AIR INDUSTRIES GROUP
Form 10-K/A
April 08, 2019

**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, 2018

**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 | 80-0948413 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

1460 Fifth Avenue, Bay Shore, New York 11706

(Address of Principal Executive Offices

(631) 968-5000
(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 whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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, 2018, the aggregate market value of our common stock held by non-affiliates was $30,045,613, based on 16,692,007 shares of outstanding common stock held by non-affiliates, and a price of $1.80 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 28,655,572 shares of the registrant's common stock outstanding as of March 27, 2019.

**DOCUMENTS INCORPORATED BY REFERENCE:** None

**Explanatory Note**

This amendment is being filed to include the information required by Part III of Form 10-K previously omitted pursuant to General Instruction G(3) to Form 10-K and to correct typographical errors in the original filing of this Form 10-K filed on April 1, 2019.

**AIR INDUSTRIES GROUP**

**FORM 10-K/A**

**For the Fiscal Year Ended December 31, 2018**


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**Cautionary Note Regarding Forward-Looking Statements**

This report contains forward-looking statements. Certain of the matters discussed herein concerning, among other items, our operations, cash flows, financial position and economic performance including, in particular, future sales, product demand, competition and the effect of economic conditions, include forward-looking statements.

Forward-looking statements are predictive in nature and can be identified by the fact that they do not relate strictly to historical or current facts and generally include words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimat and similar expressions. Although we believe that these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital, capital expenditures, distribution channels, profitability, new products, adequacy of funds from operations, and general economic conditions, these statements and other projections contained herein expressing opinions about future outcomes and non-historical information, are subject to uncertainties and, therefore, there is no assurance that the outcomes expressed in these statements will be achieved.

Investors are cautioned that forward-looking statements are not guarantees of future performance and actual results or developments may differ materially from the expectations expressed in forward-looking statements contained herein. Given these uncertainties, you should not place any reliance on these forward-looking statements which speak only as of the date hereof. See “Risk factors” for a discussion of factors that could cause our actual results to differ from those expressed or implied by forward-looking statements.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. You are advised, however, to consult any additional disclosures we make in our reports filed with the Securities and Exchange Commission (“SEC”).

**PART I**

**ITEM 1. BUSINESS**

**Introduction**

As used in this report, unless otherwise stated or the context requires otherwise, the "Company" and terms such as "we," "us" "our," and "AIRI" refer to Air Industries Group, a Nevada corporation, and its directly and indirectly wholly-owned subsidiaries.

We are an aerospace and defense company. We manufacture and design structural parts and assemblies that focus on flight safety, including landing gear, arresting gear, engine mounts, flight controls, throttle quadrants, components for jet engines and other components. Our products are currently deployed on a wide range of high profile military and commercial aircraft including Sikorsky's UH-60 Black Hawk, Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2 Hawkeye, Boeing's 777, Airbus' 380 commercial airliners, the US Navy F-18 and USAF F-16 fighter aircraft. Our Turbine Engine sector makes components for jet engines that are used on the USAF F-15, the Airbus A-330 and A-380, and the Boeing 777, in addition to a number of ground turbine applications.

We became a public company in 2005 when our net sales were approximately $30 million. Air Industries Machining, Corp. ("AIM"), our principal subsidiary, has manufactured components and subassemblies for the defense and commercial aerospace industry for over 50 years and has established long-term relationships with leading defense and aerospace manufacturers

In response to recent operating losses and their impact on our working capital, we have repositioned our business through the sale and liquidation of certain businesses we acquired since becoming a public company. We also consolidated our headquarters and the operations of our subsidiaries, Air Industries Machining and Nassau Tool Works, at our corporate campus in Bay Shore, New York, allowing us to re-focus our operations on our core competencies.

On December 20, 2018, we completed the sale of all of the outstanding shares of our subsidiary, Welding Metallurgy, Inc., which included our subsidiaries Miller Stuart, Woodbine, Decimal and Compac Development Corp. (collectively, the "WMI Group"), to CPI Aerostructures, Inc. ("CPI") for a purchase price of $9,000,000, net of a working capital adjustment of $(1,093,000), pursuant to a Stock Purchase Agreement dated as of March 21, 2018. On March

19, 2019, we received a notice from CPI claiming that the working capital deficit used to compute the purchase price was understated which we intend to contest.

On November 8, 2018 EPC received formal notice from the Department of the Navy that EPC was barred from future government contracts until October 29, 2020. Management chose to implement its plan to complete existing contracts that had already been awarded and closed EPC by March 31, 2019.

We now conduct our operations through the following wholly-owned subsidiaries: Air Industries Machining ("AIM"); Nassau Tool Works ("NTW"); and The Sterling Engineering Corporation ("Sterling"). AIM and NTW comprise our Complex Machining segment and Sterling represents our Turbine Engine Components segment.

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.

***Our Market***

We operate primarily in the military and, to a lesser degree, commercial aviation industries. Defense revenues represent a preponderance of our sales. Our principal customers include Sikorsky Aircraft, Goodrich Landing Gear Systems, Northrop Grumman, the United States Department of Defense, GKN Aerospace, Lockheed, Boeing, Raytheon, Piper Aircraft, M7 Aerospace, Vought Aerospace, Ametek/Hughes-Treitler and Airbus.

Our products are incorporated into many aircraft platforms, the majority of which remain in production, and of which there are a substantial number of operating aircraft in fleets maintained by the military and commercial airlines. We believe that we are the largest supplier of flight critical parts to Sikorsky's Black Hawk helicopter. We have made, or currently make, or have been awarded, products for Lockheed Martin's F-35 Joint Strike Fighter, Northrop Grumman's E2 Hawkeye, Boeing's 777, Airbus' 380 commercial airliners, and the US Navy F-18 and USAF F-16 fighter aircraft. Our Turbine Engine Components segment makes components for jet engines that are used on the USAF F-15, the Airbus A-330 and A-380, and the Boeing 777, in addition to a number of non-military ground turbine applications.

Many of our products are "flight critical," essential to aircraft performance and safety on takeoff, during flight and when landing. These products require advanced certifications as a condition to being a supplier. For many of our products we are the sole or one of a limited number of sources of supply. Many of the parts we supply are subject to wear and tear or fatigue and are routinely replaced on aircraft on a time in service or flight cycle basis. Replacement demand for these products will continue, albeit at perhaps a lower rate, so long as an aircraft remains in service, which is usually many years after production has stopped.

***Sales and Marketing***

Our approach to sales and marketing can be best understood through the concept of customer alignment. The aerospace industry is dominated by a small number of large prime contractors and equipment manufacturers. These customers rely heavily upon subcontractors to supply quality parts meeting specifications on a timely and cost effective basis. These customers and other customers we supply routinely rate their suppliers based on a variety of performance factors. One of our principal goals is to be highly rated and thus relied upon by all of our customers.

The large prime contractors are increasingly seeking subcontractors who can supply and are qualified to integrate the fabrication of larger, more complex and more complete subassemblies. We seek to position ourselves within the supply chain of these contractors and manufacturers to be selected for subcontracted projects. Successful positioning requires that we qualify to be a preferred supplier by achieving and maintaining independent third-party quality approval certifications, specific customer quality system approvals and top supplier ratings through strong

performance on existing contracts.

During our sales and marketing efforts we let customers know that we have employees with the talent and experience to manage the manufacture of sections of aircraft structures to be delivered to the final assembly phase of the aircraft manufacturing cycle, and customers have now engaged us for these services.

Initial contracts are usually obtained through competitive bidding against other qualified subcontractors, while follow-on contracts are usually retained by successfully performing initial contracts. Our long-term business generally benefits from barriers to entry resulting from investments, certifications, familiarization with the needs and systems of customers, and manufacturing techniques developed during the initial manufacturing phase. We endeavor to develop each of our relationships to one of a “partnership” where we participate in the resolution of pre-production design and build issues, and initial contracts are obtained as single source awards and follow-on pricing is determined through negotiations.

***Our Backlog***

The production cycle of products we manufacture can extend from several months to a year or longer. This gives rise to significant backlogs as customers must order product with sufficient lead time to ensure timely delivery.

We have a number of long-term multi-year General Purchase Agreements or GPA's with several of our customers. These agreements specify part numbers, specifications and prices of the covered products for an agreed upon period, but do not authorize immediate production and shipment. Shipments are authorized periodically by the customer to fit its production schedule. In late 2017, we received a renewal of our multi-year contract with Sikorsky, MY9, for the years 2018 to 2023. This contract is for $47 million worth of product during this period. This is the third multi-year contract award we have received from Sikorsky.

Our "firm backlog" includes only fully authorized orders received for products to be delivered within the forward 18-month period. As of February 28, 2019, our 18-month "firm funded backlog" was approximately $92.4 million.

***Competition***

Winning a new contract is highly competitive. We manufacture to customer design specifications, and we compete against companies that have similar manufacturing capabilities in a global marketplace. Consequently, the ability to obtain contracts requires providing quality products at competitive prices. To accomplish this requires that we strive for continuous improvement in our capabilities to assure our competitiveness and provide value to our customers. Our marketing strategy involves developing long-term ongoing working relationships with customers. These relationships enable us to develop entry barriers to would-be competitors by establishing and maintaining advanced quality approvals, certifications and tooling investments that are difficult and expensive to duplicate. Many of our competitors are well-established subcontractors engaged in the supply of aircraft parts and components to prime military contractors and commercial aviation manufacturers. Among our competitors are: Monitor Aerospace, a division of Stellex Aerospace; Hydromil, a division of Triumph Aerospace Group; Heroux Aerospace and Ellanef Manufacturing, a division of Magellan Corporation.

Many of our competitors are larger enterprises or divisions of significantly larger companies having greater financial, physical and technical resources, and the capabilities to timelier respond under much larger contracts.

***Raw Materials and Replacement Parts***

The manufacturing process for certain products, particularly those for which we serve as product integrator, requires significant purchases of raw materials, hardware and subcontracted details. As a result, much of our success in profitably meeting customer demand for these products requires efficient and effective subcontract management. Price and availability of many raw materials utilized in the aerospace industry are subject to volatile global markets and political conditions. Most suppliers of raw materials are unwilling to commit to long-term contracts at fixed prices. This is a substantial risk as our strategy often involves long term fixed price commitments to our customers. Recently, we have had difficulties in securing timely shipments of raw materials and components from certain vendors due to our liquidity problems.

***Employees***

As of March 22, 2019, we employed approximately 209 people. Of these, approximately 32 were in administration, 3 were in sales and procurement, and 174 were in manufacturing.

Air Industries Machining is a party to a collective bargaining agreement (the “Agreement”) with the United Service Workers, IUJAT, Local 355 (the “Union”) with which we believe we maintain good relations. The Agreement was renewed as of December 31, 2018 and expires on December 31, 2021 and covers all of AIM’s production personnel, of which there are approximately 107 people. In light of the continuing consolidation and integration of NTW business with AIM, we intend to add more employees to the Union during 2019. AIM is required to make a monthly contribution to each of the Union’s United Welfare Fund and the United Services Worker’s Security Fund. This is the only pension benefit required by the Agreement and the Company is not obligated for any future defined benefit to retirees. The Agreement contains a “no-strike” clause, whereby, during the term of the Agreement, the Union will not strike and AIM will not lockout its employees.

All of our employees are covered under a co-employment agreement with Extensis, Inc., a professional employer organization that provides out-sourced human resource services.

***Regulations***

***Environmental Regulation; Employee Safety***

We are subject to regulations administered by the United States Environmental Protection Agency, the Occupational Safety and Health Administration, various state agencies and county and local authorities acting in cooperation with federal and state authorities. Among other things, these regulatory bodies impose restrictions that require us to control air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous chemicals and substances. The extensive regulatory framework imposes compliance burdens and financial and operating risks on us. Governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose civil and criminal fines in the case of violations.

The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (“CERCLA”) imposes strict, joint and several liability on the present and former owners and operators of facilities that release hazardous substances into the environment. The Resource Conservation and Recovery Act of 1976 (“RCRA”) regulates the generation, transportation, treatment, storage and disposal of hazardous waste. New York and Connecticut, the states where our production facilities are located, also have stringent laws and regulations governing the handling, storage and disposal of hazardous substances, counterparts of CERCLA and RCRA. In addition, the Occupational Safety and Health Act, which requires employers to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, obligates employers to provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances.

***Federal Aviation Administration***

We are subject to regulation by the Federal Aviation Administration (“FAA”) under the provisions of the Federal Aviation Act of 1958, as amended. The FAA prescribes standards and licensing requirements for aircraft and aircraft components. We are subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. Our failure to comply with applicable regulations could result in the termination of or our disqualification from some of our contracts, which could have a material adverse effect on our operations. We have never been subject to such fines or disqualifications.

***Government Contract Compliance***

Our government contracts and those of many of our customers are subject to the procurement rules and regulations of the United States government, including the Federal Acquisition Regulations. Many of the contract terms are dictated by these rules and regulations. During and after the fulfillment of a government contract, we may be audited in respect of the direct and allocated indirect costs attributed to the project. These audits may result in adjustments to our contract costs. Additionally, we may be subject to U.S. government inquiries and investigations because of our participation in government procurement. Any inquiry or investigation can result in fines or limitations on our ability to continue to bid for government contracts and fulfill existing contracts.

We believe that we are in compliance with all federal, state and local laws and regulations governing our operations and have obtained all material licenses and permits required for the operation of our business.

**ITEM 1A. RISK FACTORS**

The purchase of our common stock involves a very high degree of risk.

In evaluating our common stock and our business, you should carefully consider the risks and uncertainties described below and the other information and our consolidated financial statements and related notes included herein. If any of the events described in the risks below actually occurs, our financial condition or operating results may be materially and adversely affected, the price of our common stock may decline, perhaps significantly, and you could lose all or a part of your investment.

The risks below can be characterized into three groups:

1) Risks related to our business, including risks specific to the defense and aerospace industry:

2) Risks arising from our indebtedness; and

3) Risks related to our common stock.

***Risks Related to Our Business***

***We incurred substantial net losses in 2018 and 2017 and may not be able to continue to operate as a going concern.***

We suffered net losses from operations of $5,963,000 and $12,758,000 and net losses of $10,992,000 and $22,551,000 for the years ended December 31, 2018 and 2017, respectively. We also had negative cash flows from operations for the year ended December 31, 2017. In 2018 we sold our subsidiary WMI for $9,000,000, net of a working capital adjustment of $(1,093,000). Of the net purchase price for WMI, $2,000,000 is held in escrow to secure any obligation we may have under the Purchase Agreement as a result of the working capital adjustment and as a result of our breach of the representations and warranties we made in the Purchase Agreement. During the years ended December 31, 2017 and 2018, and subsequent thereto, we sold in excess of $29,000,000 in debt and equity securities to fund our business. The report of our independent registered public accountants on our financial statements for the year ended December 31, 2018 states that these factors raise uncertainty about our ability to continue as a going concern.

Unless we are able to generate positive cash flows from operations, we will continue to depend upon further issuances of debt, equity or other financings to fund ongoing operations. We may continue to incur additional operating losses and we cannot assure you that we will continue as a going concern.

***We may need additional financing***.

In the past, we have funded a portion of our operating losses through borrowings from two of our principal stockholders who are also directors. As of December 31, 2018, related party notes payable to Michael and Robert Taglich (and their affiliated entities), totaled $4,835,000. Additional funding may not be available to us on reasonable terms, if at all, from third parties or our two principal stockholders. If we are unable to fund such losses from third parties or our principal stockholders, we may become insolvent.

The Seventeenth Amendment to our Amended and Restated Loan Agreement (the "Loan Facility") with PNC Bank, our principal lender, increased the interest rate we pay for amounts borrowed thereunder to an Alternative Base Rate plus 4% per annum. The Seventeenth Amendment extended the Termination Date of the Loan Facility to December 31, 2019, provided that we pay an extension fee of (i) $250,000 on the earlier of (a) the date that all obligations under the loan agreement ("Obligations") are indefeasibly paid in full or (b) June 30, 2019, (ii) $125,000 on the earlier of (a) the date that the Obligations are indefeasibly paid in full or (b) December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of July 1, 2019, (iii) $125,000 on the earlier of (a) the date that the Obligations are indefeasibly paid in full or (b) December 31, 2019, which amounts is deemed earned in full if the Obligations have not been satisfied as of October 1, 2019, and (iv) $500,000 on December 31, 2019, which amounts is deemed earned in full if the Obligations have not been satisfied as of December 31, 2019.

There can be no assurance that PNC will renew the Loan Facility on December 31, 2019, or that the terms of any renewal will be acceptable to us.

