expenses of \$4,495,000 due to the timing of the receipt and payment of invoices, an increase in deferred rent of \$82,000, and an increase in deferred revenue of \$84,000, partially offset by an increase in income taxes payable of \$6,000.

### ***Cash Provided By (Used in) Investing Activities***

Cash provided by investing activities consists of the cash received from the businesses we sold, reduced by capital expenditures for property and equipment and capitalized engineering costs. 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.

For the year ended December 31, 2017, cash provided by investing activities was \$1,761,000. This was comprised of the proceeds from the sale of the AMK subsidiary of \$4,260,000, offset by \$985,000 for capitalized engineering costs and \$1,514,000 for the purchase of property and equipment.

For the year December 31, 2016, cash used in investing activities was \$924,000. This was comprised of \$963,000 of capitalized engineering costs, \$1,632,000 used for the purchase of property and equipment, offset by the proceeds of the sale of fixed assets of \$1,671,000.

### ***Cash Provided By Financing Activities***

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

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For the year ended December 31, 2017, cash provided by financing activities was \$1,551,000. This was comprised of repayments of \$3,178,000 on our term loan, \$7,938,000 on our revolving loans, \$1,397,000 on our capital lease obligations, payments of notes payable issuances of \$463,000, and deferred financing costs of \$50,000, offset by proceeds from notes payable issuances of \$2,660,000 to related parties and \$4,184,000 to third parties and proceeds from the issuance of common stock of \$7,733,000.

For the year ended December 31, 2016, cash provided by financing activities was \$2,391,000. This was comprised of repayments of \$5,211,000 under our revolving credit facility, as well as repayments on our term loans of \$3,184,000, proceeds from note payable of \$4,500,000, as well as repayments under our capital leases of \$1,226,000, proceeds from notes payable of \$3,695,000, expense for issuance of preferred stock of \$663,000, expense for issuance of debt offering \$547,000, proceeds from the issuance of preferred stock of \$5,250,000, and deferred financing costs of \$223,000.

## CONTRACTUAL OBLIGATIONS

*The following table sets forth our future contractual obligations as of December 31, 2017:*

	Total	Payment due by period (in thousands)			
		Less than 1 year*	1-3 years	3-5 years	More than 5 years
Debt and capital leases	\$ 27,069	25,169	1,806	67	—
Operating leases	8,492	1,294	1,886	1,811	3,501
Total	\$ 35,561	26,490	3,692	1,878	3,501

\*The revolving loans and term loans with our senior lender are classified as due in less than 1 year, see Note 11 to our Consolidated Financial Statements.

## OFF-BALANCE SHEET ARRANGEMENTS

We did not have any off-balance sheet arrangements as of December 31, 2017.

## Going Concern

We suffered losses from operations of \$12,758,000 and \$10,135,000 and net losses of \$22,551,000 and \$15,623,000, respectively, for the years ended December 31, 2017 and 2016. We also had negative cash flows from operations for the year ended December 31, 2017. In addition, in 2016 we disposed of the real estate on which one of our operating subsidiaries was located through a sale leaseback transaction, and in January 2017 we sold that operating subsidiary. We have had to sell debt and equity securities to secure funds to operate our business and may have to continue to do so. From September 2016 through June 2017, we issued additional shares of Series A Preferred Stock in lieu of cash payment of accrued dividends on outstanding shares of Series A Preferred Stock and in February 2017, May 2017 and August 2017, we issued additional convertible notes in lieu of cash payment of accrued interest on outstanding convertible notes.

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 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 September 30, 2017.



In late fiscal 2017, we initiated a repositioning of our business to obtain profitability and improve our liquidity position. We named a new CEO and on March 21, 2018, we entered into a Stock Purchase Agreement for the sale of WMI, for a purchase price of \$9,000,000, subject to a working capital adjustment. The sale is subject to certain conditions, including the buyer obtaining financing and is anticipated to close in May or June 2018 although it is possible that that closing may be delayed. In addition, although management believes such event is unlikely, the SPA does provide for certain limited termination rights by either party. Although we believe the proceeds of this acquisition will improve our liquidity position, we still may need further issuances of debt, equity or financing to fund ongoing operations until we achieve sustainable profitability.

The continuation of our business is dependent upon our 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 we are unable to continue as a going concern.

### ***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.

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.

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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***

During fiscal 2017 and 2016, the Company recognized revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." The Company recognizes revenue when products are shipped and/or the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable. Payments received in advance from customers for products delivered are recorded as customer deposits until earned, at which time revenue is recognized. The Terms and Conditions contained in our customer purchase orders often provide for liquidated damages in the event that a stop work order is issued prior to the final delivery. The Company utilizes a Returned Merchandise Authorization or RMA process for determining whether to accept returned products. Customer requests to return products are reviewed by the contracts department and if the request is approved, a credit is issued upon receipt of the product. Net sales represent gross sales less returns and allowances. Freight out is included in operating expenses.

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

### ***Income Taxes***

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

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

### ***Stock-Based Compensation***

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

### ***Goodwill***

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

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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.

### ***Recently Issued Accounting Pronouncements***

In January 2017, the FASB issued ASU 2017-01 (“ASU 2017-01”), Business Combinations, which clarifies the definition of a business, particularly when evaluating whether transactions should be accounted for as acquisitions or dispositions of assets or businesses. The first part of the guidance provides a screen to determine when a set is not a business; the second part of the guidance provides a framework to evaluate whether both an input and a substantive process are present. The guidance will be effective after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted for transactions that have not been reported in issued financial statements. The Company is currently assessing the impact of this update on the presentation of these financial statements.

In January 2017, FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment, Step 2 of the goodwill impairment test, which requires determining the implied fair value of goodwill and comparing it with its carrying amount has been eliminated. Thus, the goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount (i.e., what was previously referred to as Step 1). In addition, ASU No. 2017-04 requires entities having one or more reporting units with zero or negative carrying amounts to disclose (1) the identity of such reporting units, (2) the amount of goodwill allocated to each, and (3) in which reportable segment the reporting unit is included. ASU No. 2017-04 is effective as follows: (1) for a public business entity that is an SEC filer for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company is currently in the process of evaluating the impact of the adoption of this standard on our financial statements.

In July 2017, the FASB issued ASU 2017-11, *Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*. The ASU allows companies to exclude a down round feature when determining whether a financial instrument (or embedded conversion feature) is considered indexed to the entity’s own stock. As a result, financial instruments (or embedded conversion features) with down round features may no longer be required to be accounted classified as liabilities. A company will recognize the value of a down round feature only when it is triggered and the strike price has been adjusted downward. For equity-classified freestanding financial instruments, such as warrants, an entity will treat the value of the effect of the down round, when triggered, as a dividend and a reduction of income available to common shareholders in computing basic earnings per share. For convertible instruments with embedded conversion features containing down round provisions, entities will recognize the value of the down round as a beneficial conversion discount to be amortized to earnings. The guidance in ASU 2017-11 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, and the guidance is to be applied using a full or modified retrospective approach. The Company adopted this guidance in the current quarter, effective April 1, 2017. As a result, the warrants issued on May 12, 2017, in connection with the bridge financing, were equity-classified.

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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.

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.

### ***JOBS Act***

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

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

### **Consolidated Financial Statements**

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

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## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following exhibits are included as part of this amendment to this report. References to “the Company” in this Exhibit List mean Air Industries Group, a Nevada corporation.

Exhibit No. Description

31.1	<a href="#">Certification of principal executive officer pursuant to Rule 13a-14 or Rule 15d-14 of Securities Exchange Act of 1934.</a>
31.2	<a href="#">Certification of principal financial officer pursuant to Rule 13a-14 or Rule 15d-14 of the Exchange Act of 1934.</a>
32.1	<a href="#">Certification of principal executive officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).</a>
32.2	<a href="#">Certification of principal financial officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).</a>
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: April 19, 2018

AIR INDUSTRIES GROUP

By: /s/ Michael E. Recca  
Michael E. Recca  
Chief Financial Officer  
(principal financial and accounting officer)

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Air Industries Group

### Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Air Industries Group and subsidiaries (the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

### Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities law and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

### Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, among other going concern matters discussed, the Company has suffered a net loss in 2017 and has had negative cash flows from operating activities, and is dependent upon future issuances of equity or other financing to fund ongoing operations, all of which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.



We have served as the Company's auditors since 2008.

Saddle Brook, NJ

April 17, 2018

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**AIR INDUSTRIES GROUP**  
**Consolidated Balance Sheets**

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
<b>ASSETS</b>		
Current Assets		
Cash and Cash Equivalents	\$ 630,000	\$ 1,304,000
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$494,000 and \$403,000, respectively	5,464,000	6,073,000
Inventory	31,141,000	32,568,000
Prepaid Expenses and Other Current Assets	214,000	299,000
Prepaid Taxes	49,000	409,000
Assets Held for Sale	10,082,000	21,297,000
<b>Total Current Assets</b>	<b>47,580,000</b>	<b>61,950,000</b>
Property and Equipment, Net	10,050,000	11,197,000
Capitalized Engineering Costs - Net of Accumulated Amortization of \$5,380,000 and \$4,957,000, respectively	2,188,000	1,627,000
Deferred Financing Costs, Net, Deposits and Other Assets	665,000	1,088,000
Intangible Assets, Net	—	471,000
Goodwill	272,000	6,467,000
<b>TOTAL ASSETS</b>	<b>\$ 60,755,000</b>	<b>\$ 82,800,000</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Notes Payable and Capitalized Lease Obligations - Current Portion	\$ 23,131,000	\$ 32,913,000
Notes Payable – Related Party – Current Portion	262,000	1,086,000
Accounts Payable and Accrued Expenses	10,872,000	14,150,000
Deferred Gain on Sale - Current Portion	38,000	38,000
Deferred Revenue	931,000	946,000
Liabilities Directly Associated with Assets Held for Sale	2,795,000	4,235,000
Income Taxes Payable	20,000	20,000
<b>Total Current Liabilities</b>	<b>38,049,000</b>	<b>53,388,000</b>
Long Term Liabilities		
Notes Payable and Capitalized Lease Obligations - Net of Current Portion	1,798,000	2,971,000
Notes Payable – Related Party – Net of Current Portion	1,650,000	—
Deferred Gain on Sale - Net of Current Portion	295,000	333,000
Deferred Rent	1,197,000	1,218,000
<b>TOTAL LIABILITIES</b>	<b>42,989,000</b>	<b>57,910,000</b>
Commitments and Contingencies		
Stockholders' Equity		
Preferred Stock, par value \$.001 - Authorized 3,000,000 shares, Designated as Series A Convertible Preferred Stock – par value \$.001, Authorized 0 at December 31, 2017 and 2,000,000 shares at December 31, 2016; 0 and 1,202,548 outstanding at December 31, 2017 and 2016	—	1,000
Common Stock - Par Value \$.001 - Authorized 50,000,000 Shares, 25,213,805 and 7,626,945 Shares Issued and Outstanding as of December 31, 2017 and December 31, 2016, respectively	25,000	7,000
Additional Paid-In Capital	71,272,000	55,862,000
Accumulated Deficit	(53,531,000)	(30,980,000)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>17,766,000</b>	<b>24,890,000</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 60,755,000</b>	<b>\$ 82,800,000</b>

See Notes to Consolidated Financial Statements



**AIR INDUSTRIES GROUP**  
**Consolidated Statements of Operations For the Years Ended December 31,**

	<u>2017</u>	<u>2016</u>
Net Sales	\$ 49,869,000	\$ 51,321,000
Cost of Sales	45,002,000	47,052,000
Gross Profit	4,867,000	4,269,000
Operating Expenses	(11,430,000)	(14,404,000)
Impairment of goodwill	(6,195,000)	—
Loss from Operations	(12,758,000)	(10,135,000)
Interest and Financing Costs	(3,378,000)	(2,500,000)
Loss on Extinguishment of Debt	(112,000)	—
Gain on Sale of Subsidiary	200,000	—
Other Expenses, Net	(22,000)	(131,000)
Loss before Provision for Income Taxes	(16,070,000)	(12,766,000)
(Benefit from) Provision for Income Taxes	(197,000)	2,101,000
Loss from Continuing Operations	(15,873,000)	(14,867,000)
Loss from Discontinued Operations, net of tax	(6,678,000)	(756,000)
Net Loss	<u>\$ (22,551,000)</u>	<u>\$ (15,623,000)</u>
Net Loss per share - basic		
Continuing operations	(1.20)	\$ (1.96)
Discontinued operations	<u>\$ (0.50)</u>	<u>\$ (0.10)</u>
Net Loss per share – diluted		
Continuing operations	(1.20)	(1.96)
Discontinued operations	<u>\$ (0.50)</u>	<u>\$ (0.10)</u>
Weighted average shares outstanding – basic	13,230,775	7,579,419
Weighted average shares outstanding – diluted	<u>13,230,775</u>	<u>7,579,419</u>

See Notes to Consolidated Financial Statements

**AIR INDUSTRIES GROUP**  
**Consolidated Statements of Stockholders' Equity**  
**For the Years Ended December 31, 2017 and 2016**

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount			
Balance, January 1, 2016	—	—	7,560,040	\$ 7,000	\$ 44,155,000	\$ (15,357,000)	\$ 28,805,000
Issuance of Preferred Stock	1,202,548	\$ 1,000	—	—	10,304,000	—	10,305,000
Fair Value Allocation of Warrants	—	—	—	—	1,236,000	—	1,236,000
Issuance of Restricted Stock	—	—	42,000	—	—	—	—
Exercise of Options and Warrants	—	—	24,905	—	—	—	—
Stock Compensation Expense	—	—	—	—	167,000	—	167,000
Net Loss	—	—	—	—	—	(15,623,000)	(15,623,000)
<b>Balance, December 31, 2016</b>	<b>1,202,548</b>	<b>\$ 1,000</b>	<b>7,626,945</b>	<b>\$ 7,000</b>	<b>\$ 55,862,000</b>	<b>\$ (30,980,000)</b>	<b>\$ 24,890,000</b>
Issuance of Preferred stock	91,893	—	—	—	—	—	—
Fair Value Allocation of Warrants	—	—	—	—	2,500,000	—	2,500,000
Issuance of Common stock	—	—	5,900,390	6,000	7,621,000	—	7,627,000
Common stock issued for directors fees	—	—	154,463	—	232,000	—	232,000
Common stock issued for legal fees	—	—	92,000	—	200,000	—	200,000
Conversion of preferred to common	(1,294,441)	(1,000)	8,629,606	9,000	—	—	8,000
Common stock issued for convertible notes	—	—	2,810,401	3,000	4,525,000	—	4,528,000
Stock Compensation Expense	—	—	—	—	332,000	—	332,000
Net Loss	—	—	—	—	—	(22,551,000)	(22,551,000)
<b>Balance, December 31, 2017</b>	<b>—</b>	<b>—</b>	<b>25,213,805</b>	<b>\$ 25,000</b>	<b>\$ 71,272,000</b>	<b>(53,531,000)</b>	<b>\$ 17,766,000</b>

See Notes to Consolidated Financial Statements

**AIR INDUSTRIES GROUP**  
**Consolidated Statements of Cash Flows For the Years Ended December 31,**

	<u>2017</u>	<u>2016</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Loss	\$ (22,551,000)	\$ (15,623,000)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation of property and equipment	2,723,000	3,347,000
Amortization of intangible assets	673,000	1,279,000
Amortization of capitalized engineering costs	423,000	362,000
Loss on Impairment of goodwill – continuing operations	6,195,000	—
Loss on Impairment of goodwill – discontinued operations	3,417,000	—
Bad debt expense (recovery)	87,000	274,000
Non-cash employee compensation expense	332,000	167,000
Non-cash directors compensation expense	232,000	—
Amortization of deferred financing costs	267,000	371,000
Deferred gain on sale of real estate	(38,000)	(38,000)
Loss on sale of fixed assets held for sale	—	5,000
(Gain) loss on sale of subsidiary	(200,000)	—
Deferred income taxes	—	2,063,000
Loss on impairment of intangible assets – discontinued operations	1,085,000	—
Loss on Assets Held for Sale	1,563,000	—
Loss on extinguishment of debt	112,000	172,000
Amortization of convertible notes payable	2,301,000	217,000
Changes in Assets and Liabilities		
(Increase) Decrease in Operating Assets:		
Assets held for sale - AMK Cash	39,000	(39,000)
Accounts receivable	1,004,000	4,616,000
Inventory	905,000	(2,902,000)
Prepaid expenses and other current assets	281,000	394,000
Prepaid taxes	360,000	126,000
Deposits and other assets	(113,000)	(150,000)
Increase (Decrease) in Operating Liabilities:		
Accounts payable and accrued expense	(3,527,000)	4,495,000
Deferred rent	34,000	82,000
Deferred revenue	410,000	84,000
Income taxes payable	—	6,000
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<u>(3,986,000)</u>	<u>(692,000)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capitalized engineering costs	(985,000)	(963,000)
Purchase of property and equipment	(1,514,000)	(1,632,000)
Proceeds from the sale of fixed assets	—	1,671,000
Proceeds from sale of subsidiary	4,260,000	—
<b>NET CASH PROVIDED BY(USED IN) INVESTING ACTIVITIES</b>	<u>1,761,000</u>	<u>(924,000)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Note payable – revolver – net	(7,938,000)	(5,211,000)
Payments of note payable – term notes	(3,178,000)	(3,184,000)
Capital lease obligations	(1,397,000)	(1,226,000)
Proceeds from note payable – related party	2,660,000	4,500,000
Proceeds from notes payable – third parties	4,184,000	3,695,000
Payments of notes payable – third parties	(463,000)	—
Deferred financing costs	(50,000)	(223,000)
Expense for issuance of preferred stock	—	(663,000)
Expenses for issuance of debt offering	—	(547,000)
Proceeds from issuance of common stock	7,733,000	—
Proceeds from the issuance of preferred stock	—	5,250,000
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<u>1,551,000</u>	<u>2,391,000</u>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENT</b>	<u>(674,000)</u>	<u>775,000</u>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>1,304,000</u>	<u>529,000</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 630,000</u>	<u>\$ 1,304,000</u>

See Notes to Consolidated Financial Statements

**AIR INDUSTRIES GROUP**  
**Consolidated Statements of Cash Flows For the Years Ended December 31, (Continued)**

	<u>2017</u>	<u>2016</u>
<b>Supplemental cash flow information</b>		
Cash paid during the period for interest	\$ 2,035,000	\$ 1,494,000
Cash paid during the period for income taxes	\$ 8,000	\$ 13,000
<b>Supplemental schedule of non-cash investing and financing activities</b>		
Common Stock issued for notes payable - related party	2,254,000	—
Common Stock issued for notes payable - third parties	1,941,000	—
Placement agent warrants issued	85,000	—
Preferred stock issued for notes payable – related party	\$ —	\$ 3,250,000
Preferred stock issued for notes payable – other	\$ —	\$ 2,745,000
Preferred stock issued for PIK dividends	\$ 913,000	\$ 502,000
Acquisition of property and equipment financed by capital lease	\$ 225,000	\$ 2,096,000
Classification of assets held for sale	\$ 10,082,000	\$ 21,297,000
Liabilities directly associated with assets held for sale	\$ (2,795,000)	\$ (4,235,000)

See Notes to Consolidated Financial Statements

**Note 1. FORMATION AND BASIS OF PRESENTATION**

**Organization**

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

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

**Going Concern**

The Company suffered a net loss from operations of \$12,758,000 for the year ended December 31, 2017, and net losses of \$22,551,000 and \$15,623,000 for the years ended December 31, 2017 and 2016, respectively. The Company also had negative cash flows from operations for 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. In January 2017, the Company sold one of its operating subsidiaries. The Company has entered in a Stock Purchase Agreement to sell a majority of its Aerostructures & Electronics segment. During the year ended December 31, 2016 and subsequent thereto, the Company sold in excess of \$29,856,000 in debt and equity securities to secure funds to operate its business. Furthermore, as of 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.

**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.

At December 31, 2016, AMK's assets and liabilities have been reclassified as Assets Held for Sale and Liabilities Directly Associated with Assets Held for Sale, respectively. The carrying value of the assets, net of liabilities, held for sale was less than the contract sales price and accordingly no loss or impairment was recorded for the year ended December 31, 2016.