We may need to raise additional capital in the future. Future financings may involve the issuance of debt, equity and/or securities convertible into or exercisable or exchangeable for our equity securities. These financings may not be available to us on reasonable terms or at all when and as we require funding. If we are able to consummate such financings, the trading price of our common stock could be adversely affected and/or the terms of such financings may adversely affect the interests of our existing stockholders. Any failure to obtain additional working capital when required would have a material adverse effect on our business and financial condition and may result in a decline in our stock price. Any issuances of our common stock, preferred stock, or securities such as warrants or notes that are convertible into, exercisable or exchangeable for, our capital stock, would have a dilutive effect on the voting and economic interest of our existing stockholders.

***Sales and liquidations of our subsidiaries completed during 2017 and 2018 likely will lead to reduced revenues.***

During 2017 and 2018 we sold or otherwise liquidated certain of our subsidiaries to enable us to focus on our capabilities in our Complex Machining (AIM and NTW), and Turbine Engine Components (Sterling) segments. The absence of the subsidiaries we sold or liquidated may reduce the range of services we can provide to our customers and likely will lead to a reduction in our revenues for the immediate future.

***We have identified deficiencies and material weaknesses in our internal controls and we may not be successful in remediating these deficiencies and weakness in the near future.***

In connection with our review of our disclosure controls and internal controls over financial reporting for the fiscal year ended December 31, 2018, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and internal controls over financial reporting were not effective as of such dates. In particular, certain portions of our inventory control system and the enterprise reporting system used to track employee hours have not been integrated into the system used by the balance of our company which could result in a failure to properly account for the costs associated with work in process, slow moving inventory and the value of inventory on hand. Accordingly, costs to be included in work in process, may not be sufficiently automated to ensure compliance at all times. In addition, our Chief Executive Officer and Chief Financial Officer concluded that our quarterly closing process was deficient at our subsidiaries and that our consolidating process and period end reporting and disclosure procedures were materially weak. They also concluded that our system for administering and disclosing stock compensation was deficient and that we lacked the accounting personnel necessary to account for complex accounting matters and unusual and nonstandard transactions. We intend to remediate these conditions. In the event we do not remediate these deficiencies and material weaknesses in our internal controls, our operations may be adversely affected and the market price of our common stock could decline. In addition, if we are unable to meet the requirements of Section 404 of the Sarbanes-Oxley Act, we may not be able to maintain our listing on the NYSE American.

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

A large percentage of our revenue is derived from products for US military aviation. There are risks associated with programs that are subject to appropriation by Congress, which could be potential targets for reductions in funding. Reductions in United States Government spending on defense or future changes in the mix of defense products required by United States Government agencies could limit demand for our products, and may have a materially adverse effect on our operating results and financial condition. For the past several years, our operations have been impacted by volatility in government procurement cycles and spending patterns. There can be no assurance that our financial condition and results of operations will not be materially adversely impacted by future volatility in defense

spending or a change in the mix of products purchased by defense departments in the United States or other countries, or the perception on the part of our customers that such changes are about to occur.

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***We depend on revenues from a few significant relationships. Any loss, cancellation, reduction, or interruption in these relationships could harm our business.***

We derive most of our revenues from a small number of customers. Three customers represented approximately 70% and 62% of total sales for the years ended December 31, 2018 and 2017, respectively. The markets in which we sell our products are dominated by a relatively small number of customers which have contracts with United States governmental agencies, thereby limiting the number of potential customers. Our success depends on our ability to develop and manage relationships with significant customers. We cannot be sure that we will be able to retain our largest customers or that we will be able to attract additional customers, or that our customers will continue to buy our products in the same amounts as in prior years. The loss of one or more of our largest customers, any reduction or interruption in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may have to make, could significantly harm our business.

***We depend on revenues from components for a few aircraft platforms and the cancellation or reduction of either production or use of these aircraft platforms could harm our business.***

We derive a significant portion of our revenues from components for a few aircraft platforms, specifically the Sikorsky BlackHawk helicopter, the Northrop Grumman E-2 Hawkeye naval aircraft, the McDonnell Douglas (Boeing) C-17 Globemaster, the F-16 Falcon and the F-18 Hornet. Boeing closed its C-17 production line in 2015. A reduction in demand for our products as a result of either a reduction in the production of new aircraft or a reduction in the use of existing aircraft in the fleet (reducing after-market demand) would have a material adverse effect on our operating results and financial condition.

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

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

***We may lose sales if our suppliers fail to meet our needs or shipments of raw materials are not timely made.***

Although we procure most of our parts and components from multiple sources or believe that these components are readily available from numerous sources, certain components are available only from a sole or limited number of sources. While we believe that substitute components or assemblies could be obtained, use of substitutes would require development of new suppliers or would require us to re-engineer our products, or both, which could delay shipment of our products and could have a materially adverse effect on our operating results and financial condition. Recently, due to our liquidity problems, we have had difficulties in securing timely shipments of raw materials from certain vendors which has negatively impacted our results of operations. Any delays in the shipment of raw materials could significantly harm our business, our operating results and our financial condition.

***There are risks associated with the bidding processes in which we compete.***

We obtain many contracts through a competitive bidding process. We must devote substantial time and resources to prepare bids and proposals and may not have contracts awarded to us. Even if we win contracts, there can be no assurance that the prices that we have bid will be sufficient to allow us to generate a profit from any particular contract. There are significant costs involved with producing a small number of initial units of any new product and it may not be possible to recoup such costs on later production runs.

***Due to fixed contract pricing, increasing contract costs expose us to reduced profitability and the potential loss of future business.***

The cost estimation process requires significant judgment and expertise. Reasons for cost growth may include unavailability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in performance, availability and timing of funding from the customer, natural disasters, and the inability to recover any claims included in the estimates to complete. A significant change in cost estimates on one or more programs could have a material effect on our consolidated financial position or results of operations.

***The prices of raw materials we use are volatile.***

The prices of raw materials used in our manufacturing processes are volatile. If the prices of raw materials rise we may not be able to pass along such increases to our customers and this could have an adverse impact on our consolidated financial position and results of operations. It is possible that some of the raw materials we use might become subject to new or increased tariffs. Significant increases in the prices of raw materials could adversely impact our customers' demand for certain products which could lead to a reduction in our revenues and have a material adverse impact on our revenues and on our consolidated financial position and results of operations.

***Some of the products we produce have long lead times.***

Some of the products we produce require months to produce and we sometimes produce products in excess of the number ordered intending to sell the excess as spares when orders arise. As a result, our inventory turns slowly and ties up our working capital. Our inventory represented approximately 61% of our assets as of December 31, 2018. Any requirement to write down the value of our inventory due to obsolescence or a drop in the price of materials could have a material adverse effect on our consolidated financial position, results of operations and could result in a breach of the financial covenants in our Loan Facility.

***We do not own the intellectual property rights to products we produce.***

Nearly all the parts and subassemblies we produce are built to customer specifications and the customer owns the intellectual property, if any, related to the product. Consequently, if a customer desires to use another manufacturer to fabricate its part or subassembly, it would be free to do so, which could have a material adverse effect on our business,

our operating results and financial condition.

***There are risks associated with new programs.***

New programs typically carry risks associated with design changes, acquisition of new production tools, funding commitments, imprecise or changing specifications, timing delays and the accuracy of cost estimates associated with such programs. In addition, any new program may experience delays for a variety of reasons after significant expenditures are made. If we were unable to perform under new programs to the customers' satisfaction or if a new program in which we had made a significant investment was terminated or experienced weak demand, delays or other problems, then our business, financial condition and results of operations could be materially adversely affected. This could result in low margin or forward loss contracts, and the risk of having to write-off costs and estimated earnings in excess of billings on uncompleted contracts if it were deemed to be unrecoverable over the life of the program.

To perform on new programs we may be required to incur material up-front costs which may not have been separately negotiated and may not be recoverable. Such charges and the loss of up-front costs could have a material impact on our liquidity.

The need to control our expenses will place a significant strain on our management and operational resources. If we are unable to control our expenses effectively, our business, results of operations and financial condition may be adversely affected.

***Attracting and retaining executive talent and other key personnel is an essential element of our future success.***

Our future success depends to a significant extent upon our ability to attract executive talent, as well as the continued service of our existing executive officers and other key management and technical personnel. Experienced management and technical, marketing and support personnel in the defense and aerospace industries are in demand and competition for their talents is intense. Our failure to attract executive talent, or retain our existing executive officers and key personnel, could have a material adverse effect on our business, financial condition and results of operations.

***We are subject to strict governmental regulations relating to the environment, which could result in fines and remediation expense in the event of non-compliance.***

We are required to comply with extensive and frequently changing environmental regulations at the federal, state and local levels. Among other things, these regulatory bodies impose restrictions to control air, soil and water pollution, to protect against occupational exposure to chemicals, including health and safety risks, and to require notification or reporting of the storage, use and release of certain hazardous substances into the environment. This extensive regulatory framework imposes significant compliance burdens and risks on us. In addition, these regulations may impose liability for the cost of removal or remediation of certain hazardous substances released on or in our facilities without regard to whether we knew of, or caused, the release of such substances. Furthermore, we are required to provide a place of employment that is free from recognized and preventable hazards that are likely to cause serious physical harm to employees, provide notice to employees regarding the presence of hazardous chemicals and to train employees in the use of such substances. Our operations require the use of chemicals and other materials for painting and cleaning that are classified under applicable laws as hazardous chemicals and substances. If we are found to be in violation of any of these rules, regulations or permits, we may be subject to fines, remediation expenses and the obligation to change our business practice, any of which could result in substantial costs that would adversely impact our business operations and financial condition.

***We may be subject to fines and disqualification for non-compliance with Federal Aviation Administration regulations.***

We are subject to regulation by the FAA under the provisions of the Federal Aviation Act of 1958, as amended. The FAA prescribes standards and licensing requirements for aircraft and aircraft components. We are subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. Our failure to comply with applicable regulations could result in the termination of or our disqualification from some of our contracts, which could have a material adverse effect on our operations. We have never been subject to such fines or disqualification.

**Cyber security attacks, internal system or service failures may adversely impact our business and operations.**

Any system or service disruptions, including those caused by projects to improve our information technology systems, if not anticipated and appropriately mitigated, could disrupt our business and impair our ability to effectively provide products and related services to our customers and could have a material adverse effect on our business. We could also be subject to systems failures, including network, software or hardware failures, whether caused by us, third-party service providers, intruders or hackers, computer viruses, natural disasters, power shortages or terrorist attacks. Cyber security threats are evolving and include, but are not limited to, malicious software, unauthorized attempts to gain access to sensitive, confidential or otherwise protected information related to us or our products, customers or suppliers, or other acts that could lead to disruptions in our business. Any such failures could cause loss of data and interruptions or delays in our business, cause us to incur remediation costs or require us to pay to ransom to a hacker which takes over our systems, or subject us to claims and damage our reputation. In addition, the failure or disruption of our communications or utilities could cause us to interrupt or suspend our operations or otherwise adversely affect our business. Although we utilize various procedures and controls to monitor and mitigate the risk of these threats, there can be no assurance that these procedures and controls will be sufficient. Our property and business interruption insurance may be inadequate to compensate us for all losses that may occur as a result of any system or operational failure or disruption which would adversely affect our business, results of operations and financial condition. Moreover, expenditures incurred in implementing cyber security and other procedures and controls could adversely affect our results of operations and financial condition.

***Terrorist acts and acts of war may seriously harm our business, results of operations and financial condition.***

United States and global responses to actual or potential military conflicts, terrorism, perceived nuclear, biological and chemical threats and other global political crises increase uncertainties with respect to U.S. and other business and financial markets. Several factors associated, directly or indirectly, with actual or potential military conflicts, terrorism, perceived nuclear, biological and chemical threats, and other global political crises and responses thereto, may adversely affect the mix of products purchased by defense departments in the United States or other countries to platforms not serviced by us. A shift in defense budgets to product lines we do not produce could have a material adverse effect on our business, financial condition and results of operations.

***Risks Related to Our Indebtedness***

***Our indebtedness may have a material adverse effect on our operations.***

We have substantial indebtedness under our Loan Facility. As of December 31, 2018, we had approximately $15,615,000 of indebtedness outstanding under the Loan Facility. All of our indebtedness under the Loan Facility is secured by substantially all of our assets.

We also have outstanding a significant amount of indebtedness in the form of subordinated convertible notes which are payable on December 31, 2020. If we are unable to pay the outstanding principal and accrued interest on these notes when due, our operations may be materially and adversely affected.

Our leverage may adversely affect our ability to finance future operations and capital needs, may limit our ability to pursue business opportunities and may make our results of operations more susceptible to adverse economic conditions.

***Our principal commercial lender recently increased the interest rate and fees we pay under our Loan Facility.***

We recently amended our Loan Facility with PNC Bank, our principal lender. In the amendment, the termination date of the Loan Facility was extended until December 31, 2019, In addition, the interest rate we pay for amounts borrowed thereunder was increased and are required to we pay periodic fixed fees so long as we remain indebted under the Loan Facility.

There can be no assurance that PNC will renew the Loan Facility when it matures on December 31, 2019, or that the terms of any renewal will be acceptable to us. Further, there can be no assurance that we will be able to find a lender to succeed to the position of PNC or that the terms of any loan we may be offered will be acceptable to us.

***Our indebtedness may limit our ability to pay dividends in the future.***

We currently do not pay dividends and the terms of our Loan Facility require that we maintain certain financial covenants. Unless we are in compliance with our Loan Facility in the future, we would need to seek covenant changes under our Loan Facility to pay dividends in the future. There can be no assurance our lenders would agree to covenant changes acceptable to us or at all. In addition, we may in the future incur indebtedness or otherwise become subject to agreements whose terms restrict our ability to pay dividends in the future.

***Risks Related to our common stock***

***The ownership of our common stock is highly concentrated, and your interests may conflict with the interests of our existing stockholders.***

Two of our directors, Michael N. Taglich and Robert F. Taglich, and their affiliates own a significant number of shares of our outstanding common stock, which together with their position as directors of our company, give them significant influence over the outcome of corporate actions requiring stockholder approval and the terms on which we complete transactions with their affiliates. The interests of these directors may be different from the interests of other stockholders on these matters. This concentration of ownership could also have the effect of delaying or preventing a change in our control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could reduce the price of our common stock.

***We can provide no assurance that our common stock will continue to meet NYSE American listing requirements. If we fail to comply with the continuing listing standards of the NYSE American, our common stock could be delisted.***

If we fail to satisfy the continued listing requirements of the NYSE American, the NYSE American may take steps to delist our common stock. The delisting of our common stock would likely have a negative effect on the price of our common stock and would impair your ability to sell or purchase common stock when you wish to do so.

***There is only a limited public market for our common stock.***

Our common stock is listed on the NYSE American. However, trading volume has been limited and a more active public market for our common stock may not develop or be sustained over time. The lack of a robust market may impair a stockholder’s ability to sell shares of our common stock. In the absence of a more active trading market, any attempt to sell a substantial number of our shares could result in a decrease in the price of our stock. Specifically, you may not be able to resell your shares of common stock at or above the price you paid for such shares or at all.

Moreover, sales of our common stock in the public market, or the perception that such sales could occur, could negatively impact the price of our common stock. As a result, you may not be able to sell your shares of our common stock in short time periods, or possibly at all, and the price per share of our common stock may fluctuate significantly.

***If we fail to meet the expectations of securities analysts or investors, our stock price could decline significantly.***

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

Fluctuations in quarterly results or announcements of extraordinary events such as acquisitions or litigation may cause earnings to fall below the expectations of securities analysts and investors. In this event, the trading price of our common stock could significantly decline. These fluctuations, as well as general economic and market conditions, may adversely affect the future market price of our common stock, as well as our overall operating results. Consequently, our share price may experience significant volatility and may not necessarily reflect the value of our expected performance.

***We are currently unable to pay cash dividends on our common stock and are not likely to do so for the foreseeable future***

Our ability to pay cash dividends on our common stock is limited by the terms of our Loan Facility (and the terms of any future indebtedness or other agreements), under applicable law, and our status as a holding company. Given our current cash needs, it is not likely we will pay cash dividends in the foreseeable future.

***Future financings or acquisitions may adversely affect the market price of our common stock.***

Future sales or issuances of our common stock, including upon conversion of the 6% Notes, upon exercise of our outstanding warrants or as part of future financings or acquisitions, would be substantially dilutive to the outstanding shares of common stock. Any dilution or potential dilution may cause our stockholders to sell their shares, which would contribute to a downward movement in the price of common stock.

**We incur significant costs as a result of operating as a public company, and our management is required to devote substantial time to compliance requirements, including establishing and maintaining internal controls over financial reporting, and we may be exposed to potential risks if we are unable to comply with these requirements.**

As a public company, we incur significant legal, accounting and other expenses under the Sarbanes-Oxley Act of 2002, together with rules implemented by the Securities and Exchange Commission and applicable market regulators. These rules impose various requirements on public companies, including requiring certain corporate governance practices. Our management and other personnel will need to devote a substantial amount of time to these requirements. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly.

The Sarbanes-Oxley Act, among other things, requires that we maintain effective internal controls for financial reporting and disclosure controls and procedures. In particular, we must perform system and process evaluations and testing of our internal controls over financial reporting to allow management to report on the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Compliance with Section 404 may require that we incur substantial accounting expenses and expend significant management efforts. Our testing may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses. In the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner, the market price of our stock could decline if investors and others lose confidence in the reliability of our financial statements and we could be subject to sanctions or investigations by the SEC or other applicable regulatory authorities.

**ITEM 2. PROPERTIES**

As part of the effort to focus on our core businesses, our executive offices have been moved to our 5.4 acre corporate campus in Bay Shore, New York. We remain liable under the lease for our previous office in Hauppauge, New York. This lease has a term which ends January 2022. The annual rent was approximately $113,000 for the lease year which began in January 2019 and increases by approximately 3% per annum each year thereafter.

The operations of AIM and NTW are conducted on our 5.4-acre corporate campus in Bay Shore, New York. We occupy three buildings on the campus, consisting of 76,000 square feet. On October 24, 2006, we entered into a “sale/leaseback” transaction whereby we sold the buildings and real property located at the corporate campus and entered into a 20-year triple-net lease for the property. Base annual rent for 2018 was approximately $621,000 and increases by 3% each subsequent year. The lease grants us an option to renew the lease for an additional five years. Under the terms of the lease, we are required to pay all of the costs associated with the operation of the facilities, including, without limitation, insurance, taxes and maintenance.

The operations of Sterling are conducted in a 74,923 square foot facility on a 24 acre parcel in Barkhamsted, Connecticut.

**ITEM 3. LEGAL PROCEEDINGS**

A number of actions have been commenced against us 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 us. 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, which we estimate to be $104,584, plus attorney’s fees. We believe that we have a meritorious defense, and there was no lease on the property and that our subsidiary Compac Development Corp was a hold-over tenant occupying the space on month-to-month tenancy. We recently submitted our response to plaintiff’s motion for summary judgement.

An employee of our 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. We believe we are not liable to the employee and any amount we might have to pay in excess of our deductible would be covered by insurance.

An employee of our 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. We believe we are not liable to the employee and any amount we might have to pay would be covered by insurance.

Contract Pharmacal Corp. commenced an action on October 2, 2018, relating to a Sublease entered into between us and Contract Pharmacal in May 2018 with respect to the property that was formerly occupied by Welding Metallury, Inc., at 110 Plant Avenue, Hauppauge, New York. In the action Contract Pharmacal seeks damages for an amount in excess of $1,000,000 for our failure to make the entire premises available by the Sublease commencement date. We dispute the validity of the claims asserted by Contract Pharmacal and believe we have meritorious defenses to those claims and have recently submitted a motion in opposition to its motion for summary judgement.

On October 15, 2018, a complaint was filed by a stockholder of our company in the United States District Court for the Eastern District of New York (Michael Kishmoian vs. Air Industries et al Case No. 18cv5757) naming our company and certain of our directors and a former director. The Complaint alleges that the proxy statement for our 2017 Annual Meeting contained false and misleading misstatements relating to whether brokers had discretionary authority to vote the shares of their customers in connection with the proposal to increase the number of shares we are authorized to issue (the "2017 Charter Amendment"). In the Complaint the plaintiff seeks to void the amendment and rescind any shares issued using the shares authorized by the amendment. Our Board of Directors has adopted an amendment to further increase the number of shares of Common Stock we are authorized to issue (the "2019 Charter Amendment"), subject to stockholder approval at our 2019 Annual Meeting of Stockholders, which we anticipate will be held in May or June of 2019. Counsel to our insurance carrier has advised counsel to the plaintiff of the proposed amendment. We believe that approval of the 2019 Charter Amendment will remove any issues concerning our ability to issue shares of Common Stock, or the validity of shares issued in excess of the 25,000,000 authorized pursuant to the adoption of the 2017 Charter Amendment and that any amount we may pay to resolve this action will not be material.

From time to time we also may be engaged in various lawsuits and legal proceedings in the ordinary course of our business. We are currently not aware of any legal proceedings the ultimate outcome of which, in our judgment based on information currently available, would have a material adverse effect on our business, financial condition or operating results. We, however, have had claims brought against us by a number of vendors due to our liquidity constraints. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial stockholder of our common stock, is an adverse party or has a material interest adverse to our interest.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**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 "AIRI."

**Holders**

On March 27, 2019 there were 257 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, 2018:

| Plan Category | **Number of Securities to Be Issued Upon Exercise of Outstanding** | **Weighted Average Exercise Price Of Outstanding Options,** | **Number of Remaining Shares Available for Future Securities Issuance Under Equity** |
| --- | --- | --- | --- |

| | Options, Warrants and Rights | Warrants and Rights | Compensation Plans |
|---|---|---|---|
| Equity compensation plans approved by security holders | 838,149 | 3.08 | 730,658 |
| Equity compensation plans not approved by security holders | 2,239,702 | 3.10 | None |
| Total | 3,077,851 | | 730,658 |

**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, 2018.

**Purchases of Our Equity Securities**

No repurchases of our common stock were made during the fiscal year ended December 31, 2018.

**ITEM 6. SELECTED FINANCIAL DATA**

Not required.

**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, 2018 and 2017 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 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, 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.

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 50 years and has established long-term relationships with leading defense and aerospace manufacturers. In response to recent operating losses and their impact on our working capital, we have repositioned our business through the sale and liquidation of certain businesses we acquired since becoming a public company. We also consolidated our headquarters and the operations of our subsidiaries, AIM and NTW, at our corporate campus in Bay Shore, New York, allowing us to re-focus our operations on our core competencies. In addition:

1) In January 2017 we sold AMK Welding, Inc., for $4,500,000, net of a working capital adjustment of ($163,000) plus additional payments based on net revenue not to exceed $1,500,000 million (the "AMK Revenue Stream Payments"). In January 2019 we assigned our right to $1,136,710 of these payments to a group of accredited investors for gross proceeds of $800,000.

2) On December 20, 2018, we completed the sale of all of the outstanding shares of our WMI Group to CPI for a purchase price of $9,000,000, net of a working capital adjustment of $(1,093,000), pursuant to a Stock Purchase Agreement dated as of March 21, 2018.The amount of the working capital deficit has been contested by CPI and the discrepancy will likely be resolved through arbitration in accordance with the terms of the Stock Purchase Agreement.

In addition to repositioning our business to obtain profitability and positive cash flow, we remain resolute on meeting customers' needs 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 in recent years have reduced the demand for both new production and replacement spares. This has reduced our sales, particularly in our complex machining segment. Recent increases in Defense Department spending has increased orders for our products. We are focusing greater efforts on the civilian aircraft market though we still remain dependent upon the military for an overwhelming portion of our revenues.

**Segment Data**

We follow Financial Accounting Standards Board (“FASB”) ASC 280, “Segment Reporting” (“ASC 280”), which establishes standards for reporting information about operating segments in annual and interim financial statements, ASC 280 requires that companies report financial and descriptive information about their reportable segments based on a management approach. ASC 280 also establishes standards for related disclosures about products and services, geographic areas and major customers.

We currently divide our operations into three 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). All operating costs are allocated to the Company’s three segments.

In March 2018, we announced our intention to divest WMI Group and related operation which divestiture was completed in December 2018. These operations are part of our Aerostructures & Electronics operating segment. Although WMI Group and the related operations have been classified as a discontinued operation, we continued to operate these businesses until the sale closed on December 20, 2018. In November 2018, our Eur-Pac (“EPC”) subsidiary received a notice of debarment from bidding on or fulfilling future government contracts. The existing contracts that had already been awarded have been completed and the operations of the entity were effectively closed on March 31, 2019.

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, 2018 and 2017:***

In March 2018, we announced our intent to divest WMI Group and related operations which divestiture was completed in December 2018 enabling us to focus on complex, machined products for aircraft landing gear, flight critical / flight safety equipment and jet turbine applications. Although WMI Group and the related operations had been classified as a discontinued operation, we continued to operate these businesses until the sale closed on December 20, 2018. In November 2018 our Eur-Pac subsidiary received a notice of debarment from bidding on or fulfilling future government contracts. The operations of EPC and our subsidiary Electronic Connections ("ECC") were effectively closed on March 31, 2019. From January 2018 through the closing date of the sale of WMI Group and the completion of the wind down of Eur-Pac, respectively, both operations generated 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:***

| | 2018 | 2017 |
|---|---|---|
| Net sales | $ 46,309,000 | $ 49,869,000 |
| Cost of sales | 40,895,000 | 45,002,000 |
| Gross profit | 5,414,000 | 4,867,000 |
| Operating expenses and interest and financing costs | 12,760,000 | 14,808,000 |
| Other income (expense) net | 278,000 | (22,000) |
| Provision for (Benefit from) income taxes | 3,000 | (197,000) |
| Net loss from continuing operations | $ (9,609,000) | $ (16,073,000) |

***Balance Sheet Data:***

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Cash and cash equivalents | $ 2,012,000 | $ 630,000 |
| Working capital | 9,041,000 | 9,531,000 |
| Total assets | 47,756,000 | 60,755,000 |
| Total stockholders' equity | $ 11,606,000 | $ 17,766,000 |

***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,** | |
|---|---|---|
| | **2018** | **2017** |
| ***COMPLEX MACHINING*** | | |
| Net Sales | $ 39,745,000 | $ 38,489,000 |
| Gross Profit | 5,871,000 | 4,906,000 |
| Pre Tax Loss | (75,000 ) | (2,839,000 ) |
| Assets | 41,947,000 | 43,207,000 |
| ***AEROSTRUCTURES & ELECTRONICS*** | | |
| Net Sales | 1,779,000 | 4,574,000 |
| Gross (Loss) Profit | (31,000 ) | 507,000 |
| Pre Tax Loss | (1,380,000 ) | (4,233,000 ) |
| Assets | 110,000 | 1,021,000 |
| ***TURBINE ENGINE COMPONENTS*** | | |
| Net Sales | 4,785,000 | 6,806,000 |
| Gross Loss | (426,000 ) | (546,000 ) |
| Pre Tax Loss | (1,385,000 ) | (7,599,000 ) |
| Assets | 5,243,000 | 6,157,000 |
| ***CORPORATE*** | | |
| Net Sales | - | - |
| Gross Profit | - | - |
| Pre Tax Loss | (6,766,000 ) | (1,599,000 ) |
| Assets | 456,000 | 288,000 |
| ***CONSOLIDATED*** | | |
| Net Sales | 46,309,000 | 49,869,000 |
| Gross Profit | 5,414,000 | 4,867,000 |
| Pre Tax Loss | (9,606,000 ) | (16,270,000 ) |
| (Benefit from) provision for Income Taxes | 3,000 | (197,000 ) |
| Loss from Discontinued Operations | (1,383,000 ) | (6,478,000 ) |
| Assets Held for Sale | - | 10,082,000 |
| Net Loss | (10,992,000 ) | (22,551,000 ) |
| Assets | $ 47,756,000 | $ 50,673,000 |

***Net Sales:***

Consolidated net sales for the year ended December 31, 2018 were $46,309,000, a decrease of $3,560,000, or 7.1%, compared with $49,869,000 for the year ended December 31, 2017. Net sales of our Complex Machining segment were $39,745,000, an increase of $1,256,000, or 3.3%, from $38,489,000 in the prior year. Net sales in our Turbine Engine Components segment were $4,785,000, a decrease of $2,021,000 or 29.7%, compared with $6,806,000 for the year ended December 31, 2017. This decrease was due primarily to a change in product mix and poor decisions by prior management that was replaced in early 2018. We believe that under new management this segment of our operations will realize sales in 2019 over those of 2018. The decrease was also due to the sale of AMK in January 2017 which had sales of $417,000 in 2017. Net sales in our Aerostructures segment were $1,779,000, a decrease of $2,795,000 or 61.1%, compared with $4,574,000 for the year ended December 31, 2017. Our Aerostructures segment consists solely of EPC which has been closed effective March 31, 2019.

As indicated in the table below, three customers represented 70.0% and three customers represented 62.0% of total sales for the years ended December 31, 2018 and 2017, respectively.

| Customer | Percentage of Sales | |
|---|---|---|
| | 2018 | 2017 |
| Goodrich Landing Gear Systems | 30.7% | 20.5% |
| Sikorsky Aircraft | 27.4% | 25.5% |
| Rohr | 11.9% | * |
| United States Department of Defense | * | 16.0% |

*Customer was less than 10% of sales at December 31, 2018 and 2017, respectively.

***As indicated in the table below, two customers represented 64.5% and three customers represented 68.7% of gross accounts receivable at December 31, 2018 and 2017, respectively.***

| Customer | Percentage of Receivables | |
|---|---|---|
| | 2018 | 2017 |
| Goodrich Landing Gear Systems | 38.3 % | 41.9 % |
| Rohr | 26.2 % | 14.6 % |
| United State Department of Defense | * | 12.2 % |

*Customer was less than 10% of Gross Accounts Receivable at December 31, 2018.

***Gross Profit:***

Consolidated gross profit from operations for the year ended December 31, 2018 was $5,414,000, an increase of $547,000, or 11.2%, as compared to gross profit of $4,867,000 for the year ended December 31, 2017. Consolidated gross profit as a percentage of sales was 11.7% and 9.8% for the years ended December 31, 2018 and 2017, respectively. The increase in gross profit was due primarily to the implementation of cost reduction and productivity improvement initiatives.

***Interest and Financing Costs***

Our interest and financing costs increased from $3,378,000 in 2017 to $3,921,000 in 2018.

***Impairment Charges***

In connection with the closing of Eur-Pac we recorded impairment charges to goodwill and to assets in the amounts of $109,000 and $386,000, respectively, in fiscal year 2018. 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, 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, which amounts are included in the loss from discontinued operations.

***Operating Expense***

Consolidated operating expenses for the year ended December 31, 2018 totaled $8,839,000 and decreased by $2,591,000 or 22.7% compared to $11,430,000 for the year ended December 31, 2017. 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, 2018 was $10,992,000, an improvement of $11,559,000, compared to a net loss $22,551,000 for the year ended December 31, 2017, for the reasons discussed above. Our net losses for 2018 and 2017 included net losses from the discontinued operations of WMI Group of $1,042,000 and $6,678,000, respectively. In addition, our net losses for 2018 and 2017 included impairment charge related to ongoing operations of approximately $495,000 and $6,195,000, respectively.

***Impact of Inflation***

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

***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. 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 two years 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 stockholders.

The Loan Facility provides for a $15,000,000 revolving loan and a term loan with a balance of $1,572,000 at December 31, 2018 (the “Term Loan”). 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 scheduled maturity date.

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. The Loan Facility also restricts the amount of dividends we may pay to our stockholders.

The Loan Facility has been amended many times during its term, most recently on May 30, 2018 (the “Sixteenth Amendment”), January 2, 2019 (the “Seventeenth Amendment”), and February 8, 2019 (the “Eighteenth Amendment”).

The Sixteenth Amendment waived Fixed Charge Coverage Ratio covenant violations for the periods ending September 30, 2017, December 31, 2017 and March 31, 2018. The Sixteenth Amendment imposes minimum EBITDA (as defined in the Loan Agreement) covenants of not less than (i) $75,000 for the three-month period ending March 31, 2018, (ii) $485,000 for the six month period ending June 30, 2018, and (iii) $1,200,000 for the nine-month period ending September 30, 2018. We were in compliance with these new covenants for the three-months ended March 31, 2018, the six-month period ended June 30, 2018 and the nine-month period ended September 30, 2018. In addition, the amendment prohibits us from paying dividends to our stockholders and limits capital expenditures.

Under the terms of the Seventeenth Amendment, the revolving loan and the Term Loan bear interest at a rate equal to the sum of the Alternate Base Rate (as defined in the Loan Agreement) plus four percent (4%). In addition to the

amounts available as revolving loans secured by inventory and receivables pursuant to the formula set forth in the Loan Agreement, PNC has agreed to permit the revolving advances to exceed the formula amount by $1,000,000 as of December 31, 2018, provided that we reduce the “Out-of-Formula Loan” by $25,000 per week commencing April 1, 2019, with the unpaid balance payable in full on December 31, 2019. The indebtedness under the revolving loan and the Term Loan are classified with the current portion of notes and capital lease obligations.

Both the revolving loan, inclusive of the Out-of Formula Loan, and the Term Loan mature on December 31, 2019. As a condition to its agreement to extend the maturity of the obligations due under the Loan Agreement (the “Obligations”), we are obligated to pay PNC an extension fee of (i) $250,000 on the earlier of (a) the date the Obligations are indefeasibly paid in full or (b) June 30, 2019, (ii) $125,000 on the earlier of (a) the date the Obligations are indefeasibly paid in full or (b) December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of July 1, 2019, (iii) $125,000 on the earlier of (a) the date the Obligations are indefeasibly paid in full or (b) December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of October 1, 2019 (iv) $500,000 on December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of December 31, 2019. As a further condition to PNC’s agreement to extend the maturity of the Obligations, Michael and Robert Taglich purchased $2,000,000 principal amount of our Senior Subordinated Convertible Notes and arranged a financing giving purchasers a right to receive a pro rata portion of the AMK Revenue Stream Payments resulting in gross proceeds of $800,000, including $275,000 from Michael and Robert Taglich.