In connection with the sale of AMK to Meyer Tool, Inc., on January 27, 2017, the Company, together with its wholly-owned subsidiaries, entered into the Fourteenth Amendment to the Amended and Restated Revolving Credit, Term Loan And Security Agreement with PNC Bank, N. A. (the "PNC Loan Agreement") which amends certain terms and conditions of the PNC Loan Agreement and releases AMK from its obligations under the PNC Loan Agreement.

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 will be applied to outstanding accounts payable on a future date to be determined by PNC or used to reduce the amount of the Revolving Advance. The amendment also waives the noncompliance at September 30, 2016 with the Fixed Charge Coverage Ratio and the Minimum EBITDA covenants for the period then ended, and requires that the Company 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 shall be tested based upon the prior six (6) months, the Fixed Charge Coverage Ratio shall not be less than 1.00 to 1.00 and for the quarter ending September 30, 2017, which shall be tested based upon the prior nine (9) months, the Fixed Charge Coverage Ratio shall not be less than 1.10 to 1.00. The amendment also reduces the amount to be paid weekly in repayment of excess advances in the amount of \$5,294,071 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 will return to \$100,000 until such excess advances have been repaid in full.

### **Subsequent Events**

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

### **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.

### **Sale of Unregistered Equity Securities**

On January 9, 2018 the Company issued and sold to 35 accredited investors an aggregate of 852,000 shares of its common stock (the "Shares") and warrants to purchase an additional 255,600 shares of common stock (the "Warrants"), for gross proceeds of \$1,065,000 pursuant to a private placement (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 of common stock 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.

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.

Taglich Brothers, Inc., a related party (see related party footnote for definition), which acted as placement agent for the sale of the Shares and Warrants, is entitled to a placement agent fee equal to \$85,200 (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.

## Related Party Transactions

In April 2018, Michael and Robert Taglich advanced an aggregate of \$1,150,000 to be applied to a private placement on terms to be determined.

## Note 2. — DISCONTINUED OPERATIONS

In March 2018, the Company entered into an agreement to sell WMI and related operations to CPI Aerostructures, Inc. pursuant to a Stock Purchase Agreement (SPA) 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 which pause often after the Specified Date WMI enters into the specified agreements. 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. 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 income (loss) from discontinued operations presented separately in the consolidated statement of operations:

	December 31,	
	2017	2016
Net revenue	\$ 13,129,000	\$ 15,954,000
Cost of goods sold	11,245,000	13,143,000
Gross profit	1,884,000	2,451,000
Operating expenses:		
Selling, general and administrative	2,488,000	3,105,000
Loss on impairment of assets	1,085,000	---
Loss on assets held for sale	1,053,000	—
Impairment of Goodwill	3,417,000	—
Total operating expenses	8,553,000	3,105,000
Interest expense	12,000	96,000
Other income (expense)	3,000	5,000
Loss from discontinued operations before income taxes	(6,678,000)	(745,000)
Provision for income taxes	—	11,000
Net income (loss) from discontinued operations	\$ (6,678,000)	\$ (756,000)

The following table presents a reconciliation of the WMI and subsidiaries net cash flow from operating, investing and financing activities for the periods indicated below:

	2017	2016
Net cash used in operating activities - discontinued operation	\$ (2,765,055)	\$ (749,757)
Net cash used in investing activities - discontinued operation	\$ (33,244)	\$ (172,906)
Net cash provided by financing activities - discontinued operations	\$ 2,664,689	\$ 859,856
Depreciation and amortization	\$ 374,871	\$ 448,215
Capital expenditures	\$ (33,244)	\$ (172,906)

See Note 8 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.

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

#### **Principles of Consolidation**

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

#### **Discontinued Operations**

In March 2018, the Company entered into an agreement to sell WMI. WMI is classified as a discontinued operation (see "Note 2 - Discontinued Operations"). As required, the Company has retrospectively recast its consolidated statements of operations and balance sheets for all periods presented to reflect these businesses as discontinued operations. 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.

#### **Cash and Cash Equivalents**

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

#### **Accounts Receivable**

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

#### **Inventory Valuation**

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

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



### **Assets Held for Sale and Liabilities Directly Associated**

Assets held for sale are reported at the lower of their carrying amount or fair value less cost to sell and included in current assets. Liabilities associated to business units held for sale are classified as a current liability.

### **Capitalized Engineering Costs**

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

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

### **Property and Equipment**

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

### **Long-Lived and Intangible Assets**

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

Long-lived assets and intangible assets subject to amortization to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may be impaired. The Company records an impairment loss if the undiscounted future cash flows are found to be less than the carrying amount of the asset. If an impairment loss has occurred, a charge is recorded to reduce the carrying amount of the asset to fair value. There has been no impairment as of December 31, 2017 and 2016.

### **Deferred Financing Costs**

Costs incurred with obtaining and executing revolving debt arrangements are capitalized and amortized using the effective interest method over the term of the related debt. The amortization of such costs are included in interest and financing costs. Costs incurred with obtaining and executing other debt arrangements are presented as a direct deduction from the carrying value of the associated debt.

## Derivative Liabilities

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

## Revenue Recognition

For 2017 and 2016 the Company recognized revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." The Company recognizes revenue when products are shipped and/or the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable.

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

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

The Company had approximately \$619,000 and \$2,914,000 of net sales that were billed but not shipped under such bill and hold arrangements as of December 31, 2017 and 2016, respectively.

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

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

## Use of Estimates

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

## Credit and Concentration Risks

There were three customers that represented 62.0% of total sales, and three customers that represented 52.3% of total sales for the years ended December 31, 2017 and 2016, respectively. This is set forth in the table below.

Customer	Percentage of Sales	
	2017	2016
1	25.5	21.3
2	20.5	14.6
3	16.0	16.4

There were three customers that represented 68.7% of gross accounts receivable and two customers that represented 35.3% of gross accounts receivable at December 31, 2017 and 2016, respectively. This is set forth in the table below.

Customer	Percentage of Receivables	
	December 2017	December 2016
1	41.9	24.1
2	14.6	11.2
3	12.2	*

\*Customer was less than 10% of gross accounts receivable at December 31, 2016.

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.

## 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.

The provision for, or benefit from, income taxes includes deferred taxes resulting from the temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from the differences in the carrying value of assets and liabilities. Future realization of deferred income tax assets requires sufficient taxable income within the carryback, carryforward period available under tax law. We evaluate, on a quarterly basis whether, based on all available evidence, it is probable that the deferred income tax assets are realizable. Valuation allowances are established when it is more likely than not that the tax benefit of the deferred tax asset will not be realized. The evaluation, as prescribed by ASC 740-10, "Income Taxes," includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused.

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.

Effective July 1, 2016, the Company adopted FASB Accounting Standards Update 2015 - 17, Balance Sheet Classification of Deferred Taxes. The ASU is part of the Board's simplification initiative aimed at reducing complexity in accounting standards. To simplify presentation, the new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. Importantly, the guidance does not change the existing requirement that only permits offsetting within a jurisdiction - that is, companies are still prohibited from offsetting deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction. The amendments in this Update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. If an entity applies the guidance prospectively, the entity should disclose in the first interim and first annual period of change, the nature of and reason for the change in accounting principle and a statement that prior periods were not retrospectively adjusted. If an entity applies the guidance retrospectively, the entity should disclose in the first interim and first annual period of change the nature of and reason for the change in accounting principle and quantitative information about the effects of the accounting change on prior periods. The Company has applied this guidance prospectively and has not restated prior period balances.

### 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:

	2017	2016
Weighted average shares outstanding used to compute basic earnings per share	13,230,775	7,579,419
Effect of dilutive stock options and warrants	—	—
Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share	<u>13,230,775</u>	<u>7,579,419</u>

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

	December 31, 2017	December 31, 2016
Stock Options	354,000	633,000
Warrants	1,480,000	520,000
	<u>1,834,000</u>	<u>1,153,000</u>

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 the years:

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Stock Options	146,000	3,000
Warrants	41,000	321,000
	<u>187,000</u>	<u>324,000</u>

### **Stock-Based Compensation**

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

### **Goodwill**

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. The goodwill amount of \$272,000 at December 31, 2017 relates to the acquisitions of NTW \$163,000 and ECC \$109,000. The goodwill amount of \$9,884,000 at December 31, 2016 relates to the acquisitions of Welding \$292,000, NTW \$163,000, Woodbine \$2,565,000, Eur-Pac \$1,655,000, ECC \$109,000, Sterling \$4,540,000 and Compac \$560,000.

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

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

During 2017 the Company determined that goodwill for Welding, Woodbine, Compac, Eur-Pac and Sterling in the amounts of \$291,000, \$2,565,000, \$560,000, \$1,656,000 and \$4,540,000, respectively, had been impaired. 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.

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.

During 2017, the Company determined that goodwill for Eur-Pac and Sterling in the amounts of \$1,655,000 and \$4,540,000, respectively, had been impaired. The total of \$6,195,000 is included loss from continuing operations.

During 2017, the Company determined that goodwill for Welding, Woodbine and Compac in the amounts of \$292,000, \$2,565,000, \$560,000, respectively, had been impaired. The total of \$3,417,000 is included in loss from discontinued operations.

### **Freight Out**

Freight out is included in operating expenses and amounted to \$196,000 and \$180,000 for the years ended December 31, 2017 and 2016, respectively.

## JOBS Act

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

## Recently Issued Accounting Pronouncements

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

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

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

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 August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The standard provides guidance on how certain cash receipts and payments are presented and classified in the statement of cash flows, including beneficial interests in securitization, which would impact the presentation of the deferred purchase price from sales of receivables. The standard is intended to reduce current diversity in practice. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of these amendments to have a significant impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows: Restricted Cash, which clarifies the presentation requirements of restricted cash within the statement of cash flows. The changes in restricted cash and restricted cash equivalents during the period should be included in the beginning and ending cash and cash equivalents balance reconciliation on the statement of cash flows. When cash, cash equivalents, restricted cash or restricted cash equivalents are presented in more than one-line item within the statement of financial position, an entity shall calculate a total cash amount in a narrative or tabular format that agrees to the amount shown on the statement of cash flows. Details on the nature and amounts of restricted cash should also be disclosed. This standard is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company is currently in the process of evaluating the impact of the adoption of this standard on our financial statements.