The Eighteenth Amendment requires us to maintain a minimum EBITDA of not less than (i) $1,500,000 for the twelve-month period ending December 31, 2018, (ii) $655,000 for the three-month period ending March 31, 2019, (iii) $1,860,000 for the six-month period ending June 30, 2019 and (iv) $3,110,000 for the nine-month period ending September 30, 2019. At December 31, 2018 we were in compliance with the minimum EBIDA covenant.

As of December 31, 2018, our debt to PNC in the amount of $15,615,000 consisted of the revolving credit loan in the amount of $14,043,000 and the term loan in the amount of $1,572,000. The revolver balance included the Company’s negative general ledger balances in its controlled disbursement cash accounts. As of December 31, 2017, our debt to PNC in the amount of $19,926,000 consisted of the revolving credit note due to PNC in the amount of $16,455,000 and the term loan due to PNC in the amount of $3,471,000. In addition, as of December 31, 2018 we had capitalized lease obligations to third parties of $1,787,000, as compared to capitalized lease obligations to third parties of $3,073,000 as of December 31, 2017.

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

***Dispositions***

On December 20, 2018, we completed the sale of our WMI Group to CPI for a purchase price of $9,000,000, net of a working capital adjustment of $(1,093,000), pursuant to a Stock Purchase Agreement dated as of March 21, 2018. Of the net purchase price for WMI, $2,000,000 is held in escrow to secure any obligation we may have under the Purchase Agreement as a result of the working capital adjustment and as a result of our breach of the representations and warranties we made in the Purchase Agreement. The amount of the working capital deficit has been contested by CPI and the discrepancy will likely be resolved through arbitration in accordance with the terms of the Stock Purchase Agreement.

***Financings – Related Parties***

Due to net losses and negative cash flow in recent years, we have financed our operations in part through private placements of our debt and equity securities. Each of Michael and Robert Taglich, two of our directors, have invested substantial amounts in our company in various debt and equity financings, including the financings in 2018 described below and in other financings discussed in Note 11 to our consolidated financial statements for the years ended December 31, 2018 and 2017 appearing elsewhere in this report.

Taglich Brothers, Inc. (“Taglich Brothers”), a corporation founded by Michael and Robert Taglich, and in which a third director of our company is a vice president of Investment Banking, has acted as placement agent for our debt and equity financing transactions and has received cash and equity compensation for its services. For additional information, see Note 11 to our consolidated financial statements for the years ended December 31, 2018 and 2017 appearing elsewhere in this report.

Debt Financings

On March 29, 2018 and April 4, 2018 Michael Taglich and Robert Taglich, advanced $1,000,000 and $100,000, respectively, to our company for use as working capital. We subsequently issued our Subordinated Notes due May 31, 2019 to Michael and Robert Taglich, together with shares of our common stock, in the financing described below, to evidence our obligation to repay the foregoing advances.

In May 2018, we issued $1,200,000 principal amount of subordinated notes due May 31, 2019 (the "2019 Notes"), together with a total of 214,762 shares of common stock (the "Shares"), to Michael Taglich, Robert Taglich and another accredited investor. As part of the financing, we issued to Michael Taglich $1,000,000 principal amount of 2019 Notes and 178,571 shares of common stock for a purchase price of $1,000,000 and we issued to Robert Taglich $100,000 principal amount of 2019 Notes and 17,857 shares of common stock. We issued and sold a 2019 Note in the principal amount of $100,000, plus 18,334 shares of common stock, to the other accredited investor for a purchase price of $100,000. Seventy percent (70%) of the total purchase price for the 2019 Notes and Shares purchased by each investor has been allocated to the 2019 Notes with the remaining thirty percent (30%) allocated to the Shares purchased with the 2019 Notes. The number of Shares purchased by Michael Taglich and Robert Taglich was calculated based upon $1.68, the closing price of the common stock on May 18, 2018, the trading day immediately preceding the date they purchased the 2019 Notes and shares of common stock.

Interest on the 2019 Notes is payable on the outstanding principal amount thereof at the rate of one percent (1%) per month, payable monthly commencing June 30, 2018. Upon the occurrence and continuation of a failure to pay accrued interest, interest shall accrue and be payable on such amount at the rate of 1.25% per month; provided that upon the occurrence and continuation of a failure to timely pay the principal amount of the 2019 Note, interest shall accrue and be payable on such principal amount at the rate of 1.25% per month and shall no longer be payable on interest accrued but unpaid. The 2019 Notes are subordinate to our obligations to PNC under the Loan Facility.

Taglich Brothers acted as placement agent for the offering and received a commission in the aggregate amount of 4% of the amount invested which was paid in kind.

Related party notes payable, net of debt discount to Michael and Robert Taglich, and their affiliated entities, totaled $4,835,000 and $1,912,000, as of December 31, 2018 and December 31, 2017, respectively.

On January 15, 2019, we issued our 7% senior subordinated convertible promissory notes due December 31, 2020, each in the principal amount of $1,000,000 (together, the “7% Notes” and each a “7% Note”), to Michael Taglich and Robert Taglich, each for a purchase price of $1,000,000. Each 7% Note bears interest at the rate of 7% per annum, is convertible into shares of our common stock at a conversion price of $0.93 per share, subject to the anti-dilution adjustments set forth in the 7% Note, is subordinated to our indebtedness under the Credit Facility, and matures at December 31, 2020, or earlier upon an Event of Default (as defined in the7% Note).

We paid Taglich Brothers, Inc. a fee of $80,000 (4% of the purchase price of the 7% Notes), in the form of a promissory note having terms similar to the 7% Notes, in connection with the purchase of the 7% Notes.

Amendments to 8% Notes

In September 2018, holders of a majority of the outstanding principal amount of our 8% subordinated convertible notes (the “8% Notes) consented to an amendment to the terms of the 8% Notes to extend the maturity date to December 31, 2020 and to reduce the interest rate from and after September 30, 2018, to 6% per annum, if paid in cash, or at the rate of 8% per annum if converted into common stock. In addition, accrued interest on the 8% Notes, as so amended (the “6% Notes”), was payable at maturity, rather than quarterly.

At September 30, 2018, Michael Taglich, Robert Taglich and Taglich Brothers (collectively, the “Taglich Parties”) owned $1,300,000, $650,000 and $382,000, respectively, principal amount of 8% Notes, with accrued interest thereon from the date of issuance through September 30, 2018 of $203,613, $120,097 and $68,294, respectively. In consideration for waiving all defaults in payment of principal and accrued interest on the 8% Notes through the date of the amendment, the conversion price of the 6% Notes was reduced to $1.50 per share, subject to the anti-dilution adjustments set forth in the 6% Notes, and we issued to the holders of the 8% Notes such number of shares of common stock calculated based upon a value of $1.39 per share, the closing market price of common stock on the NYSE American on September 28, 2018, the date immediately prior to the date the holders of a majority of the outstanding principal amount of the 8% Notes approved the amendment as is equal to the interest accrued on their 8% Notes from the date of issuance through September 30, 2018. As a result, we issued to Michael Taglich, Robert Taglich and Taglich Brothers 146,484 shares, 86,401 shares and 49,132 shares, respectively, of common Stock. From and after September 30, 2018, interest on the unpaid principal amount of the Amended Notes shall accrue and be paid at the rate of six (6%) percent per annum, if paid in cash or at the rate of eight (8%) percent if converted into common stock.

For soliciting noteholders in connection with the adoption of the amendments, we agreed to pay Taglich Brothers $95,550, representing a fee equal to 2% of the outstanding principal amount of 8% Notes whose registered holders (other than Taglich Brothers) received shares of common stock in lieu of cash payment of accrued interest on the 8% Notes as of September 30, 2018.

Equity Financings

On July 19, 2018, we issued and sold a total of 322,000 shares of our common stock for gross proceeds of $460,460, or a $1.43 per share, to four accredited investors pursuant to subscription agreements.

For acting as placement agent of the offering, Taglich Brothers, Inc. is entitled to a placement agent fee equal to $27,627.60 (6% of the gross proceeds of the offering), payable at our option, in cash or shares of Common Stock on the terms sold to the purchasers.

On October 1, 2018, we sold 800,000 shares of common stock and warrants to purchase 280,000 additional shares of common stock for gross proceeds of $1,000,000 to RBI Private Investment III, LLC, an accredited investor within the meaning of Rule 501(a) of Regulation D under the Securities Act (“Regulation D”), in a private offering exempt from the registration requirements of the Securities Act under Rule 506 of Regulation D and Section 4(a)(2) of the Securities Act. We agreed to pay Taglich Brothers $70,000 (7% of the gross proceeds of the offering) for acting as placement agent for the offering.

AMK Revenue Stream Payments Financing

On January 15, 2019, we entered into a Purchase Agreement with 15 accredited investors (the "Purchasers"), including Michael and Robert Taglich, pursuant to which we assigned to the Purchasers all of our right, title and interest to the remaining $1,136,710 of the $1,500,000 in payments due from Meyer Tool, Inc. for the sale of AMK Welding, Inc. (the "Remaining Amount") for an aggregate purchase price of $800,000, including $100,000 from each of Michael and Robert Taglich, and $75,000 for the benefit of the children of Michael Taglich. The timing of the payments is based upon the net sales of AMK Welding, Inc., which we sold to Meyer Tool in January 2017. If the Purchasers have not received the entire Remaining Amount by March 31, 2023, they have the right to demand payment of their pro rata portion of the unpaid Remaining Amount from us ("Put Right"). To the extent the Purchasers exercise their Put Right, the remaining payments from Meyer will be made to us.

The Purchasers agreed to pay Taglich Brothers a fee equal to 2% per annum of the purchase price paid by such Purchasers, payable quarterly, to be deducted from the payments of the Remaining Amount, for acting as paying agent in connection with the assignment of our rights to the payments from Meyer Tool.

***Cash Flow***

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Cash provided by (used in) | | |
| Operating activities | $(2,336) | (3,986) |
| Investing activities | 3,685 | 1,761 |
| Financing activities | 33 | 1,551 |
| Net increase (decrease) in cash and cash equivalents | $1,382 | (674) |

***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, 2018, net cash was impacted by a net loss of $10,992,000, offset by $7,943,000 of non-cash items, consisting primarily of goodwill impairment of $109,000, depreciation of property and equipment of $2,877,000, amortization of debt discount on convertible notes payable of $941,000, and amortization and change in useful life of capitalized engineering costs of $2,711,000. Operating assets and liabilities further provided cash in the net amount of $713,000, consisting primarily of the net increases in deposits and other long term assets and accounts receivable amounts of $1,112,000 and $561,000, and a decrease in inventory and accounts payable and accrued expenses in the amounts of $1,395,000 and $1,127,000, partially offset primarily by an increase in deferred revenue of $2,076,000.

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, and 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 decreases in accounts receivable, prepaid taxes and inventory of $1,004,000, $360,000 and $905,000, respectively, partially offset primarily by an increase in deferred revenue and deposits and other assets of $410,000 and $113,000, respectively.

***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, 2018.

For the year ended December 31, 2018, cash provided by investing activities was $3,685,000. This was comprised of the net proceeds from the sale of WMI of $5,472,000, offset by $523,000 for capitalized engineering costs and $1,264,000 for the purchase of property and equipment.

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.

***Cash Provided By (Used in) Financing Activities***

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

For the year ended December 31, 2018, cash provided by financing activities was $33,000. This was comprised of repayments of $1,899,000 on our term loan, $2,415,000 on our revolving loans, $1,286,000 on our capital lease obligations, $125,000 on our deferred financing costs, offset by proceeds from notes payable issuances of $2,803,000 to related parties and $70,000 to third parties and proceeds from the issuance of common stock of $2,885,000.

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.

***CONTRACTUAL OBLIGATIONS***

***The following table sets forth our future contractual obligations as of December 31, 2018:***

Payment due by period (in thousands)
Total

| | | Less than 1 year* | 1-3 years | 3-5 years | More than 5 years |
|---|---|---|---|---|---|
| Debt and capital leases | $ 25,153 | 24,544 | 594 | 15 | - |
| Operating leases | 7,769 | 1,149 | 2,253 | 1,763 | 2,604 |
| Total | $ 32,922 | 25,693 | 2,847 | 1,778 | 2,604 |

* 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, 2018.

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***Going Concern***

We suffered losses from operations of $5,963,000 and $12,758,000 and net losses of $10,992,000 and $22,551,000, respectively, for the years ended December 31, 2018 and 2017, respectively. We also had negative cash flows from operations for the year ended December 31, 2017. In addition, in each of January 2017 and December 2018 we sold an operating subsidiary. We also have had to sell debt and equity securities to secure funds to operate our business and may have to continue to do so until we are able to achieve profitability and positive cash flow.

In late fiscal 2017, we initiated a repositioning of our business to obtain profitability and improve our liquidity position. 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.

***Assets Held for Sale***

We classify assets as held for sale and suspend depreciation and amortization when approval at the appropriate level has been provided, the assets can be immediately removed from operations, an active program has begun to locate a buyer, the assets are being actively marketed for sale at or near their current fair value, significant changes to the plan of sale are not likely and the sale is probable within one year. Upon classification as held for sale, long-lived assets are no longer depreciated, and an assessment of impairment is performed to identify and expense any excess of carrying value over fair value less costs to sell. Subsequent changes to the estimated fair value less costs to sell will impact the measurement of assets held for sale. To the extent fair value increases, any impairment previously recorded is reversed. If the carrying value of the assets held for sale exceeds the fair value less costs to sell, we will record a loss for the amount of the excess.

If we decide not to sell previously classified assets held for sale, the assets are reclassified back to their original asset group in the period that it’s determined to no longer be held for sale. The assets are recorded at the lower of the

carrying value before being classified as held for sale adjusted for depreciation that would have been recognized during the time they were classified as held for sale or fair value at the date we decided not to sell.

As of December 31, 2018, we sold WMI Group.

***Inventory Valuation***

We do not take physical inventories at interim quarterly reporting periods. The value of the majority of the items in inventory has been estimated using a gross profit percentage based on sales of previous periods as compared 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 our 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, we value inventory at the lower of cost on a first-in-first-out basis or estimated net realizable value.

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.

We present 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***

We have contractual agreements with customers to produce parts, which the customers design. Though have not designed and thus have 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 were amortized on a straight line basis over the shorter of the estimated length of the contract, or three years.

If we were reimbursed for all or a portion of the pre-production expenses associated with a particular contract, only the unreimbursed portion would be capitalized. We also may 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.

Based on various technological advances by our customer's and the rapid pace of innovation including change in future production methodologies and systems, it has become more complicated to estimate the future life and recoverability of the assets we are currently capitalizing. It is the belief of the Company that it would be preferable and therefore justifiable to expense these costs as incurred through cost of goods sold, rather than continue to capitalize these costs and amortize them through operating expense.

As of December 31, 2018 we changed our policy to no longer capitalize engineering costs and to write-off the capitalized engineering balance of $2,043,000.

***Revenue Recognition***

On January 1, 2018, the Company adopted ASC 606 "Revenue from Contracts with Customers", as amended regarding revenue from contracts with customers using the modified retrospective approach, which was applied to all contracts with Customers. Under the new standard an entity is required to recognize revenue to depict the transfer of promised goods to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods.

There was no cumulative financial statement effect of initially applying the new revenue standard because an analysis of our contracts supported the recognition of revenue consistent with our historical approach. In accordance with the modified retrospective approach, the comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company does not expect the adoption of the new revenue standard to have a material impact on the Company's revenues or net income on an ongoing basis.

The Company's revenues are primarily derived from consideration paid by customers for tangible goods. The Company analyzes its different goods by segment to determine the appropriate basis for revenue recognition, as described below. Revenue is not generated from sources other than contracts with customers and revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities. There are no material upfront costs for operations that are incurred from contracts with customers.

Our rights to payments for goods transferred to customers are conditional only on the passage of time and not on any other criteria. Payment terms and conditions vary by contract, although terms generally include a requirement of payment within 30 to 75 days.

Payments received in advance from customers 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. We utilize 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.

Under ASC 606, revenue is recognized as the customer obtains control of the goods and services promised in the contract (i.e., performance obligations). In evaluating our contracts with our customers under ASC 606, we have determined that there is no future performance obligation once delivery has occurred. Accordingly, we have determined that there is no impact on the timing of recording sales and operating profit.

We recognize certain revenues under a bill and hold arrangement with two of its large customers. For any requested bill and hold arrangement, we make 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***

We account for income taxes in accordance with accounting guidance now codified as FASB ASC 740, “Income Taxes,” which requires that we 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.

We account 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***

We account 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. We estimate 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.

We account 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.

We perform 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. Step “two” 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. We record 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, 2018, the intangible assets have been fully amortized and there has been no impairment.

***Recently Issued Accounting Pronouncements***

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

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases and ASU 2018-11 "Leases (Topic 842): Targeted Improvements" (ASU 2018-11). ASU 2018-10 clarifies certain areas within ASU 2016-02. Prior to ASU 2018-11, a modified retrospective transition was required for financing or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. ASU 2018-11 allows entities an additional transition method to the existing requirements whereby an entity could adopt the provisions of ASU 2016-02 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption. ASU 2018-11 also allows a practical expedient that permits lessors to not separate non-lease components from the associated lease component if certain conditions are present. An entity that elects to use the practical expedients will, in effect, continue to account for leases that commenced before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. ASU 2016-02, ASU 2018-10 and ASU 2018-11 will be effective for our fiscal year beginning April 1, 2019 and subsequent interim periods. Our current lease arrangements expire through 2021 and we are currently evaluating the impact the adoption of these ASUs will have on our consolidated 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. We do not believe that the adoption of this pronouncement has an impact on the presentation of its 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. We are currently in the process of evaluating the impact of the adoption of this standard on our financial statements.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This update will be effective for all interim and annual reporting periods beginning after December 15, 2018. We do not believe that the adoption of this pronouncement has an impact on the presentation of its financial statements.

In March 2018, the FASB issued Accounting Standards Update No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 ("ASU 2018-05"). ASU 2018-05 adds various SEC paragraphs pursuant to the issuance of the December 2017 SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB No. 118"), which was effective immediately. SAB No.118 provides for a provisional one year measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act. The adoption of ASU 2018-05 had no material impact on our consolidated financial statements as of and for the year ending December 31, 2018. See Note 15, Income Taxes, for disclosures related to this amended guidance.

In June 2018, the FASB issued ASU No. 2018-07, Compensation Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting. This ASU is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share based compensation. The guidance is effective for our fiscal year beginning January 1, 2020. While the exact impact of this standard is not known, the guidance is not expected to have a material impact on our consolidated financial statements, as non-employee stock compensation is nominal relative to our total expenses as of December 31, 2018.

In October 2018, the FASB issued ASU No. 2018-17, "Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities" ("ASU 2018-17"). This ASU reduces the cost and complexity of financial reporting associated with consolidation of variable interest entities (VIEs). A VIE is an organization in which consolidation is not based on a majority of voting rights. The new guidance supersedes the private company alternative for common control leasing arrangements issued in 2014 and expands it to all qualifying common control arrangements. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. We are currently assessing the impact the adoption of ASU 2018- 17 will have on the Company's consolidated financial statements.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases and ASU 2018-11 "Leases (Topic 842): Targeted Improvements" (ASU 2018-11). ASU 2018-10 clarifies certain areas within ASU 2016-02. Prior to ASU 2018-11, a modified retrospective transition was required for financing or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. ASU 2018-11 allows entities an additional transition method to the existing requirements whereby an entity could adopt the provisions of ASU 2016-02 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption. ASU 2018-11 also allows a practical expedient that permits lessors to not separate non-lease components from the associated lease component if certain conditions are present. An entity that elects to use the practical expedients will, in effect, continue to account for leases that commenced before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. ASU 2016-02, ASU 2018-10 and ASU 2018-11 will be effective for the Company's fiscal year beginning April 1, 2019 and subsequent interim periods. Our current lease arrangements expire through 2021 and we are currently evaluating the impact the adoption of these ASUs will have on our consolidated financial statements.

We do 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.

## ITEM 8.  FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**Consolidated Financial Statements**

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

## ITEM 9.  CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A.  CONTROLS AND PROCEDURES

*Evaluation of Disclosure Controls and Procedures*

An evaluation was conducted under the supervision and with the participation of the Company’s management, including the Chief Executive Officer (“CEO”), its principal executive officer, and Chief Financial Officer (“CFO”), its principal financial officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) as of December 31, 2018. Based on that evaluation, the CEO and CFO concluded that, for the reasons discussed below, our disclosure controls and procedures were not effective as of December 31, 2018. This was due to certain deficiencies in our controls over financial reporting, described below.

*Management’s Report on Internal Control over Financial Reporting*

Section 404 of the Sarbanes-Oxley Act of 2002 requires that management document and test the Company’s internal controls over financial reporting and include in this Annual Report on Form 10-K a report on management’s assessment of the effectiveness of our internal controls over financial reporting.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal controls over financial reporting refers to the process designed by, or under the supervision of our Chief Executive Officer and our Chief Accounting Officer, and effected by our management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP, and includes those policies and procedures that:

(1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management relies upon the criteria established in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in designing a system intended to meet the needs of our Company and provide reasonable assurance for its assessment.

In connection with their review of our internal controls over financial reporting for the fiscal year ended December 31, 2018, our Chief Executive Officer and Chief Financial Officer have concluded that our internal controls over financial reporting were not effective as of December 31, 2018. In particular, certain portions of our inventory control system have not been integrated into the management system used by the balance of the Company which could result in a failure to properly account for the costs associated with work in process, slow moving inventory and the value of inventory on hand, and the enterprise reporting system used to track employee hours and, hence, costs to be included in work in process, is not sufficiently automated to ensure compliance at all times. In addition, our Chief Executive Officer and Chief Financial Officer concluded that our quarterly closing process was deficient and that our consolidating process and period end reporting and disclosure procedures were materially weak. They also concluded that we lacked the accounting personnel necessary to account for complex accounting matters and unusual and non-standard transactions and were deficient in supervision and internal control monitoring. While we have taken remedial action both prior to and subsequent to the year ended December 31, 2018, by adding to our accounting staff, continuing to implement our ERP system throughout our operations and reducing the complexity of our operations as

a result of the sale or wind down of various businesses we do not feel that enough time has passed to allow us to determine whether these remedial efforts have been effective and eliminated all of our deficiencies.

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

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

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. The rules of the Securities and Exchange Commission do not require an attestation of the Management's report by our registered public accounting firm in this annual report.

***Change in Internal Control over Financial Reporting***

There have been no changes in our internal control over financial reporting that occurred during our fiscal quarter and year ended December 31, 2018 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION.**

None

## PART III

### Item 10. Directors, Executive Officers, and Corporate Governance

The information required by Paragraph (a), and Paragraphs (c) through (g) of Item 401 of Regulation S-K (except for information required by Paragraph (e) of that Item to the extent the required information pertains to our executive officers) and Item 405 of Regulation S-K is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year.

The following table presents the information required by Paragraph (b) of Item 401 of Regulation S-K.

***Our directors and executive officers are:***

| Name: | Age | Position |
|---|---|---|
| Luciano (Lou) Melluzzo | 54 | President and Chief Executive Officer |
| Michael E. Recca | 68 | Chief Financial Officer |
| Michael N. Taglich | 53 | Chairman of the Board |
| Robert F. Taglich | 52 | Director |
| David J. Buonanno | 63 | Director |
| Peter D. Rettaliata | 68 | Director |
| Robert C. Schroeder | 52 | Director |
| Michael Brand | 61 | Director |
| Michael D. Porcelain | 50 | Director |

*Luciano (Lou) Melluzzo* has been our President and Chief Executive Officer since November 15, 2017. He joined our company on September 11, 2017 as Chief Operating Officer. From November 2003 to September 2011, Mr. Melluzzo was employed in various capacities by EDAC Technologies Corporation ("EDAC"), a designer, manufacturer and distributor of precision aerospace components and assemblies, precision spindles and complex fixturing, tooling and gauging with design and build capabilities, whose shares were then listed on the Nasdaq Capital Market. He served as EDAC's Vice President and Chief Operating Officer from November 2005 until February 2010. From September 2011 to November 2015, Mr. Melluzzo was self-employed in the residential real estate redevelopment industry. From November 2015 to January 2017, he was general manager of Polar Corporation, a privately-held company specializing in computer numeric controlled milling and turning of small hardware components for the aerospace industry.

*Michael E. Recca* has been our Chief Financial Officer since October 1, 2016. Mr. Recca has been engaged by us since September 2008 in a variety of positions related to our capital finance and acquisition programs. Most recently he served as Chief of Corporate Development& Capital Markets, a position in which he directed our acquisition program and coordinated with our lenders. Mr. Recca received a Bachelor of Arts degree from the SUNY Stony Brook and an MBA from Columbia University.

*Michael N. Taglich* has been Chairman of our Board of Directors since September 22, 2008. He is Chairman and President of Taglich Brothers, a New York City based securities firm which he co-founded in 1992 and which is focused on public and private micro-cap companies.  Mr. Taglich is currently Chairman of the Board of Mare Island Dry Dock LLC, a company engaged in ship repair services, and BioVentrix, Inc., a privately held medical device company whose products are directed at heart failure. He also serves as a Director of Bridgeline Digital Inc., a publicly traded company, Icagen Inc., a reporting but not trading company engaged in early stage pharmaceutical research, Decision Point Systems Inc., a private company engaged in Field service automation, Dilon Technologies, a private medical device company and Autonet Mobile Inc., a private company focused on connecting automobiles to the internet.

*Robert F. Taglich* has been a director of our company since 2008. He is a Managing Director of Taglich Brothers, which he co-founded in 1992. Prior to founding Taglich Brothers, Mr. Taglich was a Vice President at Weatherly Securities. Mr. Taglich has served in various positions in the securities brokerage industry for the past 25 years. Mr. Taglich serves on the board of privately held BioVentrix, Inc., a medical device company whose products are directed at heart failure. Mr. Taglich holds a Bachelor's degree from New York University.

*David J. Buonanno* has been a director of our company since 2008. He is the Founder and President of Buonanno Enterprises Consulting, providing strategic management, supply chain/operations and recruitment services to aerospace and defense industry clients. Mr. Buonanno has extensive experience in manufacturing, supply management and operations. He was employed by Sikorsky Aircraft, Inc., a subsidiary of United Technologies Corporation, as Vice President, Supply Management and International Offset (from January 1997 to July 2006) and as Director, Systems Subcontracts (from November 1992 to January 1997). From May 1987 to November 1992, he was employed by General Electric Company serving as Operations Manager and Manager, Program Materials Management of GE's Astro-Space Division. From June 1977 to May 1987, he was employed by RCA and affiliated companies. Mr. Buonanno attended Lehigh University College of Electrical Engineering and holds a B.S. in Business Administration from Rutgers University. He completed the Program for Management Development at Harvard Business School in 1996.

*Peter D. Rettaliata* has been a director of our company since 2005. He served as our Acting President and Chief Executive Officer from March 2, 2017 to November 15, 2017, and served as our President and Chief Executive Officer from November 30, 2005 to December 31, 2014. He also served as the President of our wholly-owned subsidiary, AIM, from 1994 to 2008. Prior to his involvement at AIM, Mr. Rettaliata was employed by Grumman Aerospace Corporation for twenty-two years, where he attained the position of Senior Procurement Officer. Professionally, Mr. Rettaliata has served as the Chairman of "ADDAPT", an organization of regional aerospace companies, as a member of the Board of Governors of the Aerospace Industries Association, and as a member of the Executive Committee of the AIA Supplier Council. He is a graduate of Niagara University where he received a B.A. in History and Harvard Business School where he completed the PMD Program.

*Robert C. Schroeder* has been a director of our company since 2008. He is Vice President - Investment Banking of Taglich Brothers and specializes in advisory services and capital raising for small public and private companies. Mr. Schroeder joined Taglich Brothers in April 1993 as an Equity Analyst publishing sell-side research. Prior to joining Taglich Brothers, he served in various positions in the brokerage and public accounting industry. Mr. Schroeder also serves as a director of the following publicly traded companies: DecisionPoint Systems, Inc., a leading provider and integrator of Enterprise Mobility, Wireless Applications and RFID solutions, and Intellinetics, Inc., a provider of cloud-based enterprise content management solutions. Mr. Schroeder received a B.S. degree in accounting and economics from New York University. He is a Chartered Financial Analyst and a member of the Association for Investment Management and Research and a member of the New York Society of Security Analysts.

Michael Brand has been a director of our company since 2012, and from March 2017 to November 2017 served as a consultant to our company focused on day to day production issues, scheduling of the products to be manufactured and related operational issues such as the maintenance of appropriate inventory levels. He was the President of Goodrich Landing Gear, a unit of Goodrich Corporation, from July 2005 to June 2012. Prior to joining Goodrich for over 25 years he held senior management positions in the Aerospace industry. He began his career at General Electric Corporation and rose to senior management in its jet engine manufacturing operations. Mr. Brand is a graduate of Clarkson University, with advanced degrees and certificates from Xavier University and the Wharton School.

Michael Porcelain has a director of our company since October 23, 2017. Mr. Porcelain has been Senior Vice President and Chief Financial Officer of Comtech Telecommunications Corp., a publicly traded company and leading provider of advanced communication solutions for both commercial and government customers worldwide, since March 2006, and from 2002 to March 2006, he served as Vice President of Finance and Internal Audit of Comtech. From 1998 to 2002, Mr. Porcelain was Director of Corporate Profit and Business Planning for Symbol Technologies, a mobile wireless information solutions company. Previously, he spent five years in public accounting holding various positions, including Manager in the Transaction Advisory Services Group of PricewaterhouseCoopers. Since 1998, he has owned and operated The Independent Adviser Corporation, a privately held company which holds the rights to use certain intellectual properties and trademarks (including various Internet websites) related to the financial planning and advisory industry. Mr. Porcelain is an Adjunct Professor at St. John's University located in New York where he teaches graduate level accounting courses. Mr. Porcelain has a B.S. in Business Economics from State University of Oneonta, New York, a M.S. in Accounting and an M.B.A. degree from Binghamton University.

Michael N. Taglich and Robert F. Taglich are brothers.

All directors hold office until the next annual meeting of shareholders and until their successors have been duly elected and qualified. Officers are elected by and serve at the discretion of the Board of Directors. Employee directors do not receive any compensation for their services as directors. Non-employee directors are entitled to receive compensation for serving as directors and may receive option grants from our company.

**Information Concerning the Board of Directors**

***Board Leadership Structure and Risk Oversight***

The Board does not have a policy requiring separation of the roles of Chief Executive Officer and Chairman of the Board. Nevertheless, Michael N. Taglich is Chairman of the Board and Lou Melluzzo is Chief Executive Officer of the Company.

The Board has determined that a non-employee director serving as Chairman is in the best interests of our stockholders at this time. This structure ensures a greater role of non-employee Directors in the active oversight of our business, including risk management oversight, and in setting agendas and establishing Board priorities and procedures. This structure also allows the Chief Executive Officer to focus to a greater extent on the management of our day-to-day operations.

The Board of Directors as a whole is responsible for consideration and oversight of risks facing the Company, and is responsible for ensuring that material risks are identified and managed appropriately. Certain risks are overseen by committees of the Board of Directors and these committees make reports to the full Board of Directors, including reports on noteworthy risk-management issues. Members of the Company’s senior management team regularly report to the full Board about their areas of responsibility and a component of these reports is risk within the area of responsibility and the steps management has taken to monitor and control such exposures. Additional review or reporting on risks is conducted as needed or as requested by the Board or one of its committees.

***Board Independence***

Our Board of Directors has determined that Robert Schroeder, David Buonanno, Peter Rettaliata and Michael Porcelain are “independent directors” within the meaning of NYSE American Rule 803A(2).

***Director Compensation***

Non-employee Directors are entitled to receive compensation for serving as directors and may receive option grants from our company. Each Director also is entitled to be repaid or prepaid all traveling, hotel and incidental expenses reasonably incurred or expected to be incurred in attending meetings of our Board of Directors or committees of our Board of Directors or stockholder meetings or otherwise in connection with the discharge of his duties as a Director. The compensation committee will assist the directors in reviewing and approving the compensation structure for our directors.

The following table sets forth certain information regarding the compensation paid to, earned by or accrued for, our directors during the fiscal year ended December 31, 2018.

DIRECTOR COMPENSATION

| Name | Fees Earned or Paid In Cash ($) | Stock Awards ($)[1] | Option Awards ($) | Non-Equity Incentive Plan Compensation ($) | Non-Qualified Deferred Compensation Earnings ($) | All Other Compensation ($) | Total ($) |
|---|---|---|---|---|---|---|---|
| Michael Taglich | | 57,500 | 14,475 | — | — | — | 71,975 |
| Robert Taglich | | 57,500 | 14,475 | — | — | — | 71,975 |
| Robert Schroeder | | 31,000 | 14,475 | — | — | — | 45,475 |
| David Buonanno | | 29,500 | 14,475 | — | — | --- | 43,975 |
| Michael Brand | | 31,000 | 14,475 | — | — | --- | 45,475 |
| Michael Porcelain | | 43,000 | 14,475 | — | — | — | 57,475 |
| Peter Rettaliata | | 56,000 | 14,475 | --- | --- | --- | 70,475 |

(1) Director fees paid in shares.