In January 2017, the FASB issued ASU 2017-01 (“ASU 2017-01”), Business Combinations, which clarifies the definition of a business, particularly when evaluating whether transactions should be accounted for as acquisitions or dispositions of assets or businesses. The first part of the guidance provides a screen to determine when a set is not a business; the second part of the guidance provides a framework to evaluate whether both an input and a substantive process are present. The guidance will be effective after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted for transactions that have not been reported in issued financial statements. The Company is currently assessing the impact of this update on the presentation of these financial statements.

In January 2017, FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment, Step 2 of the goodwill impairment test, which requires determining the implied fair value of goodwill and comparing it with its carrying amount has been eliminated. Thus, the goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount (i.e., what was previously referred to as Step 1). In addition, ASU No. 2017-04 requires entities having one or more reporting units with zero or negative carrying amounts to disclose (1) the identity of such reporting units, (2) the amount of goodwill allocated to each, and (3) in which reportable segment the reporting unit is included. ASU No. 2017-04 is effective as follows: (1) for a public business entity that is an SEC filer for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company is currently in the process of evaluating the impact of the adoption of this standard on our financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception. The ASU allows companies to exclude a down round feature when determining whether a financial instrument (or embedded conversion feature) is considered indexed to the entity’s own stock. As a result, financial instruments (or embedded conversion features) with down round features may no longer be required to be accounted classified as liabilities. A company will recognize the value of a down round feature only when it is triggered and the strike price has been adjusted downward. For equity-classified freestanding financial instruments, such as warrants, an entity will treat the value of the effect of the down round, when triggered, as a dividend and a reduction of income available to common shareholders in computing basic earnings per share. For convertible instruments with embedded conversion features containing down round provisions, entities will recognize the value of the down round as a beneficial conversion discount to be amortized to earnings. The guidance in ASU 2017-11 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, and the guidance is to be applied using a full or modified retrospective approach. The Company adopted this guidance in the current quarter, effective April 1, 2017. As a result, the warrants issued on May 12, 2017, in connection with the bridge financing, were equity-classified.

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

### **Reclassifications**

Reclassifications occurred to certain 2016 amounts to conform to the 2017 classification.

**Note 4. ACCOUNTS RECEIVABLE**

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

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Accounts Receivable Gross	\$ 5,958,000	\$ 6,476,000
Allowance for Doubtful Accounts	(494,000)	(403,000)
Accounts Receivable Net	<u>\$ 5,464,000</u>	<u>\$ 6,073,000</u>

The allowance for doubtful accounts for the years ended December 31, 2017 and 2016 is as follows:

	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions from Reserves	Balance at End of Year
<b>Year ended December 31, 2017</b>				
Allowance for Doubtful Accounts	\$ 403,000	\$ 91,000	\$ —	\$ 494,000
<b>Year ended December 31, 2016</b>				
Allowance for Doubtful Accounts	\$ 196,000	\$ 274,000	\$ 67,000	\$ 403,000

**Note 5. INVENTORY**

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

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Raw Materials	\$ 5,346,000	\$ 5,513,000
Work In Progress	19,947,000	21,903,000
Finished Goods	10,122,000	8,928,000
Inventory Reserve	(4,274,000)	(3,776,000)
Total Inventory	<u>\$ 31,141,000</u>	<u>\$ 32,568,000</u>

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

	Balance at Beginning of Year	Additions to Reserve	Deductions from Reserves	Balance at End of Year
<b>Year ended December 31, 2017</b>				
Reserve for Inventory	\$ (3,776,000)	\$ (503,000)	\$ 5,000	\$ (4,274,000)
<b>Year ended December 31, 2016</b>				
Reserve for Inventory	\$ (3,181,000)	\$ (681,000)	\$ 86,000	\$ (3,776,000)



**Note 6. PROPERTY AND EQUIPMENT**

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

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>	
Land	\$ 300,000	\$ 300,000	
Buildings and Improvements	1,650,000	1,650,000	31.5 years
Machinery and Equipment	11,554,000	12,172,000	5 - 8 years
Capital Lease Machinery and Equipment	6,534,000	5,573,000	5 - 8 years
Tools and Instruments	8,538,000	7,520,000	1.5 - 7 years
Automotive Equipment	172,000	195,000	5 years
Furniture and Fixtures	311,000	312,000	5 - 8 years
Leasehold Improvements	528,000	525,000	Term of Lease
Computers and Software	406,000	406,000	4 - 6 years
Total Property and Equipment	<u>29,993,000</u>	<u>28,653,000</u>	
Less: Accumulated Depreciation	<u>(19,943,000)</u>	<u>(17,456,000)</u>	
Property and Equipment, net	<u>\$ 10,050,000</u>	<u>\$ 11,197,000</u>	

Depreciation expense for the years ended December 31, 2017 and 2016 was approximately \$1,868,000 and \$3,175,000, 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 2017 and 2016. Accumulated depreciation on these assets was approximately \$3,595,000 and \$2,320,000 as of December 31, 2017 and 2016, respectively.

**Note 7. INTANGIBLE ASSETS**

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

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>	
Customer Relationships	\$ 4,925,000	\$ 4,925,000	5 to 14 years
Trade Names	—	—	15-20 years
Technical Know-how	—	—	10 years
Non-Compete	50,000	50,000	5 years
Professional Certifications	—	—	.25 to 2 years
Total Intangible Assets	<u>4,975,000</u>	<u>4,975,000</u>	
Less: Accumulated Amortization	<u>(4,975,000)</u>	<u>(4,504,000)</u>	
Intangible Assets, net	<u>\$ —</u>	<u>\$ 471,000</u>	

The expense for amortization of the intangibles for the years ended December 31, 2017 and 2016 was approximately \$471,000 and \$995,000, respectively. As of December 31, 2017 Intangible Assets have been fully amortized.

**Note 8. ASSETS HELD FOR SALE AND LIABILITIES DIRECTLY ASSOCIATED****AMK**

As discussed in Note 1, on January 27, 2017, the Company sold all of the outstanding shares of AMK Welding, Inc. (“AMK”) to Meyer Tool, Inc., pursuant to a Stock Purchase Agreement dated January 27, 2017 (“the Stock Purchase Agreement”) for a purchase price of \$4,500,000, subject to a working capital adjustment, plus additional quarterly payments, not to exceed \$1,500,000, equal to five percent (5%) of Net Revenues of AMK commencing April 1, 2017. At December 31, 2016, the Company had 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

Assets Held for Sale	December 31, 2016
Cash	\$ 40,000
Accounts Receivable, net of allowance for doubtful accounts	722,000
Inventory, net of reserves	260,000
Prepaid and other assets	96,000
Property and equipment, net of accumulated depreciation	3,478,000
Intangible Assets, net of accumulated amortization	819,000
Goodwill	635,000
<b>Assets Held for Sale</b>	<b>\$ 6,050,000</b>
Accounts payable and accrued expenses	379,000
Capital lease obligations	1,680,000
Deferred revenues	96,000
<b>Liabilities directly associated to Assets Held for Sale</b>	<b>\$ 2,155,000</b>

Additionally, AMK's operations were previously reported in the Company's Turbine Engine Components segment. The amounts below represent AMK's operations that have been excluded from this segment for the year ended December 31, 2016:

<b>Segment Data</b>	
Turbine Engine Components	2016
Net Sales	\$ 4,511,000
Gross Profit	169,000
Pre Tax (Loss) Income	(1,595,000)
Assets	6,050,000

### WMI

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 December 31, 2017 and 2016, 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

Assets Held for Sale	December 31, 2017	December 31, 2016
Accounts Receivable, net of allowance for doubtful accounts	\$ 2,217,000	\$ 1,976,000
Inventory, net of reserves	8,065,000	7,283,000
Prepaid and other assets	485,000	266,000
Property and equipment, net of accumulated depreciation	878,000	1,022,000
Intangible Assets, net of accumulated amortization	—	1,283,000
Impairment of Assets Held for Sale	(1,563,000)	—
Goodwill	—	3,417,000
<b>Assets Held for Sale</b>	<b>\$ 10,082,000</b>	<b>\$ 15,247,000</b>
Accounts payable and accrued expenses	2,138,000	2,010,000
Deferred Revenue	521,000	—
Notes Payable & Capital lease obligations	11,000	—
Deferred rent	125,000	70,000
<b>Liabilities directly associated to Assets Held for Sale</b>	<b>\$ 2,795,000</b>	<b>\$ 2,080,000</b>

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 years ended December 31, 2017 and 2016, respectively:

<b>Segment Data</b>		
Aerostructures & Electronics	2017	2016
Net Sales	\$ 13,129,000	\$ 15,594,000
Gross Profit	1,884,000	2,451,000
Pre Tax (Loss) Income	(6,678,000)	(756,000)
Assets	10,082,000	15,247,000

**Note 9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

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

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Accounts Payable	\$ 8,634,000	\$ 11,994,000
Accrued Expenses	2,238,000	2,156,000
	<b>\$ 10,872,000</b>	<b>\$ 14,150,000</b>

**Note 10. SALE AND LEASEBACK TRANSACTION**

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

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

On October 24, 2006, the Company consummated a Sale - Leaseback Arrangement, whereby the Company sold the buildings and real property located in Bay Shore, New York (the "Bay Shore Property") for a purchase price of \$6,200,000. The Company realized a gain on the sale of \$1,051,000 of which \$300,000 was recognized during the year ended December 31, 2006. The remaining \$751,000 is being recognized ratably over the remaining term of the twenty - year lease at approximately \$38,000 per year. The gain is included in Other Income in the accompanying Consolidated Statements of Operations. The unrecognized portion of the gain in the amount of \$333,000 and \$371,000 as of December 31, 2017 and 2016, respectively, is classified as Deferred Gain on Sale in the accompanying Consolidated Balance Sheets.

Simultaneous with the closing of the sale of the Bay Shore Property, the Company entered into a 20-year triple-net lease (the "Lease") with the purchaser for the property. Base annual rent is approximately \$540,000 for the first five years, \$560,000 for the sixth year, and thereafter increases 3% per year. The Lease grants the Company an option to renew the Lease for an additional period of five years. The Company has on deposit with the purchaser \$89,000 as security for the performance of its obligations under the Lease. In addition, the Company has on deposit \$150,000 with the landlord as security for the completion of certain repairs and upgrades to the Bay Shore Property. This amount is included in the caption Deferred Finance costs, Net, Deposit and Other Assets in the accompanying Consolidated Balance Sheets. Pursuant to the terms of the Lease, the Company is required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance. The lease also contains customary representations, warranties, obligations, conditions and indemnification provisions and grants the purchaser customary remedies upon a breach of the lease by the Company, including the right to terminate the Lease and hold the Company liable for any deficiency in future rent. See Note 14 Commitments and Contingencies.