***Board Meetings; Committees and Membership***

The Board of Directors held four meetings during the fiscal year ended December 31, 2018 (“fiscal 2018”). During fiscal 2018, each of the directors then in office attended more than 75% of the aggregate of (i) the total number of meetings of the Board of Directors and (ii) the total number of meetings of all committees of the Board on which such director served.

We maintain the following committees of the Board of Directors: the Audit Committee, the Compensation Committee and the Nominating Committee. Each committee is comprised entirely of directors who are “independent” within the

meaning of NYSE American Rule 803A(2). Each committee acts pursuant to a separate written charter, and each such charter has been adopted and approved by the Board of Directors. Copies of the committee charters are available on our website at airindustriesgroup.com under the heading "Investor Relations."

**Audit Committee**. Messrs. Porcelain, Schroeder and Buonanno are members of the Audit Committee. Mr. Porcelain serves as Chairman of the Audit Committee and also qualifies as an "audit committee financial expert," as that term is defined in Item 407(d)(5)(ii) of Regulation S-K. The Board has determined that each member of our Audit Committee meets the financial literacy requirements under the Sarbanes-Oxley Act and SEC rules and the independence requirements under NYSE American Rule 803A(2).

Our Audit Committee is responsible for preparing reports, statements and charters of audit committees required by the federal securities laws, as well as:

- overseeing and monitoring the integrity of our consolidated financial statements, our compliance with legal and regulatory requirements as they relate to financial statements or accounting matters, and our internal accounting and financial controls;

- preparing the report that SEC rules require be included in our annual proxy statement;

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overseeing and monitoring our independent registered public accounting firm's qualifications, independence and performance;

providing the Board with the results of its monitoring and its recommendations; and

providing to the Board additional information and materials as it deems necessary to make the Board aware of significant financial matters that require the attention of the Board.

The Audit Committee held four meetings during fiscal 2018.

**Compensation Committee**. Our Compensation Committee is composed of Messrs. Buonanno, Brand and Porcelain. The Compensation Committee is responsible for:

establishing the Company's general compensation policy, in consultation with the Company's senior management, and overseeing the development and implementation of compensation programs;

reviewing and approving corporate goals and objectives relevant to the compensation of the CEO, and evaluating the performance of the CEO at least annually in light of those goals and objectives and communicating the results of such evaluation to the CEO and the Board, and determining the CEO's compensation level based on this evaluation, subject to ratification by the independent directors on the Board. In determining the incentive component of CEO compensation, the Committee will consider, among other factors, the Company's performance and relative stockholder return, the value of similar incentive awards to CEOs at comparable companies, the awards given to the CEO in past years, and such other factors as the Committee may determine to be appropriate;

reviewing and approving the compensation of all other executive officers of the Company, such other managers as may be directed by the Board, and the directors of the Company;

overseeing the Board's benefit and equity compensation plans, overseeing the activities of the individuals and committees responsible for administering these plans, and discharging any responsibilities imposed on the Committee by any of these plans;

approving issuances under, or any material amendments to, any stock option or other similar plan pursuant to which a person not previously an employee or director of the Company, as an inducement material to the individual's entering into employment with the Company, will acquire stock or options;

in consultation with management, overseeing regulatory compliance with respect to compensation matters, including overseeing the Company's policies on structuring compensation programs to preserve related tax objectives;

reviewing and approving any severance or similar termination payments proposed to be made to any current or former officer of the Company; and

preparing an annual report on executive compensation for inclusion in our proxy statement for the election of directors, if required under the applicable SEC rules.

The Compensation Committee held one meeting during fiscal 2018.

**Nominating Committee**. Our Nominating Committee is composed of Messrs. Schroeder, Brand and Porcelain. The purpose of the Nominating Committee is to seek and nominate qualified candidates for election or appointment to our Board of Directors. The Nominating Committee held one meeting during fiscal 2018.

The Nominating Committee will seek candidates for election and appointment that possess the integrity, leadership skills and competency required to direct and oversee the Company's management in the best interests of its stockholders, customers, employees, communities it serves and other affected parties.

A candidate must be willing to regularly attend Committee and Board of Directors meetings, to develop a strong understanding of the Company, its businesses and its requirements, to contribute his or her time and knowledge to the Company and to be prepared to exercise his or her duties with skill and care. In addition, each candidate should have an understanding of all corporate governance concepts and the legal duties of a director of a public company.

Stockholders may contact the Nominating Committee Chairman, the Chairman of the Board or the Corporate Secretary in writing when proposing a nominee. This correspondence should include a detailed description of the proposed nominee's qualifications and a method to contact that nominee if the Nominating Committee so chooses.

***Stockholder Communications***

Any stockholder who desires to contact any of our Directors can write to Air Industries Group, 1460 Fifth Avenue, Bay Shore, New York 11706, Attention: Stockholder Relations. Your letter should indicate that you are an Air Industries Group stockholder. Depending on the subject matter, our stockholder relations personnel will:

- forward the communication to the Director(s) to whom it is addressed;
- forward the communication to the appropriate management personnel;
- attempt to handle the inquiry directly, for example where it is a request for information about the Company, or it is a stock-related matter; or
- not forward the communication if it is primarily commercial in nature or if it relates to an improper or irrelevant topic.

***Section 16(a) Beneficial Ownership Reporting Compliance***

Section 16(a) of the Securities Exchange Act of 1934 requires our Directors, Executive Officers and beneficial owners of more than 10% of our common stock to file with the SEC reports of their holdings of, and transactions in, our common stock. Based solely upon our review of copies of such reports and written representations from reporting persons that were provided to us, we believe that our officers, directors and 10% stockholders complied with these reporting requirements with respect to 2018, except that Form 4s reporting the grant of stock awards to directors in lieu of cash payment of directors' fees and the receipt by Michael Taglich and Robert Taglich of shares of Common

Stock in lieu of accrued interest on our 8% Subordinated Notes and the indirect beneficial ownership by Michael Taglich and Robert Taglich of pay-in-kind securities issued to Taglich Brothers, Inc., of which they are the principals, in lieu of payment of sales commissions for acting as placement agent for certain private placements of our securities were not timely filed.

***Code of Ethics***

We have adopted a written code of ethics that applies to our principal executive officers, senior financial officers and persons performing similar functions. Upon written request to our corporate secretary, we will provide you with a copy of our code of ethics, without cost.

**Item 11. Executive Compensation**

The following summary compensation table shows, for the periods indicated, information regarding the compensation awarded to, earned by or paid to each individual that served as our principal executive officer during the fiscal year ended December 31, 2018 (the “2018 fiscal year”) and each other executive officer whose compensation for the 2018 fiscal year exceeded $100,000 for all services rendered in all capacities to our company and its subsidiaries. The individuals listed in the following table are referred to herein collectively as our “Named Executive Officers.”

**Summary Compensation Table**

| Name and Principal Position | Year | Salary ($) | Bonus ($) | Stock awards ($) | Option awards ($) | Non-equity Incentive Plan Information ($) | Nonqualified deferred compensation earnings ($) | All other compensation ($) | Total ($) |
|---|---|---|---|---|---|---|---|---|---|
| Luciano Melluzzo[1] | 2018 | 280,000 | — | — | --- | — | — | 10,800 [2] | 290,800 |
| President and CEO | 2017 | 80,769 | --- | --- | 218,700 | --- | --- | 2,475 [2] | 301,944 |
| Michael Recca | 2018 | 203,846 | — | — | | — | — | 5,400 [2] | 209,246 |
| CFO | 2017 | 200,000 | -- | -- | 48,100 | -- | -- | 5,400 [2] | 253,500 |

(1) Mr. Melluzzo was appointed President and CEO on November 15, 2017.

(2) Represents car allowance.

None of our executive officers or key employees named in the above table has an employment agreement providing for a fixed term of employment. All are employees at will terminable at any time without any severance, other than that payable to employees generally.

**Executive Compensation Policies as They Relate to Risk Management**

The Compensation Committee and management have considered whether our compensation policies might encourage inappropriate risk taking by the Company’s executive officers and other employees. The Compensation Committee has determined that the current compensation structure aligns the interests of the executive officers with those of the Company without providing rewards for excessive risk taking by awarding a mix of fixed and performance based or discretionary bonuses with the performance based compensation focused on profits as opposed to revenue growth.

During the years ended December 31, 2018 and 2017, less than 1% of the total compensation paid to employees was paid in performance-based compensation, including commissions and bonuses.

**Equity Awards – 2018**

We did not grant any equity awards in the form of shares or options to any of the Named Executive Officers during 2018.

**Outstanding Equity Awards at 2018 Year-End**

The following table shows certain information regarding outstanding equity awards held by our Named Executive Officers as of December 31, 2018.

| | **Option Awards** | | | | **Stock Awards** | |
|---|---|---|---|---|---|---|
| **Name** | **Number of Securities Underlying Unexercised Options (#) Exercisable** | **Number of Securities Underlying Unexercised Options (#) Unexercisable** | **Option Exercise Price ($)** | **Option Expiration Date** | **Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)** | **Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested** |
| Luciano Melluzzo | 90,000 | 180,000 | $ 1.50 | 09/30/2024 | — | — |
| Michael Recca | — | 50,000 | 1.42 | 7/24/2024 | — | — |
| | 25,000 | 25,000 | 10.31 | 5/1/2021 | — | — |
| | 56,250 | | 6.60 | 8/31/2020 | | |

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**Equity Incentive Plans**

We have four equity incentive plans, the 2017 Equity Incentive Plan (the "2017 Plan"), which our Board of Directors adopted on July 24, 2017 and our stockholders approved on October 3, 2017, the 2016 Equity Incentive Plan ("the "2016 Plan"), which our Board of Directors adopted in June 2016 and our stockholders approved on November 30, 2016, the 2015 Equity Incentive Plan (the "2015 Plan"), which our Board of Directors adopted in March 2015 and our stockholders approved in June 2015, and the 2013 Equity Incentive Plan (the "2013 Plan"), which our Board of Directors adopted in May 2013 and our stockholders approved in July 2013. The Plans are virtually identical, except that the 2017 Plan authorizes the issuance of 1,200,000 shares of Common Stock, the 2016 Plan and the 2015 Plan authorize the issuance of 350,000 shares of Common Stock and the 2013 Plan authorizes the issuance of 600,000 shares of Common Stock.

The Plans permit the Company to grant stock awards and non-qualified and incentive stock options to employees, directors and consultants. The Plans are administered by the Compensation Committee of the Board and each has a term of ten years from the date it was adopted by the Board.

We adopted the Plans to provide a means by which employees, directors, and consultants of our Company and those of our subsidiaries and other designated affiliates, which we refer to together as our affiliates, may be given an opportunity to purchase our common stock, to assist in retaining the services of such persons, to secure and retain the services of persons capable of filling such positions, and to provide incentives for such persons to exert maximum efforts for our success and the success of our affiliates.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The following table sets forth information known to us regarding beneficial ownership of our Common Stock as of March 27, 2019 by (i) each person known by us to own beneficially more than 5% of our outstanding Common Stock, (ii) each of our directors, (iii) our chief executive officer and the other Named Executive Officers, and (iii) all of our directors and executive officers as a group.

Except as otherwise indicated, we believe, based on information provided by each of the individuals named in the table below, that such individuals have sole investment and voting power with respect to such shares, subject to community property laws, where applicable. As of March 27, 2019, we had outstanding 28,655,572 shares of Common Stock. Except as stated in the table, the address of the holder is c/o our company, 1460 Fifth Avenue, Bay Shore, New York 11706

| **Directors and Executive Officers:** | Number of Shares Beneficially Owned | | Percent |
|---|---|---|---|
| Michael N. Taglich | 6,352,951 | (1) | 20.23 % |
| Robert F. Taglich | 4,318,976 | (2) | 14.01 % |
| Peter D. Rettaliata | 140,879 | (3) | * |
| David Buonanno | 75,540 | (4) | * |
| Robert Schroeder | 171,629 | (5) | * |
| Michael Brand | 125,004 | (6) | * |
| Michael Porcelain | 64,341 | (7) | * |
| Luciano Melluzzo, President and CEO | 450,000 | (8) | 1.55 % |
| Michael Recca, CFO | 206,250 | (9) | * |
| All Directors and Executive Officers as a group (9 persons owning shares) | 11,505,523 | (10) | 33.80 % |
| | | | |
| Beneficial Ownership of More Than 5% of Shares: | | | |
| Richmond Brothers, Inc. et al.[11] | | (11) | (11) |

* Less than 1%

(1) Includes 3,576,090 shares owned by Mr. Taglich, 27,891 shares owned by Taglich Brothers, 2,282,621 shares he may acquire upon conversion of convertible notes (including 340,687 shares which may be acquired by Taglich Brothers), but excluding shares for accrued interest thereon, 437,849 shares he may acquire upon exercise of warrants (including 31,469 shares which may be acquired by Taglich Brothers) and 28,500 shares he may acquire upon exercise of options, in each case exercisable within 60 days.

(2) Includes 2,082,681 shares owned by Mr. Taglich, 27,891 shares owned by Taglich Brothers, 44,760 shares owned by custodial accounts for the benefit of his children under the NY UGMA, 1,849,288 shares he may acquire upon conversion of convertible notes (including 340,687 shares that may be acquired by Taglich Brothers) , but excluding shares for accrued interest thereon, 285,856 shares he may acquire upon exercise of warrants (including 31,469 shares which may be acquired by Taglich Brothers, and 3,416 shares which may be acquired as custodian for his children) and 28,500 shares he may acquire upon exercise of options, in each case exercisable within 60 days.

(3) Includes 41,250 shares he may acquire upon exercise of options exercisable within 60 days.

(4) Includes 1,016 shares he may acquire upon exercise of warrants and 28,500 shares he may acquire upon exercise of options, in each case exercisable within 60 days.

(5) Includes 55,278 shares he may acquire upon exercise of warrants and 28,500 shares he may acquire upon exercise of options, in each case exercisable within 60 days.

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(6) Includes 78,500 shares he may acquire upon exercise of options exercisable within 60 days.

(7) Includes 28,500 shares he may acquire upon exercise of options exercisable within 60 days.

(8) Includes 380,000 shares he may acquire upon exercise of options exercisable within 60 days.

(9) Represents shares he may acquire upon exercise of options exercisable within 60 days.

(10) Includes 3,791,222 shares that may be acquired upon conversion of convertible notes, 748,530 shares that may be acquired upon exercise of warrants and 848,500 shares that may be acquired upon exercise of options, in each case exercisable within 60 days.

(11) The information set forth below is based on the amended Schedule 13D filed with the SEC and the Company on October 9, 2018 reflecting ownership as of that date. By virtue of their Joint Filing Agreement, dated October 9, 2018, the persons and entities affirm their membership in a group under SEC Rule 13d-5(b) and the group is deemed to beneficially own all of the shares beneficially owned by the group members. The beneficial ownership of each of the group members was disclosed as follows, based upon 27,388,914 shares outstanding:

| | Sole Voting Power | Shared Voting Power | Sole Dispositive Power | Shared Dispositive Power | Total | Percent |
|---|---|---|---|---|---|---|
| Richmond Brothers, Inc.[a] | -- | -- | -- | 4,289,219 # | 4,289,219 # | 15.5 % |
| RBI Private Investment II, LLC | 15,333 | -- | 15,333 | -- | 15,333 | * |
| RBI Private Investment III, LLC | 1,080,000 + | -- | 1,080,000 + | -- | 1,080,000 + | 3.9 % |
| RBI PI Manager, LLC[b] | 1,095,333 + | -- | 1,095,333 + | -- | 1,095,333 + | 4.0 % |
| Richmond Brothers 401(k) Profit Sharing Plan | 67,006 | -- | 67,006 | -- | 67,006 | * |
| David S. Richmond[c] | 1,095,333 + | 67,006 | 1,095,333 + | 4,356,225 # | 5,451,558 #+ | 19.5 % |
| Matthew J. Curfman[d] | -- | 67,006 | -- | 4,356,225 # | 4,356,225 # | 15.7 % |

(a) Held as investment advisor to certain separately managed accounts.

(b) Includes the shares owned by RBI Private Investment II, LLC and RBI Private Investment III, LLC.

(c) Sole voting and dispositive power includes shares owned by Mr. Richmond directly and by RBI Private Investment II, LLC and RBI Private Investment III, LLC. Shared voting and dispositive power includes shares owned by Richmond Brothers, Inc. and the Profit Sharing Plan.

(d) Sole voting and dispositive power includes shares owned by Mr. Curfman. Shared voting and dispositive power includes shares owned by Richmond Brothers, Inc. and the Profit Sharing Plan.

# Includes 312,000 shares which may be acquired upon exercise of warrants.

+ Includes 280,000 shares which may be acquired upon exercise of warrant.

* Less than 1 percent

The address for Richmond Brothers, Inc., RBI Private Investment I, LLC, RBI Private Investment II, LLC, RBI PI Manager, LLC, Richmond Brothers 401(k) Profit Sharing Plan, David S. Richmond and Matthew J. Curfman is 3568 Wildwood Avenue, Jackson, Michigan 49202.

**Item 13. Certain Relationships and Related Transactions and Director Independence**

***Our Policy Concerning Transactions with Related Persons***

Under Item 404 of SEC Regulation S-K, a related person transaction is any actual or proposed transaction, arrangement or relationship or series of similar transactions, arrangements or relationships, including those involving indebtedness not in the ordinary course of business, to which we or our subsidiaries were or are a party, or in which we or our subsidiaries were or are a participant, in which the amount involved exceeded or exceeds the lesser of $120,000 or one percent of the average of our total assets at year-end for the last two completed fiscal years and in which any of our directors, nominees for director, executive officers, beneficial owners of more than 5% of any class of our voting securities (a “significant shareholder”), or any member of the immediate family of any of the foregoing persons, had or will have a direct or indirect material interest.

We recognize that transactions between us and any of our Directors or Executives or with a third party in which one of our officers, directors or significant shareholders has an interest can present potential or actual conflicts of interest and create the appearance that our decisions are based on considerations other than the best interests of our Company and

stockholders.

The Audit Committee of the Board of Directors is charged with responsibility for reviewing, approving and overseeing any transaction between the Company and any related person (as defined in Item 404 of Regulation S-K), including the propriety and ethical implications of any such transactions, as reported or disclosed to the Committee by the independent auditors, employees, officers, members of the Board of Directors or otherwise, and to determine whether the terms of the transaction are not less favorable to us than could be obtained from an unaffiliated party.

***Transactions***

The following includes a summary of transactions since January 1, 2018, or any currently proposed transaction, in which we were or are to be a participant and the amount involved exceeded or exceeds the lesser of $120,000 or one percent of the average of our total assets at year-end for the last two completed fiscal years, and in which any related person had or will have a direct or indirect material interest.

From time to time when needed, we have borrowed funds from Michael Taglich and Robert Taglich, as discussed below. In addition, as discussed below, Taglich Brothers, of which Michael Taglich and Robert Taglich are principals, has acted as placement agent for offerings of our securities and provided us with other investment banking and advisory services.

On March 29, 2018 and April 4, 2018, Michael Taglich and Robert Taglich advanced $1,000,000 and $100,000, respectively, to our company for use as working capital. In May 2018, these advances were applied against the purchase price of our Subordinated Notes due May 31, 2019 (the “Notes”), which we issued together with shares of Common Stock (the “Shares”), as part of a private placement (the “Note Offering”). We issued to Michael Taglich a Note in the principal amount of $1,000,000, together with 178,571 shares of Common Stock, for a purchase price of $1,000,000 and we issued to Robert Taglich a Note in the principal amount of $100,000, together with 17,857 shares of Common Stock. Seventy percent (70%) of the total purchase price for the Notes and Shares purchased by each investor was allocated to the Notes, with the remaining thirty percent (30%) allocated to the Shares. The number of Shares issued to Michael Taglich and Robert Taglich was calculated based upon $1.68, the closing price of the Common Stock on the trading day immediately preceding the date they purchased the Notes and shares of Common Stock in the Note Offering. In addition, we issued to Taglich Brothers, which acted as placement agent for the Note Financing, a Note in the principal amount of $48,000 and 8,571 shares of Common Stock in lieu of cash payment for the sales commissions with respect to the Note Financing.

In September 2018, holders of a majority of the outstanding principal amount of our 8% Notes consented to an amendment to the terms of the 8% Notes to extend the maturity date to December 31, 2020 and to provide that interest on the 8% Notes, as amended (the “Amended Notes”), shall accrue and be paid on the due date of the Amended Notes or, if earlier, upon conversion of the Amended Notes into shares of our Common Stock. From and after September 30, 2018, interest on the unpaid principal amount of the Amended Notes shall accrue and be paid at the rate of six (6%)

percent per annum, if paid in cash, or at the rate of eight (8%) percent per annum if converted into Common Stock.

At September 30, 2018, Michael Taglich, Robert Taglich and Taglich Brothers (collectively, the “Taglich Parties”) owned $1,300,000, $650,000 and $382,000, respectively, principal amount of 8% Notes, with accrued interest thereon from the date of issuance through September 30, 2018 of $203,613, $120,097 and $68,294, respectively. In consideration for waiving all defaults in payment of principal and accrued interest on the 8% Notes through the date of the amendment, the conversion price of the Amended Notes owned by the Taglich Parties and the other holders of the Amended Notes has been reduced to $1.50 per share, subject to the anti-dilution adjustments set forth in the Amended Notes and the 8% Notes, and we issued to the Taglich Parties and the other holders of the 8% Notes such number of shares of our common stock calculated based upon a value of $1.39 per share, the closing market price of our Common Stock on the NYSE American on September 28, 2018, the date immediately prior to the date the holders of a majority of the outstanding principal amount of the 8% Notes approved the amendment as is equal to the interest accrued on their 8% Notes from the date of issuance through September 30, 2018. As a result, we issued to Michael Taglich, Robert Taglich and Taglich Brothers 146,484 shares, 86,401 shares and 49,132 shares, respectively, of our Common Stock.

For soliciting noteholders in connection with the adoption of the amendments, we have agreed to pay Taglich Brothers $95,550, representing a fee equal to 2% of the outstanding principal amount of Notes whose registered holders (other than Taglich Brothers) received shares of our Common Stock in lieu of cash payment of accrued interest on the 8% Notes as of September 30, 2018.

On October 1, 2018, we sold 800,000 shares of our Common Stock and warrants to purchase 280,000 additional shares of our Common Stock for gross proceeds of $1,000,000 to RBI Private Investment III, LLC, an accredited investor within the meaning of Rule 501(a) of Regulation D under the Securities Act (“Regulation D”), in a private offering exempt from the registration requirements of the Securities Act under Rule 506 of Regulation D and Section 4(a)(2) of the Securities Act. We have agreed to pay Taglich Brothers $70,000 (7% of the gross proceeds of the offering) for acting as placement agent for the offering.

On January 15, 2019, we issued our 7% senior subordinated convertible promissory notes due December 31, 2020, each in the principal amount of $1,000,000 (together, the “7% Notes” and each a “7% Note”), to Michael Taglich and Robert Taglich, each for a purchase price of $1,000,000. Each 7% Note bears interest at the rate of 7% per annum, is convertible into shares of our Common Stock at a conversion price of $0.93 per share, subject to the anti-dilution adjustments set forth in the 7% Note, is subordinated to our indebtedness under our credit facility with PNC Bank, National Association, and matures at December 31, 2020, or earlier upon an Event of Default (as defined in the 7% Notes).

We paid Taglich Brothers, Inc. a fee of $80,000 (4% of the purchase price of the 7% Notes), in the form of a promissory note having terms similar to the 7% Notes, in connection with the purchase of the 7% Notes.

On January 15, 2019, we entered into a Purchase Agreement with 15 accredited investors (the “Purchasers”), including Michael and Robert Taglich, pursuant to which we assigned to the Purchasers all of our right, title and interest to $1,136,710 in payments due from Meyer Tool, Inc. (the “Remaining Amount”) for an aggregate purchase price of $800,000, including $100,000 from each of Michael and Robert Taglich, and $75,000 for the benefit of the children of Michael Taglich. The payments are based upon the net sales of AMK Welding, Inc., which we sold to Meyer Tool in January 2017. The Purchasers have the right to demand payment from us of their pro rata portion of the unpaid Remaining Amount commencing March 31, 2023 (“Put Right”). To the extent the Purchasers exercise their Put Right, the remaining payments from Meyer will be made to us.

The Purchasers have agreed to pay Taglich Brothers, Inc. a fee equal to 2% per annum of the purchase price paid by such Purchasers, payable quarterly, to be deducted from the payments of the Remaining Amount, for acting as paying agent in connection with the assignment of our rights to the payments from Meyer Tool.

Taglich Brothers or its affiliates may in the future provide investment banking, commercial banking and/or other services to us from time to time, for which they may in the future receive customary fees and expenses.

The foregoing transactions were reviewed and approved by the Audit Committee or our Board of Directors. We believe that the terms of each transaction were not less favorable to us than those terms that could be obtained from an unaffiliated third party.

***Board Independence***

Our Board of Directors has determined that Robert Schroeder, David Buonanno, Peter Rettaliata and Michael Porcelain are "independent directors" within the meaning of NYSE American Rule 803A(2).

**Item 14. Principal Accountant Fees and Services**

As required by our Audit Committee charter, our Audit Committee pre-approved the engagement of Rotenberg Meril Solomon Bertiger & Guttilla, P.C. for all audit and permissible non-audit services. The Audit Committee annually reviews the audit and permissible non-audit services performed by our principal accounting firm and reviews and approves the fees charged by our principal accounting firm. The Audit Committee has considered the role of Rotenberg Meril Solomon Bertiger & Guttilla, P.C. in providing tax and audit services and other permissible non-audit services to us and has concluded that the provision of such services, if any, was compatible with the maintenance of such firm's independence in the conduct of its auditing functions.

During fiscal year 2018 and fiscal year 2017, the aggregate fees which we paid to or were billed by Rotenberg Meril Solomon Bertiger & Guttilla, P.C. for professional services were as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Audit Fees[1] | $ 612,372 | $ 832,000 |
| Audit Related Fees[2] | 94,236 | -- |
| Tax Fees[3] | 65,000 | 72,000 |
| | $ 771,608 | $ 904,000 |

(1) Fees for services to perform our annual audit of financial statements, review of financial statements included in our quarterly filings included in Form 10-Q, and fees for services that are normally provided by the accountant for statutory and regulatory filings. This category includes fees for services rendered that only the auditor reasonably can provide, including comfort letters, consents, assistance with and review of documents filed with the SEC and accounting and financial reporting consultations billed as audit services. The annual audit fee included in this category was $367,482 and $500,000 for 2018 and 2017, respectively. Registration statements, consents and comfort letter fees were $0 and $93,000 for 2018 and 2017, respectively. The balance of the fees in this category were for the reviews of our quarterly financial statements.

(2) Fees for assurance and related services that are traditionally performed by our independent registered public accounting firm, such as due diligence services related to mergers and acquisitions, accounting consultation and audits in connections with acquisitions, consultation concerning financial accounting and reporting standards not classified as audit fees and attest services not required by statute or regulation.

(3) Fees for tax compliance, tax advice and planning. Tax compliance generally involves preparation of original and amended tax returns, claims for refunds and tax payment-planning services. Tax planning and tax advice encompass a diverse range of services, including assistance with tax audits and appeals, tax advice related to

mergers and acquisitions and requests for rulings or technical advice from taxing authorities.

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

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 8, 2019

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, 2018 and 2017, 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, 2018 and 2017, 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.

**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 2018 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.

**Change In Accounting Estimate Effected By A Change in Accounting Principal**

As discussed in Note 3 to the financial statements, management has elected to change its method of accounting for pre-production engineering costs in the 2018 financial statements. Our opinion is not modified in respect to that matter.

**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.

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

Saddle Brook, NJ

April 1, 2019

**AIR INDUSTRIES GROUP**

**Consolidated Balance Sheets**

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| ASSETS | | |
| Current Assets | | |
| Cash and Cash Equivalents | $ 2,012,000 | $ 630,000 |
| Accounts Receivable, Net of Allowance for Doubtful Accounts of $524,000 and $494,000, respectively | 6,522,000 | 5,464,000 |
| Inventory | 29,051,000 | 31,141,000 |
| Prepaid Expenses and Other Current Assets | 414,000 | 214,000 |
| Prepaid Taxes | 49,000 | 49,000 |
| Assets Held for Sale | - | 10,082,000 |
| Total Current Assets | 38,048,000 | 47,580,000 |
| | | |
| Property and Equipment, Net | 8,777,000 | 10,050,000 |
| Capitalized Engineering Costs - Net of Accumulated Amortization of $0 and $5,380,000, respectively | - | 2,188,000 |
| Deferred Financing Costs, Net, Deposits and Other Assets | 768,000 | 665,000 |
| Goodwill | 163,000 | 272,000 |
| | | |
| TOTAL ASSETS | $ 47,756,000 | $ 60,755,000 |
| | | |
| LIABILITIES AND STOCKHOLDERS’ EQUITY | | |
| Current Liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Current Portion | $ 16,793,000 | $ 23,131,000 |
| Notes Payable – Related Party – Current Portion | 2,552,000 | 262,000 |
| Accounts Payable and Accrued Expenses | 8,723,000 | 10,872,000 |
| Deferred Gain on Sale - Current Portion | 38,000 | 38,000 |
| Deferred Revenue | 881,000 | 931,000 |
| Liabilities Directly Associated with Assets Held for Sale | - | 2,795,000 |
| Income Taxes Payable | 20,000 | 20,000 |
| Total Current Liabilities | 29,007,000 | 38,049,000 |
| | | |
| Long Term Liabilities | | |
| Notes Payable and Capitalized Lease Obligations - Net of Current Portion | 3,438,000 | 1,798,000 |
| Notes Payable – Related Party – Net of Current Portion | 2,283,000 | 1,650,000 |
| Deferred Gain on Sale - Net of Current Portion | 257,000 | 295,000 |
| Deferred Rent | 1,165,000 | 1,197,000 |
| TOTAL LIABILITIES | 36,150,000 | 42,989,000 |
| | | |
| Commitments and Contingencies | | |
| | | |
| Stockholders’ Equity | | |
| | - | - |

| | | |
|---|---|---|
| Preferred Stock, par value $.001 - Authorized 3,000,000 shares, 0 outstanding at December 31, 2018 and 2017 | | |
| Common Stock - Par Value $.001 - Authorized 50,000,000 Shares, 28,392,070 and 25,213,805 Shares Issued and Outstanding as of December 31, 2018 and December 31, 2017, respectively | 28,000 | 25,000 |
| Additional Paid-In Capital | 76,101,000 | 71,272,000 |
| Accumulated Deficit | (64,523,000 ) | (53,531,000 ) |
| TOTAL STOCKHOLDERS’ EQUITY | 11,606,000 | 17,766,000 |
| TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY | $ 47,756,000 | $ 60,755,000 |

See Notes to Consolidated Financial Statements

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**AIR INDUSTRIES GROUP**

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

| | 2018 | 2017 |
|---|---|---|
| Net Sales | $ 46,309,000 | $ 49,869,000 |
| Cost of Sales | 40,895,000 | 45,002,000 |
| Gross Profit | 5,414,000 | 4,867,000 |
| Operating Expenses | 8,839,000 | 11,430,000 |
| Impairment of goodwill | (109,000) | (6,195,000) |
| Impairment on abandonment of assets | (386,000) | - |
| Change in useful life of capitalized engineering costs | (2,043,000) | - |
| Loss from Operations | (5,963,000) | (12,758,000) |
| Interest and Financing Costs | (3,921,000) | (3,378,000) |
| Loss on Extinguishment of Debt | - | (112,000) |
| Other Income (Expense), Net | 278,000 | (22,000) |
| Loss before Provision for Income Taxes | (9,606,000) | (16,270,000) |
| (Benefit from) Provision for Income Taxes | 3,000 | (197,000) |
| Loss from Continuing Operations, net of taxes | (9,609,000) | (16,073,000) |
| Loss from Discontinued Operations, net of taxes | | |
| Losses from discontinued operating activities | (1,042,000) | (6,678,000) |
| Loss (Gain) on Sale of Subsidiary | (341,000) | 200,000 |
| Total Loss from Discontinued Operations, net of tax | (1,383,000) | (6,478,000) |
| Net Loss | $ (10,992,000) | $ (22,551,000) |
| Net Loss per share – basic | | |
| Continuing operations | (0.36) | $ (1.21) |
| Discontinued operations | $ (0.05) | $ (0.49) |
| Net Loss per share – diluted | | |

| | | |
|---|---|---|
| Continuing operations | (0.36) | (1.21) |
| Discontinued operations | $ (0.05) | $ (0.49) |
| | | |
| Weighted average shares outstanding – basic | 26,897,639 | 13,230,775 |
| Weighted average shares outstanding – diluted | 26,900,952 | 13,230,775 |