The Company accounted for these transactions under the provisions of FASB ASC 840-40, "Leases-Sale-Leaseback Transactions".

On January 27, 2017, the Company entered into an agreement to sell the stock of AMK. Included in this agreement was the transfer of the capital lease obligation on the South Windsor Property transferred to the purchaser of AMK. At December 31, 2016, the Company reclassified the capital asset of \$1,700,000 and lease obligation of \$1,680,000 to Assets Held for Sale and Liabilities Held for Sale, respectively. See Note 1 for additional discussion regarding the sale of AMK.

#### Note 11. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Revolving credit note payable to PNC Bank N.A. ("PNC")	\$ 16,455,000	\$ 24,393,000
Term loans, PNC	3,471,000	6,649,000
Capital lease obligations	3,073,000	4,215,000
Related party notes payable, net of debt discount	1,912,000	1,086,000
Other note payable	1,930,000	627,000
Subtotal	<u>26,841,000</u>	<u>36,970,000</u>
Less: Current portion of notes and capital obligations	<u>(23,393,000)</u>	<u>(33,999,000)</u>
Notes payable and capital lease obligations, net of current portion	<u>\$ 3,448,000</u>	<u>\$ 2,971,000</u>

#### PNC Bank N.A. ("PNC")

The Company has a Loan Facility with PNC secured by substantially all of its assets. 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 \$16,455,000 and \$24,393,000, as of December 31, 2017 and December 31, 2016, 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. As of 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 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.

As of December 31, 2017, our debt to PNC in the amount of \$19,926,000 consisted of the revolving credit loan in the amount of \$16,455,000 and the term loan in the amount of \$3,471,000. As of December 31, 2016, our debt to PNC in the amount of \$31,042,000 consisted of the revolving credit note due to PNC in the amount of \$24,393,000 and the term loan due to PNC in the amount of \$6,649,000.

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 December 31, 2017 the future minimum principal payments for the term loans are as follows:

<u>For the year ending</u>	<u>Amount</u>
December 31, 2018	\$ 1,478,000
December 31, 2019	1,478,000
December 31, 2020	515,000
December 31, 2021	—
December 31, 2022	—
Thereafter	—
PNC Term Loans payable	3,471,000
Less: Current portion	3,471,000
Long-term portion	<u>\$ —</u>

Interest expense related to these credit facilities amounted to approximately \$2,122,000 and \$1,908,000 for the years ended December 31, 2017 and 2016, respectively.

During the year ended December 31, 2017, the Company discovered that PNC Bank had been improperly calculating interest expense on a monthly basis since 2007. The result was a net overcharge of approximately \$1,500,000 through December 31, 2017. On a monthly basis, PNC Bank had allocated the Company's line of credit balances between each of the Company's subsidiaries, based on their individual entity balance. Some of these accounts held debit balances, while others carried credit balances. PNC charged interest to the Company for its entities with debit balances without offsetting credit balances. This method of segregating the Company's debt balances by entity by PNC Bank has ceased. As of the date of this filing, the Company has recovered all of its identified overcharged interest and has not noted any further discrepancies.

#### **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 \$3,073,000 and \$4,215,000 as of December 31, 2017 and 2016, respectively, with various interest rates ranging from approximately 4% to 14%.

As of December 31, 2017, the aggregate future minimum lease payments, including imputed interest, with remaining terms of greater than one year are as follows:

<u>For the year ending</u>	<u>Amount</u>
December 31, 2018	\$ 1,428,000
December 31, 2019	1,264,000
December 31, 2020	542,000
December 31, 2021	52,000
December 31, 2022	15,000
Thereafter	—
Total future minimum lease payments	3,301,000
Less: imputed interest	(228,000)
Less: current portion	(1,293,000)
Total Long Term Portion	<u>\$ 1,780,000</u>

## 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.

Related party notes payable to Michael and Robert Taglich, and their affiliated entities, totaled \$2,126,000 and \$1,086,000, as of December 31, 2017 and December 31, 2016, respectively.

On April 8, 2016, the Company issued a promissory note (“the Taglich Note B”) to Michael Taglich in the principal amount of \$350,000. The Taglich Note B bore interest at the rate of 7% per annum. The Company’s obligation under the Taglich Note B was subordinated to its indebtedness to PNC. This note has been repaid in full.

On April 8, 2016, the Company issued a promissory note (“the Taglich Note C”) to Robert Taglich in the principal amount of \$350,000. The Taglich Note C bore interest at the rate of 7% per annum. The Company’s obligation under the Taglich Note C was subordinated to its indebtedness to PNC. This note has been repaid in full.

On May 6, 2016, the Company issued a promissory note (“the Taglich Note D”) to Michael Taglich in the principal amount of \$400,000. The Taglich Note D bore interest at the rate of 7% per annum. The Company’s obligation under the Taglich Note D was subordinated to its indebtedness to PNC. This note has been repaid in full.

On May 6, 2016, the Company issued a promissory note (“the Taglich Note E”) to Robert Taglich in the principal amount of \$300,000. The Taglich Note E bore interest at the rate of 7% per annum. The Company’s obligation under the Taglich Note E was subordinated to its indebtedness to PNC. This note has been repaid in full.

On May 25, 2016, the Company issued 110,000 and 65,000 shares of Series A Preferred Stock to Michael Taglich and Robert Taglich, respectively upon surrender of Taglich Notes D and E, in the aggregate principal of \$1,100,000 and \$650,000, respectively.

On August 1, 2016, the Company issued a promissory note (the “Taglich Note F”) to Michael Taglich, in the principal amount of \$1,000,000. The Taglich Note F bore interest at the rate of 7% per annum. The Company’s obligation under the Taglich Note F was subordinated to its indebtedness to PNC.

On August 4, 2016, the Company issued a promissory note (the “Taglich Note G”) to Michael Taglich, in the principal amount of \$500,000. The Taglich Note G bore interest at the rate of 7% per annum. The Company’s obligation under the Taglich Note G was subordinated to its indebtedness to PNC.

On August 19, 2016, the Company issued to Michael Taglich its 12% Subordinated Convertible Notes due December 31, 2017 (the “12% Notes”) in the principal amount of \$1,520,703, together with warrants to purchase 61,817 shares of common stock, upon surrender for cancellation of Taglich Notes F & G in the aggregate principal amount of \$1,500,000, together with accrued interest thereon and on notes previously exchanged for Series A Preferred Stock of \$20,703. In addition, the Company issued to Robert Taglich a 12% Note in the principal amount of \$4,373, together with warrants to purchase 177 shares of common stock, in consideration of the forgiveness of interest of \$4,373 accrued on notes previously exchanged for Series A Preferred Stock.

On March 17, 2017, the Company borrowed \$200,000 and \$300,000 from each of Michael Taglich and Robert Taglich, respectively, directors and principal stockholders of our company, and issued promissory notes in the principal amounts of \$200,000 and \$300,000 to Michael Taglich and Robert Taglich, respectively, to evidence our obligation to repay that indebtedness. The notes bore interest at the rate of 7% per annum. The notes have been converted into 346,992 shares of common stock as of December 31, 2017.

On May 2, and May 10, 2017, the Company borrowed an aggregate of \$750,000 from each of Michael Taglich and Robert Taglich. This indebtedness, together with accrued interest, were converted into May 2018 Notes on May 12, 2017.

In April 2018, Michael and Robert Taglich advanced an aggregate of \$1,150,000 to be applied to a private placement on terms yet to be determined.

Taglich Brothers acted as a placement agent in connection with the sale of the May 2018 Notes and warrants discussed below for which they are to be paid commissions in the aggregate amount of \$176,000.

As compensation for its services as placement agent for the offering of the 12% Notes discussed below, the Company paid Taglich Brothers a fee of \$295,400 and issued to Taglich Brothers five-year warrants to purchase 68,617 shares of common stock at an initial exercise price of \$6.15, subject to certain anti-dilution and other adjustments.

### **12% Subordinated Convertible Notes**

On August 19, 2016, 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 \$4,250,000 of the Company's 12% Subordinated Convertible Notes due December 31, 2017 (the "12% Notes") to accredited investors ("the Offering"), together with five-year warrants to purchase 4,065 shares of common stock (the "Warrants") for each \$100,000 principal amount of 12% Notes purchased, in a private placement exempt from the registration requirements of the Securities Act of 1933, as amended (the Securities Act).

The 12% Notes were convertible, at the option of the holders, into shares of the Company's common stock at an initial conversion price of \$4.92 per share, subject to adjustment for certain events. The 12% Notes were automatically convertible into shares of the Company's Series A Convertible Preferred Stock ("Series A Preferred Stock") at a price of \$10.00 per share, the stated value of the Series A Preferred Stock, upon the filing of a certificate of amendment to the Company's Articles of Incorporation increasing the number of shares of Series A Preferred Stock so that a sufficient number of shares are available for issuance upon conversion of the 12% Notes and for issuance in lieu of payment of cash dividends (the "Certificate of Amendment") in accordance with the provisions of the certificate of designation authorizing the issuance of the Series A Preferred Stock. The amendment was subject to the approval of the Company's stockholders.

Under the terms of the Placement Agency Agreement, the Placement Agent is entitled to a placement agent fee equal to 7% of the gross proceeds of the offering, five year warrants to purchase 8% of the number of shares of the Company's common stock issuable upon conversion of the 12% Notes at an exercise price of \$6.15 per share, equal to 125% of the initial conversion price per share of the 12% Notes, and reimbursement for its actual out-of-pocket expenses not to exceed in the aggregate \$25,000.

In August 2016, the Company issued and sold a total of \$2,720,000 principal amount of the 12% Notes, together with Warrants to purchase an aggregate of 110,556 shares of common stock, yielding net proceeds to the Company of approximately \$2,320,000, pursuant to a Securities Purchase Agreements with accredited investors. The Company also issued to Michael Taglich a 12% Note in the principal amount of \$1,520,703, together with Warrants to purchase 61,817 shares of common stock at an initial exercise price of \$6.15, subject to anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as mergers and other business combinations, upon surrender for cancellation of Taglich Notes F and G in the aggregate principal amount of \$1,500,000, together with accrued interest thereon and on notes previously exchanged for Series A Preferred Stock of \$20,703. In addition, the Company issued to Robert Taglich a 12% Note in the principal amount of \$4,373, together with Warrants to purchase 177 shares of common stock, in consideration of the forgiveness of interest of \$4,373 accrued on notes previously exchanged for Series A Preferred Stock.

The Warrants including those issued to the placement agent are classified within stockholders equity, pursuant to ASC 480, Distinguishing Liabilities from Equity and ASC 815-40, Derivatives and Hedging: Contracts in Own Equity. The 12% Notes contained a contingent put that results in early settlement of the 12% Notes upon the filing of a certificate of amendment to the Company's Articles of Incorporation, increasing the number of shares of Series A Preferred Stock so that a sufficient number of shares are available for issuance upon conversion of the 12% Notes. The embedded put feature is required to be separately measured at fair value with changes in value recognized in the statement of operations, pursuant to ASC 815-15, Derivatives and Hedging: Embedded Derivatives, as the put feature is not clearly and closely related to the convertible promissory note.

The proceeds received upon issuing the 12% Notes and Warrants was allocated to each instrument on a relative fair value basis. The initial fair value of the Warrants was determined using the Black Scholes Merton valuation model with the following assumptions: expected term of 5 years; risk free interest rate of 1.2%; and volatility of 90%. The allocated value of the 12% Notes was further reduced for the initial fair value of the embedded put of approximately \$755,000. The resulting discount to the 12% Notes, including the allocated transactions costs, is amortized to interest expense using the effective interest method over the term of the Notes.



As compensation for its services as placement agent for the offering of the 12% Notes, the Company paid Taglich Brothers, Inc. a fee of \$295,400.

On November 30, 2016, the Company's stockholders approved the amendment to the Company's Articles of Incorporation, and consequently the Company issued a total of 438,770 shares of its Series A Preferred Stock to holders of its 12% Notes upon the automatic conversion of the principal amount of, and accrued interest on, the 12% Notes at the rate of \$10.00 per share.

#### **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 year ended December 31, 2017, we issued \$354,238 principal amount of 8% Notes in lieu of cash payment of accrued interest. As of December 31, 2017, we had outstanding \$5,525,000 principal amount of 8% Notes, of which \$3,003,000 principal amount is due on November 30, 2018 and \$2,522,000 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.

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.

### **May Note Financing**

On May 12 and May 19, 2017, the Company issued and sold to 17 accredited investors (including Michael N. Taglich and Robert F. Taglich individually and a partnership of which they are partners), its “May 2018 Notes” in the aggregate principal amount of \$4,158,624, together with warrants to purchase an aggregate of 501,039 shares of common stock, for gross proceeds (net of the exchange of indebtedness totaling \$1,503,288 due to Michael N. Taglich and Robert F. Taglich for working capital advances made on May 2 and 10, 2017) of \$2,534,196. Roth Capital LLC and Taglich Brothers acted as placement agents in connection with the sale of the May 2018 Notes and warrants for which they are to be paid commissions in the aggregate amount of \$191,155.

The May 2018 Notes and warrants were issued for a purchase price equal to 97% of the principal amount of the May 2018 Notes purchased. The principal amount of each May 2018 Note will be increased by 2% for each 30 days it remains outstanding commencing August 1, 2017. Upon the occurrence of, and during the continuance of an Event of Default (as defined in the May 2018 Notes), the May 2018 Notes will accrue late interest at the rate of 10% per annum. Payment of the principal and accrued interest, if any, on the May 2018 Notes is junior and subordinate in right of payment to the Company’s indebtedness under the Loan Facility.

The principal amount, together with accrued interest, if any, of the May 2018 Notes, when issued, were convertible into shares of common stock at a conversion price of \$2.49 per share, subject to anti-dilution and other adjustments for stock splits and certain fundamental transactions, including recapitalizations, mergers and other business combination transactions (the “Fixed Conversion Price”), and thereafter at the lower of the Fixed Conversion Price and 75% of the five (5) Weighted Average Prices (as defined in the May 2018 Notes) of the common stock during the five consecutive trading day period ending on the trading day immediately preceding the day of a request by the holder for conversion of the May 2018 Note. The Company has the right to redeem all, or a portion of (on a pro rata basis), of the May 2018 Notes upon written notice to the holders not less than three trading days prior to the applicable redemption date. In connection with the Company’s July 2017 public offering of its common stock, approximately \$1,754,215 principal amount of the May 2018 Notes were converted into 1,240,605 shares of common stock at \$1.50 per share, the public offering price of the shares sold in the Public Offering, and \$463,501 principal amount of May 2018 Notes were redeemed. The balance of the May 2018 Notes were converted into 1,222,809 shares of common stock at \$1.50 per share, the public offering price of the shares sold in the Public Offering, pursuant to the restructuring approved by the Company’s stockholders at the Company’s Annual Meeting on October 3, 2017. Consequently, no May 2018 Notes remain outstanding.

The Company issued warrants to purchase 501,039 shares of common stock as part of the private placement of the May 2018 Notes. The warrants, when issued, were exercisable at an initial exercise price of \$2.49 per share until May 12, 2022, and may be exercised on a cashless basis for a lesser number of shares based upon prevailing market prices when exercised. The exercise price of the warrants is subject to anti-dilution and other adjustments, including stock splits, and in the event of certain fundamental transactions such as recapitalizations, mergers and other business combination transactions. In accordance with the terms of the warrants, the exercise price was reduced to \$1.50 per share, the public offering price of the shares of common stock sold in the Public Offering.

The Company early adopted the provisions of ASU 2017-11 in recognizing the warrants. As a result, the exercise price reset provisions were excluded from the assessment of whether the warrants are considered indexed to the Company’s own stock. The warrants otherwise meet the requirements for equity classification, as such were initially classified in Stockholders’ Equity. The Company will recognize the value of the exercise price reset provision if and when it becomes triggered, by recognizing the value of the effect of the exercise price reset as a deemed dividend and a reduction of income available to common shareholders in computing basic earnings per share.

The proceeds received upon issuing the May 2018 Notes and warrants was allocated to each instrument on a relative fair value basis. The allocation resulted in an effective conversion price for the May 2018 Notes that was below the quoted market price of the Company's common stock. As such, the Company recognized a beneficial conversion feature equal to the intrinsic value of the conversion feature on each issuance date, resulting in an additional discount to the initial carrying value of the May 2018 Notes with a corresponding credit to additional paid-in capital.

On October 3, 2017, holders of \$1,834,214 aggregate principal amount of the Company's May 2018 Notes agreed to convert their 2018 Notes into 1,222,809 shares of common stock. The May 2018 Notes, when issued, were convertible at a conversion price per share of \$2.49. The conversion that occurred on October 3, 2017 was at a lower conversion price of \$1.50 per share (the offering price of the shares of common stock in the Public Offering).

## **Note 12. STOCKHOLDERS' EQUITY**

### **Issuance of Series A Preferred Stock and Related Financings**

On May 25, 2016, and June 1, 2016, the Company completed a private placement of 700,000 shares of our Series A Preferred Stock for \$10.00 per share and received gross cash proceeds of \$5,250,000, net of \$1,750,000 principal amount of our promissory notes exchanged by Michael Taglich and Robert Taglich, two of our principal stockholders, for shares of Series A Preferred Stock. The Company had issued the promissory notes to Michael Taglich and Robert Taglich for amounts borrowed from September 2015 through May 2016. The September 2015 loan bore interest at the rate of 4% per annum and was to be paid on September 7, 2016. The other loans bore interest at the rate of 7% per annum and were to be repaid on June 30, 2016, or, if earlier, upon the sale of the Company's equity from which it derived proceeds of \$1,800,000 or \$2,000,000 depending upon the promissory notes issued.

### **Preferred Stock**

The shares of Series A Preferred Stock have a stated value of \$10.00 per share and are initially convertible into shares of common stock at a price of \$4.92 per share (subject to adjustment upon the occurrence of certain events). When issued, the dividend rate on the Series A Preferred Stock was 12% per annum, payable quarterly and was to increase to 15% per annum if we were to issue PIK Shares in lieu of payment of cash dividends payable until June 15, 2018. The dividend rate on the Series A Preferred Stock was originally to increase to 16% per annum after June 2018, 19% per annum to the extent dividends were paid in PIK Shares. In July 2017, the Company amended the Certificate of Designation authorizing the issuance of the Series A Preferred Stock to provide for the automatic conversion of the outstanding shares of Series A Preferred Stock into common stock at a conversion price of \$1.50 per share, the offering price of the shares of common stock in the Public Offering, subject to stockholder approval in accordance with the applicable rules of the NYSE MKT. In addition, the amendment to the Certificate of Designation eliminated the liquidation preference and quarterly dividend payable to holders of the Series A Preferred Stock. Under the terms of the amendment, holders of the Series A Preferred Stock were to share ratably with the holders of the common stock on an as-converted basis (2.0325 shares of common stock for each share of Series A Preferred Stock held of record) with respect to dividends declared, paid or set aside for payment, assets available for distribution to stockholders upon the liquidation, dissolution or winding up of the Company's affairs, in addition to voting upon the election of directors and other matters submitted to stockholders for approval, except for matters requiring a class vote of the holders of the Series A Preferred Stock specified in the Certificate of Designation or under applicable law.

The Company has the right to redeem the Series A Preferred Stock after May 26, 2018 for a redemption price of \$10.00, plus accrued and unpaid dividends; however, the Company may not have sufficient cash available to effect such redemption.

In connection with the placement we incurred approximately \$606,000 of direct offering costs and \$57,000 in legal expenses and granted to the placement agents warrants to purchase 8% of the number of shares of our common stock (113,820 shares) issuable upon conversion of the Series A Preferred Stock sold in the offering. The warrants are exercisable in whole or in part, at an initial exercise price per share of \$6.15, and are exercisable for cash or on a cashless basis commencing on November 26, 2016 and expiring on May 26, 2021. The exercise price and number of shares of common stock issuable under the warrants are subject to adjustments for stock dividends, splits, combinations and similar events.

Of the proceeds generated by the sale of our shares of Series A Preferred Stock, \$1,500,000 was paid to PNC to reduce the amount outstanding under our Loan Facility.

In August 2016, the Company completed the private placement of \$2,720,000 principal amount of our 12% Subordinated Convertible Notes due December 31, 2017 (the "12% Notes"), together with warrants to purchase an aggregate of 110,658 shares of common stock, for a total purchase price of \$2,720,000, from which we derived net proceeds of approximately \$2,319,800, which was used to pay down the Company's indebtedness under the Loan Facility and for working capital. The Company also issued to Michael Taglich a 12% Note in the principal amount of \$1,520,713, together with warrants to purchase 61,817 shares of common stock, upon surrender for cancellation of promissory notes in the aggregate principal amount of \$1,500,000, together with accrued interest thereon and on notes previously exchanged for Series A Preferred Stock of \$20,713. The Company had issued the promissory notes to Michael Taglich for amounts borrowed in August 2016. The promissory notes bore interest at the rate of 7% per annum and were to be repaid on December 31, 2016, or, if earlier, upon the sale of our equity securities from which we derived proceeds of \$2,000,000. In addition, the Company issued to Robert Taglich a 12% Note in the principal amount of \$4,373, together with warrants to purchase 177 shares of common stock, in consideration of the forgiveness of interest of \$4,373 accrued on notes previously exchanged for Series A Preferred Stock.

The 12% Notes provided for the automatic conversion of the principal and accrued interest of the 12% Notes into shares of Series A Preferred Stock at a price of \$10.00 per share, the stated value of the Series A Preferred Stock, upon the filing of an amendment to the Company's Articles of Incorporation increasing the number of shares of preferred stock we are authorized to issue from 1,000,000 shares to 3,000,000 shares, including 2,000,000 shares of Series A Preferred Stock (the "Charter Amendment"). The Company issued 438,770 shares of Series A Preferred Stock to the holders of the 12% Notes on November 30, 2016, the date the Company's stockholders approved the Charter Amendment and the Company filed the certificate of amendment effecting the Charter Amendment with the Office of the Secretary of State of Nevada. As a result of the automatic conversion of the 12% Notes into shares of Series A Preferred Stock, no 12% Notes are outstanding.

As compensation for its services as placement agent for the offering of the 12% Notes, the Company paid Taglich Brothers, Inc. a fee of \$295,400 and issued to Taglich Brothers, Inc. five-year warrants to purchase 68,617 shares of common stock at an initial exercise price of \$6.15, 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.

On July 12, 2017, the Company filed an amendment to the certificate of designation authorizing the issuance of its Series A Convertible Preferred Stock ("Series A Preferred Stock"). The Amendment provides for the automatic conversion of shares of Series A Preferred Stock into shares of common stock upon the consummation of the Offering at a conversion price of \$1.50 per share, subject to receiving stockholder approval of such conversion in accordance with the applicable rules of the NYSE MKT. In addition, the amendment changes the liquidation preference and dividend rights of the holders of Series A Preferred Stock to be on a pari passu basis with the Company's common stock on an as converted basis based upon a conversion price of \$4.92 per share. As a result of the consummation of the Offering, once stockholder approval has been obtained, the conversion price of the Series A Preferred Stock will automatically be reduced from \$4.92 per share to \$1.50 per share, which was the offering price of the shares of common stock in the Offering, and the conversion rate for each share of Series A Preferred Stock converted will be increased from 2.0325 shares of common stock to 6.6667 share of common stock. On October 3, 2017, holders of 1,294,441 outstanding shares of the Company's Series A Preferred Stock automatically converted into 8,629,606 shares of common stock.

As of December 31, 2017 and 2016, the Company had outstanding 0 and 1,202,548 shares of Series A Preferred Stock outstanding.

## Common Stock

On July 12, 2017, the Company sold 5,175,000 shares of common stock at a price of \$1.50 per for gross proceeds of \$7,762,500 in an underwritten public offering ("Public Offering") from which it derived net proceeds of \$6,819,125, of which approximately \$4,000,000 was used to pay outstanding trade payables, \$463,501 was used to redeem an equal principal amount of the \$4,158,624 principal amount of the May 2018 Notes and \$2,355,624 was added to the Company's working capital.

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 for each \$100,000 of shares purchased (the Warrants"), in a private placement exempt from the registration requirements of the Securities Act. 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 year ended December 31, 2017, the Company issued 246,463 shares of common stock in lieu of cash payment for various services provided to the Company.

### Note 13. EMPLOYEE BENEFITS PLANS

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

#### Union

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

Medical benefits for union employees are provided through a policy with Extensis, the costs of which are substantially borne by the Company. In addition, the Company is obligated to make contributions for union dues and a security fund (defined contribution plan) for the benefit of each union employee. Contributions to the security fund amounted to \$136,000 and \$263,000 for the years ended December 31, 2017 and 2016, respectively.

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

## Others

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

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

## Note 14. COMMITMENTS AND CONTINGENCIES

### Real Estate Leases

The Company leases its facilities under various operating lease agreements, which contain renewal options and escalation provisions. Rent expense was \$1,305,000 and \$2,429,000 for the years ended December 31, 2017 and 2016, respectively. The Company is responsible for paying all operating costs under the terms of the leases. As of December 31, 2017, the aggregate future minimum lease payments are as follows:

<b>For the year ending</b>	<b>Fifth Avenue Annual Rent</b>	<b>Lamar Street Annual Rent</b>	<b>Motor Parkway Annual Rent</b>	<b>Porter Street Annual Rent</b>	<b>Total Rents</b>
December 31, 2018	\$ 769,000	\$ 300,000	\$ 110,000	\$ 115,000	\$ 1,294,000
December 31, 2019	792,000	—	113,000	48,000	953,000
December 31, 2020	817,000	—	116,000	—	933,000
December 31, 2021	842,000	—	103,000	—	945,000
December 31, 2022	866,000	—	—	—	866,000
Thereafter	3,501,000	—	—	—	3,501,000
<b>Total Rents</b>	<b>\$ 7,587,000</b>	<b>\$ 300,000</b>	<b>\$ 442,000</b>	<b>\$ 163,000</b>	<b>\$ 8,492,000</b>

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

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

Simultaneous with the closing of the sale of the Property, the Company entered into a 15- year lease (the "Lease") with the purchaser for the property. Base annual rent was approximately \$155,000 for the first year and increases approximately 3% per year each year thereafter. The Lease granted the Company an option to renew the Lease for an additional period of five years. Pursuant to the terms of the Lease, the Company was required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance. The Lease also contained representations, warranties, obligations, conditions and indemnification provisions in favor of the purchaser and grants the purchaser remedied upon a breach of the Lease by the Company, including the right to terminate the Lease and hold the Company liable for any deficiency in future rent.

On March 21, 2018, the Company entered into an agreement to sell the stock of WMI. Included in this agreement, the operating lease obligation for the Plant Ave. facility would transfer to the purchaser of WMI upon the sale of WMI. See Note 1 Subsequent Events for additional discussion regarding the sale of WMI. At December 31, 2017, the Company has excluded this lease commitment from the table above.

### 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.

On January 18, 2018, REP B-2, LLC filed a petition for a warrant of eviction and a money judgement of approximately \$56,000 against Air Industries Group arising from rent arrears on commercial space. On January 18, 2018, 360 Motor Parkway, LLC filed a petition for a warrant of eviction and a money judgement of approximately \$12,000 against Air Industries Group arising from rent arrears on commercial space. Each proceeding has resulted in a stipulation of settlement providing monthly repayment schedules to bring those rent arrears current, the last of which are due on May 1, 2018, at which time the proceedings may be dismissed.

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.

### Note 15. INCOME TAXES

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

	<u>2017</u>	<u>2016</u>
<b>Current</b>		
Federal tax refund	\$ (178,000)	\$ —
State	8,000	38,000
Prior Year overaccruals		
Federal	—	—
State	(27,000)	—
Total (Benefit) Expense	(197,000)	38,000
<b>Deferred Tax Benefit</b>	—	(4,962,000)
Valuation Allowance	—	7,025,000
Net Provision for (Benefit from) Income Taxes	<u>\$ (197,000)</u>	<u>\$ 2,101,000</u>

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

	2017	2016
U.S. statutory income tax rate	34.00%	34.00%
State taxes	0.09%	1.50%
Permanent differences, overaccruals and non-deductible items	-0.22%	0.08%
Rate change and provision to return true-up	-22.60%	0.85%
Expired stock options	-0.19%	-0.15%
Deferred tax valuation allowance	-10.09%	-51.64%
<b>Total</b>	<b>0.99%</b>	<b>-15.36%</b>

The components of net deferred tax assets at December 31, 2017 and December 31, 2016 are set forth below:

	December 31, 2017	December 31, 2016
<b>Deferred tax assets</b>		
Current:		
Net operating losses	\$ 7,730,000	\$ 4,754,000
Bad debts	135,000	413,000
Inventory - 263A adjustment	591,000	—
Accounts payable, accrued expenses and reserves	—	930,000
Total current deferred tax assets before valuation allowance	8,456,000	6,097,000
Valuation allowance	(8,456,000)	(6,097,000)
Total current deferred tax assets after valuation allowance	—	—
Non-current:		
Section 1231 loss carry forward	—	4,000
Stock based compensation - options and restricted stock	124,000	164,000
Capitalized engineering costs	281,000	431,000
Deferred rent	299,000	468,000
Amortization - NTW Transaction	519,000	1,324,000
Inventory reserves	960,000	1,157,000
Deferred gain on sale of real estate	80,000	121,000
Other	114,000	160,000
Total non-current deferred tax assets before valuation allowance	2,377,000	3,829,000
Valuation allowance	(758,000)	(928,000)
Total non-current deferred tax assets after valuation allowance	1,619,000	2,901,000
<b>Deferred tax liabilities:</b>		
Property and equipment	(1,619,000)	(2,595,000)
Amortization – NTW Goodwill	—	(33,000)
Amortization – Welding Transaction	—	(273,000)
Total non-current deferred tax liabilities	(1,619,000)	(2,901,000)
<b>Net non-current deferred tax asset</b>	<b>\$ —</b>	<b>\$ —</b>



During the years ended December 31, 2017 and December 31, 2016, the Company recorded a valuation allowance equal to its net deferred tax assets. The Company determined that due to a recent history of net losses, that at this time, sufficient uncertainty exists regarding the future realization of these deferred tax assets through future taxable income. If, in the future, the Company believes that it is more likely than not that these deferred tax benefits will be realized, the valuation allowances will be reduced or eliminated. With a full valuation allowance, any change in the deferred tax asset or liability is fully offset by a corresponding change in the valuation allowance. At December 31, 2017 and 2016, the Company provided a valuation allowance on its deferred tax assets of \$9,214,000 and \$7,025,000, respectively.

At December 31, 2017 and 2016, the Company had no material unrecognized tax benefits and no adjustments to liabilities or operations were required. The Company does not expect that its unrecognized tax benefits will materially increase within the next twelve months. The Company recognizes interest and penalties related to uncertain tax positions in interest expense. As of December 31, 2017 and 2016, the Company has not recorded any provisions for accrued interest and penalties related to uncertain tax positions.

In certain cases, the Company's uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. The Company files federal and state income tax returns in jurisdictions with varying statutes of limitations. The 2014 through 2017 tax years generally remain subject to examination by federal and state tax authorities.

## **Note 16. STOCK OPTIONS AND WARRANTS**

### **Stock-Based Compensation**

#### Stock Options

On March 30, 2015, the Board of Directors adopted the Company's 2015 Equity Incentive Plan ("2015 Plan") which was approved by affirmative vote of the Company's stockholders on June 25, 2015. The Plan authorized the grant of rights with respect to up to 350,000 shares.

In June 2016, the Board of Directors adopted the Company's 2016 Equity Incentive Plan ("2016 Plan") which authorized the grant of rights with respect to up to 350,000 shares. The 2016 Plan was approved by affirmative vote of the Company's stockholders on November 30, 2016.

In July 2017, the Board of Directors adopted the Company's 2017 Equity Incentive Plan ("2017 Plan") which authorized the grant of rights with respect to up to 1,200,000 shares. The 2017 Plan was approved by affirmative vote of the Company's stockholders on October 3, 2017.

During the year ended December 31, 2017, the Company granted options to purchase 695,000 shares of common stock to certain of its employees and directors. The weighted average fair value of the granted options was estimated using the Black-Scholes option pricing model with the following assumptions: risk free interest rate of 1.72% to 1.81%; expected volatility factors of 82% to 85%; expected dividend yield of 0%; and estimated option term of 5 years.

During the year ended December 31, 2016, the Company granted options to purchase 100,000 shares of common stock to certain of its employees. The weighted average fair value of the granted options was estimated using the Black-Scholes option pricing model with the following assumptions: risk free interest rate of 0.73% to 2.04%; expected volatility factors of 31% to 59%; expected dividend yield of 0%; and estimated option term of 5 years.

During the year ended December 31, 2016, the Board of Directors approved the issuance of 18,000 options, to non-employee members of the Company's Board of Directors. These options vested quarterly as to 25% of the shares subject to the options, commencing June 2, 2016.

The Company recorded stock based compensation expense of \$323,000 and \$167,000 in its consolidated statement of operations for the years ended December 31, 2017 and 2016, respectively, and such amounts were included as a component of general and administrative expense.

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

	2017	2016
Risk-free interest rates	1.72 – 1.81%	0.73% - 2.04%
Expected life (in years)	4.9	5.0
Expected volatility	82%-85%	31%-59%
Dividend yield	0.0%	0.0%
Weighted-average grant date fair value per share	\$0.90	\$1.88

The expected life is the number of years that the Company estimates, based upon history, that the options will be outstanding prior to exercise or forfeiture. Expected life is determined using the “simplified method” permitted by Staff Accounting Bulletin No. 107. In addition to the inputs referenced above regarding the option pricing model, the Company adjusts the stock-based compensation expense for estimated forfeiture rates that are revised prospectively according to forfeiture experience. The stock volatility factor is based on the Company’s experience.

A summary of the status of the Company's stock options as of December 31, 2017 and 2016, and changes during the two years then ended are presented below.

	Options	Wtd. Avg. Exercise Price
Balance, December 31, 2015	564,342	\$ 7.35
Granted during the period	128,000	5.28
Exercised during the period	(24,905)	2.95
Terminated/Expired during the period	(31,095)	8.47
Balance, December 31, 2016	636,342	7.01
Granted during the period	695,000	1.45
Exercised during the period	(0)	—
Terminated/Expired during the period	(282,715)	7.66
Balance, December 31, 2017	1,048,627	\$ 3.20
Exercisable at December 31, 2017	416,125	\$ 5.43

The following table summarizes information about stock options at December 31, 2017:

Range of Exercise Prices	Number Outstanding	Wtd. Avg. Life	Wtd. Avg. Exercise Price
\$0.00 - \$5.00	842,978	5.6 years	\$1.99
\$5.01 - \$20.00	205,655	2.7 years	8.14
\$0.00 - \$20.00	1,048,633	5.1 years	\$3.20

As of December 31, 2017, there was \$470,233 of unrecognized compensation cost related to non-vested stock option awards, which is to be recognized over the remaining weighted average vesting period of three years.

The aggregate intrinsic value at December 31, 2017 was based on the Company's closing stock price of \$1.69 was \$166,050. The aggregate intrinsic value was calculated based on the positive difference between the closing market price of the Company's Common Stock and the exercise price of the underlying options. The total number of in-the-money options exercisable as of December 31, 2017 was 695,000.

The weighted average fair value of options granted during the years ended December 31, 2017 and 2016 was \$0.90 and \$1.88 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2017 and 2016 was \$0 and \$34,050, respectively. The total fair value of shares vested during the years ended December 31, 2017 and 2016 was \$235,550 and \$63,830, respectively.

## Warrants

During the year ended December 31, 2017 and 2016, the Company issued 971,611 and 571,871 warrants, respectively, in connection with convertible notes payable and common stock issuances.

The following tables summarize the Company's outstanding warrants as of December 31, 2017 and changes during the two years then ended:

	Warrants	Wtd. Avg. Exercise Price	Wtd. Ave. Remaining Contractual Life (years)
Balance, December 31, 2015	164,585	\$ 7.85	1.15
Issued	675,691	1.07	2.36
Exercised during the period	—	—	—
Terminated/Expired during the period	—	—	—
Balance, December 31, 2016	840,276	5.13	4.01
Granted during the period	971,611	2.61	4.42
Terminated/Expired during the period	(107,785)	6.30	—
Balance, December 31, 2017	1,704,102	\$ 3.62	4.04
Exercisable at December 31, 2017	1,704,102	\$ 3.62	4.04

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

	2017	2016
Risk-free interest rates	1.85%-2.20%	1.40% - 2.04%
Expected life (in years)	5	5
Expected volatility	63%-115%	33%-59%
Dividend yield	0	0
Weighted-average grant date fair value per share	\$1.10-\$2.89	\$0.81-\$1.40

## Note 17. SEGMENT REPORTING

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

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

The Company currently divides its operations into three operating segments: Complex Machining which consists of AIM and NTW; Aerostructures and Electronics which consists of WMI, WPI, MSI, Eur-Pac, ECC, and Compac; 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 years ended December 30, 2017 and December 31, 2016 are as follows:

	<b>Year Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>COMPLEX MACHINING</b>		
Net Sales	\$ 38,489,000	\$ 37,124,000
Gross Profit	4,906,000	4,382,000
Pre Tax Loss	(2,839,000)	(5,432,000)
Assets	43,207,000	45,073,000
<b>AEROSTRUCTURES &amp; ELECTRONICS</b>		
Net Sales	4,574,000	3,224,000
Gross Profit	507,000	38,000
Pre Tax Loss	(4,233,000)	(3,240,000)
Assets	1,021,000	4,596,000
<b>TURBINE ENGINE COMPONENTS</b>		
Net Sales	6,806,000	10,973,000
Gross Loss	(546,000)	(151,000)
Pre Tax Loss	(7,599,000)	(4,084,000)
Assets	6,157,000	17,235,000
<b>CORPORATE</b>		
Net Sales	—	—
Gross Profit	—	—
Pre Tax Loss	(1,399,000)	(10,000)
Assets	288,000	649,000
<b>CONSOLIDATED</b>		
Net Sales	49,869,000	51,321,000
Gross Profit	4,867,000	4,269,000
Pre Tax Loss	(16,070,000)	(12,766,000)
(Benefit from) provision for Income Taxes	(197,000)	2,101,000
Loss from Discontinued Operations	(6,678,000)	(756,000)
Assets Held for Sale	10,082,000	15,247,000
Net (Loss) Income	(22,551,000)	(15,623,000)
Assets	\$ 60,755,000	\$ 82,800,000

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO RULE 13a-14(a) UNDER THE EXCHANGE ACT

I, Luciano Melluzzo, certify that:

1. I have reviewed this annual report on Form 10-K/A (Amendment No. 2) of Air Industries Group;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: April 19, 2018

/s/ Luciano Melluzzo

Luciano Melluzzo

Chief Executive Officer (Principal Executive Officer)

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO RULE 13a-14(a) UNDER THE EXCHANGE ACT

I, Michael E. Recca, certify that:

1. I have reviewed this annual report on Form 10-K/A of Air Industries Group;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: April 19, 2018

/s/ Michael E. Recca

Michael E. Recca

Chief Financial Officer (Principal Financial Officer)

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)

In connection with the Annual Report of Air Industries Group, a Nevada corporation (the "Company"), on Form 10-K/A for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (the "Report"), Luciano Melluzzo, Chief Executive Officer of the Company, does hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. ss. 1350), that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Dated: April 19, 2018

/s/ Luciano Melluzzo

Luciano Melluzzo

Chief Executive Officer (Principal Executive Officer)

[A signed original of this written statement required by Section 906 has been provided to Air Industries Group and will be retained by Air Industries Group and furnished to the Securities and Exchange Commission or its staff upon request.]

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)

In connection with the Annual Report of Air Industries Group, a Nevada corporation (the "Company"), on Form 10-K/A for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (the "Report"), Michael E. Recca, Chief Financial Officer of the Company, does hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. ss. 1350), that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Dated: April 19, 2018

/s/ Michael E. Recca

Michael E. Recca

Chief Financial Officer (Principal Financial Officer)

[A signed original of this written statement required by Section 906 has been provided to Air Industries Group and will be retained by Air Industries Group and furnished to the Securities and Exchange Commission or its staff upon request.]