See Notes to Consolidated Financial Statements

**AIR INDUSTRIES GROUP**

**Consolidated Statements of Stockholders' Equity**

**For the Years Ended December 31, 2018 and 2017**

| | Preferred Stock Shares | Amount | Common Stock Shares | Amount | Additional Paid-in Capital | Accumulated Deficit | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| Balance, January 1, 2017 | 1,202,548 | $ 1,000 | 7,626,945 | $ 7,000 | $ 55,862,000 | $ (30,980,000 ) | $ 24,890,000 |
| 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 ) |
| Balance, December 31, 2017 | - | - | 25,213,805 | $ 25,000 | $ 71,272,000 | $ (53,531,000 ) | $ 17,766,000 |
| Fair Value Allocation of Warrants | - | - | - | - | 193,000 | - | 193,000 |
| Issuance of Common stock | - | - | 2,139,235 | 2,000 | 2,812,000 | - | 2,814,000 |
| | - | - | 253,071 | - | 305,000 | - | 305,000 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Common stock issued for directors fees | | | | | | | |
| Common stock issued for legal fees | - | - | 123,456 | - | 200,000 | - | 200,000 |
| Common stock issued for convertible notes accrued interest payment | - | - | 663,286 | 1,000 | 1,026,000 | - | 1,027,000 |
| Stock Compensation Expense | - | - | - | - | 293,000 | - | 293,000 |
| Net Loss | - | - | - | - | - | (10,992,000 ) | (10,992,000 ) |
| Balance, December 31, 2018 | - | - | 28,392,853 | $ 28,000 | $ 76,101,000 | $ (64,523,000 ) | $ 11,606,000 |

See Notes to Consolidated Financial Statements

**AIR INDUSTRIES GROUP**

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

| | 2018 | 2017 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Loss | $ (10,992,000 ) | $ (22,551,000 ) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation of property and equipment | 2,877,000 | 2,723,000 |
| Amortization of intangible assets | - | 673,000 |
| Amortization of capitalized engineering costs | 668,000 | 423,000 |
| Loss on impairment of goodwill – continuing operations | 109,000 | 6,195,000 |
| Loss on impairment of goodwill – discontinued operations | - | 3,417,000 |
| Bad debt expense | 49,000 | 87,000 |
| Non-cash employee compensation expense | 292,000 | 332,000 |
| Non-cash directors compensation expense | 64,000 | 232,000 |
| Amortization of deferred financing costs | 212,000 | 267,000 |
| Deferred gain on sale of real estate | (38,000 ) | (38,000 ) |
| (Gain) on sales of subsidiaries | 340,000 | (200,000 ) |
| Change in useful life of capitalized engineering costs | 2,043,000 | - |
| Loss on impairment of intangible assets – discontinued operations | - | 1,085,000 |
| Loss on Assets Held for Sale | 386,000 | 1,563,000 |
| Loss on extinguishment of debt | - | 112,000 |
| Amortization of convertible notes payable | 941,000 | 2,301,000 |
| Changes in Assets and Liabilities | | |
| (Increase) Decrease in Operating Assets: | | |
| Assets held for sale - AMK Cash | - | 39,000 |
| Accounts receivable | (561,000 ) | 1,004,000 |
| Inventory | 1,395,000 | 905,000 |
| Prepaid expenses and other current assets | 39,000 | 281,000 |
| Prepaid taxes | - | 360,000 |
| Deposits and other assets | (1,112,000 ) | (113,000 ) |
| Increase (Decrease) in Operating Liabilities: | | |
| Accounts payable and accrued expense | (1,127,000 ) | (3,527,000 ) |
| Deferred rent | 3,000 | 34,000 |
| Deferred revenue | 2,076,000 | 410,000 |
| NET CASH USED IN OPERATING ACTIVITIES | (2,336,000 ) | (3,986,000 ) |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capitalized engineering costs | (523,000 ) | (985,000 ) |
| Purchase of property and equipment | (1,264,000 ) | (1,514,000 ) |
| Proceeds from sale of subsidiary | 5,472,000 | 4,260,000 |
| NET CASH PROVIDED BY INVESTING ACTIVITIES | 3,685,000 | 1,761,000 |

| | | |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Note payable – revolver – net | (2,415,000 ) | (7,938,000 ) |
| Payments of note payable – term notes | (1,899,000 ) | (3,178,000 ) |
| Capital lease obligations | (1,286,000 ) | (1,397,000 ) |
| Proceeds from note payable – related party | 2,803,000 | 2,660,000 |
| Proceeds from notes payable – third parties | 70,000 | 4,184,000 |
| Payments of notes payable – third parties | - | (463,000 ) |
| Deferred financing costs | (125,000 ) | (50,000 ) |
| Proceeds from issuance of common stock | 2,885,000 | 7,733,000 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 33,000 | 1,551,000 |
| | | |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 1,382,000 | (674,000 ) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 630,000 | 1,304,000 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ 2,012,000 | $ 630,000 |

See Notes to Consolidated Financial Statements

**AIR INDUSTRIES GROUP**

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

| | 2018 | 2017 |
|---|---|---|
| Supplemental cash flow information | | |
| Cash paid during the period for interest | $ 1,509,000 | $ 2,035,000 |
| Cash paid during the period for income taxes | $ 2,000 | $ 8,000 |
| | | |
| Supplemental schedule of non-cash investing and financing activities | | |
| Common Stock issued for notes payable - related party | 330,000 | 2,254,000 |
| Common Stock issued for notes payable - third parties | 30,000 | 1,941,000 |
| Common Stock issued in lieu of accrued interest | 1,027,000 | - |
| Placement agent warrants issued | - | 85,000 |
| | | |
| Preferred stock issued for PIK dividends | $ - | $ 913,000 |
| | | |
| Acquisition of property and equipment financed by capital leases | $ - | $ 225,000 |
| | | |
| Classification of assets held for sale | $ - | $ 10,082,000 |
| | | |
| Liabilities directly associated with assets held for sale | $ - | $ (2,795,000 ) |

See Notes to Consolidated Financial Statements

AIR INDUSTRIES GROUP

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

**Going Concern**

The Company suffered losses from operations of $5,963,000 and $12,758,000 for the years ended December 31, 2018 and 2017, and net losses of $10,992,000 and $22,551,000 for the years ended December 31, 2018 and 2017, respectively. The Company also had negative cash flows from operations for the year ended December 31, 2017. In January 2017, the Company sold one of its operating subsidiaries. In December 2018, the Company sold 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.

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.

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 later was applied to the payment of the Revolving Advance.

**Sale of Welding Metallurgy Inc.**

On December 20, 2018, the Company sold 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, reduced by a working capital adjustment of ($1,093,000). The sale required 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. The amount of the working capital deficit has been contested by CPI and the discrepancy will likely be resolved through arbitration in accordance with the terms of the Stock Purchase Agreement.

At December 31, 2017, WMI Group’s assets and liabilities had been reclassified as Assets Held for Sale and Liabilities Directly Associated with Assets Held for Sale, respectively.

**Closing EPC and ECC**

On April 30, 2018 Eur Pac Corporation (“EPC”) received a “Notice of Proposed Debarment” from the Department of the Navy – its principal customer. Immediately after receiving this notice, EPC and AIRI retained counsel to appeal the proposed debarment, and submitted information in opposition to the proposed debarment, and EPC representatives met with the Navy to discuss the matter.

On November 8, 2018 EPC received formal notice from the Department of the Navy that EPC’s opposition to debarment was rejected and that EPC was debarred from future government contracts until October 29, 2020. Management implemented its plan to complete existing contracts that had already been awarded and closed EPC by March 31, 2019.

The Company recognized a loss on abandoned assets of $386,000 in connection with the shutdown of EPC. Additionally, the Company determined that goodwill for ECC in the amount of $109,000 had been impaired and is included in the loss from continuing operations.

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**Subsequent Events**

On January 15, 2019, the Company entered into a Purchase Agreement with 15 accredited investors (the “Purchasers”), pursuant to which the Company assigned to the Purchasers all of its right, title and interest to the remaining $1,136,710 of the $1,500,000 in payments due from Meyer Tool, Inc. for the sale of AMK Welding, Inc. (the “Remaining Amount”) for an aggregate purchase price of $800,000, including $100,000 from each of Michael and Robert Taglich, and $75,000 for the benefit of the children of Michael Taglich. The payments are based upon the net sales of AMK Welding, Inc., which the Company sold to Meyer Tool in January 2017. The Purchasers have the right to demand payment of their pro rata portion of the unpaid Remaining Amount from us commencing March 31, 2023 (“Put Right”). To the extent the Purchasers exercise their Put Right, the remaining payments from Meyer will be made to the Company.

The Purchasers have agreed to pay Taglich Brothers, Inc. a fee equal to 2% per annum of the purchase price paid by such Purchasers, payable quarterly, to be deducted from the payments of the Remaining Amount, for acting as paying agent in connection with the assignment of the Company’s rights to the payments from Meyer Tool. Michael and Robert Taglich, directors of the Company, are the principals of Taglich Brothers, Inc.

On January 15, 2019, the Company issued its 7% senior subordinate convertible promissory notes due December 31, 2020, each in the principal amount of $1,000,000 (together the “Notes” and each a “Note”), to Michael Taglich and Robert Taglich, each for a purchase of $1,000,000. Each Note bears interest at the rate of 7% per annum, is convertible to shares of the Company’s common stock at a conversion price of $0.93 per share, subject to the anti-dilution adjustments set forth in the 7% Note, is subordinated to the Company’s indebtedness under its credit facility with PNC Bank, National Association, and matures at December 31, 2020, or earlier upon an Event of Default (as defined in the Note).

The Company will pay Taglich Brothers, Inc. a fee of $80,000 (4% of the purchase price of the Notes), payable in the form of a promissory note having terms similar to the Notes, in connection with the purchase of the Notes.

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

**Note 2. DISCONTINUED OPERATIONS**

As discussed in Note 1, the Company sold WMI Group in December 2018. As such, this business is reported as discontinued operations for the years ended December 31, 2018 and 2017. As required, the Company has retrospectively recast its consolidated statements of operations and balance sheets for all periods presented. The Company has not segregated the cash flows of this business 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.

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,** | |
|---|---|---|
| | **2018** | **2017** |
| Net revenue | $ 13,852,000 | $ 13,129,000 |
| Cost of goods sold | 13,596,000 | 11,245,000 |
| Gross profit | 256,000 | 1,884,000 |
| Operating expenses: | | |
| Selling, general and administrative | 1,306,000 | 2,488,000 |
| Loss on assets held for sale | - | 2,648,000 |
| Impairment of Goodwill | - | 3,417,000 |
| Total operating expenses | 1,306,000 | 8,553,000 |
| Interest income (expense) | 1,000 | (12,000) |
| Other income | 7,000 | 3,000 |
| Loss from discontinued operations before income taxes | (1,042,000) | (6,678,000) |
| Provision for income taxes | - | - |
| Net loss from discontinued operations | $ (1,042,000) | $ (6,678,000) |

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

| | **2018** | **2017** |
|---|---|---|
| Net cash used in operating activities - discontinued operations | $ ( 439,000 ) | $ (2,765,000) |
| Net cash used in investing activities - discontinued operations | $ 49,000 | $ (33,000) |
| Net cash provided by financing activities - discontinued operations | $ 475,000 | $ 2,665,000 |
| Depreciation and amortization | $ 156,000 | $ 375,000 |
| Capital expenditures | $ - | $ (33,000) |

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.

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**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.

**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**

Prior to its sale, WMI Group was 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 an estimated net realizable value. The Company does not take physical inventories at interim quarterly reporting periods. The value of the majority of the items in inventory has been estimated using a gross profit percentage based on sales of previous periods compared 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 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.

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.

**Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets include purchase deposits, miscellaneous prepaid expenses and cash in escrow less a reserve. The changes in the reserve are shown below.

| Description | Balance at Beginning of Year | Charges to Loss on Sale of Subsidiary | Deductions | Balance at end of year |
|---|---|---|---|---|
| Valuation reserve deducted from Prepaid Expenses and Other Current Assets: | | | | |
| Year ended December 31, 2018 | $ - | $1,770,000 | $ - | $1,770,000 |
| Year ended December 31, 2017 | $ - | $- | $ - | $- |

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**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 were 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.

Based on various technological advances by our customer's and the rapid pace of innovation including change in future production methodologies and systems, it has become more complicated to estimate the future life and recoverability of the assets we are currently capitalizing. It is the belief of the Company that it would be preferable and therefore justifiable to expense these costs as incurred through cost of goods sold, rather than continue to capitalize these costs and amortize them through operating expense.

As of December 31, 2018, the Company has changes its policy to no longer capitalize engineering costs and to write off the capitalized engineering balance of $2,043,000.

**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 $10,000 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, 2018 and 2017.

**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**

On January 1, 2018, the Company adopted ASC 606 “Revenue from Contracts with Customers”, as amended regarding revenue from contracts with customers using the modified retrospective approach, which was applied to all contracts with Customers. Under the new standard an entity is required to recognize revenue to depict the transfer of promised goods to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods.

There was no cumulative financial statement effect of initially applying the new revenue standard because an analysis of our contracts supported the recognition of revenue consistent with our historical approach. In accordance with the modified retrospective approach, the comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company does not expect the adoption of the new revenue standard to have a material impact on the Company’s revenues or net income on an ongoing basis.

The Company’s revenues are primarily derived from consideration paid by customers for tangible goods. The Company analyzes its different goods by segment to determine the appropriate basis for revenue recognition, as described below. Revenue is not generated from sources other than contracts with customers and revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities. There are no material upfront costs for operations that are incurred from contracts with customers.

Our rights to payments for goods transferred to customers are conditional only on the passage of time and not on any other criteria. Payment terms and conditions vary by contract, although terms generally include a requirement of payment within 30 to 75 days.

For 2017 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.

For 2018 and 2017, the Company recognized certain revenues under a bill and hold arrangement with two of its large customers. For any requested bill and hold arrangement, the Company made an evaluation as to whether the bill and hold arrangement qualified for revenue recognition. The customer would initiate the request for the bill and hold arrangement. The customer must have made its request in writing in addition to their fixed commitment to purchase the item. The risk of ownership has passed to the customer, payment terms were not modified and payment would be made if the goods had shipped.

The Company had approximately $89,000 and $619,000 of net sales that were billed but not shipped under such bill and hold arrangements as of December 31, 2018 and 2017, respectively.

Payments received in advance from customers 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 70.0% of total sales, and three customers that represented 62.0% of total sales for the years ended December 31, 2018 and 2017, respectively. This is set forth in the table below.

| Customer | Percentage of Sales | |
|---|---|---|
| | 2018 | 2017 |
| 1 | 30.7 | 20.5 |
| 2 | 27.4 | 25.5 |
| 3 | 11.9 | * |
| 4 | * | 16.0 |

*Customer was less than 10% of sales at December 31, 2018 and 2017, respectively.

There were two customers that represented 64.5% of gross accounts receivable and three customers that represented 68.7% of gross accounts receivable at December 31, 2018 and 2017, respectively. This is set forth in the table below.

| Customer | Percentage of Receivables | |
|---|---|---|
| | December 2018 | December 2017 |
| 1 | 38.3 | 41.9 |
| 2 | 26.2 | 14.6 |
| 3 | * | 12.2 |

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

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.

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:

| | 2018 | 2017 |
|---|---|---|
| Weighted average shares outstanding used to compute basic earnings per share | 26,897,639 | 13,230,775 |
| Effect of dilutive stock options and warrants | 3,313 | - |
| Weighted average shares outstanding and dilutive securities used to compute dilutive earnings per share | 26,900,952 | 13,230,775 |

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, 2018 | December 31, 2017 |
|---|---|---|
| Stock Options | 568,000 | 354,000 |
| Warrants | 1,960,000 | 1,480,000 |
| | 2,528,000 | 1,834,000 |

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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:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Stock Options | 3,000 | 146,000 |
| Warrants | 7,000 | 41,000 |
| | 10,000 | 187,000 |

**Stock-Based Compensation**

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

**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 $163,000 at December 31, 2018 relates to the acquisition of NTW. The goodwill amount of $272,000 at December 31, 2017 relates to the acquisitions of NTW $163,000 and ECC $109,000.

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 a reporting unit is less than its carting amount.

During 2018 the company determined that goodwill for ECC in the amount of $109,000 had been impaired and is included in the loss from continuing operations.

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 was included in the loss from continuing operations.

Also, 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 was included in loss from discontinued operations.

**Freight Out**

Freight out is included in operating expenses and amounted to $151,000 and $196,000 for the years ended December 31, 2018 and 2017, 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. An "emerging growth 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, that 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. A 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 December 31, 2018, the date that it was no longer an "emerging growth company".

**Recently Issued Accounting Pronouncements**

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

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases and ASU 2018-11 "Leases (Topic 842): Targeted Improvements" (ASU 2018-11). ASU 2018-10 clarifies certain areas within ASU 2016-02. Prior to ASU 2018-11, a modified retrospective transition was required for financing or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. ASU 2018-11 allows entities an additional transition method to the existing requirements whereby an entity could adopt the provisions of ASU 2016-02 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption.

ASU 2018-11 also allows a practical expedient that permits lessors to not separate non-lease components from the associated lease component if certain conditions are present. An entity that elects to use the practical expedients will, in effect, continue to account for leases that commenced before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. ASU 2016-02, ASU 2018-10 and ASU 2018-11 will be effective for the Company's fiscal year beginning April 1, 2019 and subsequent interim periods. The Company's current lease arrangements expire through 2021 and the Company is currently evaluating the impact the adoption of these ASUs will have on the Company's consolidated 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 does not believe that the adoption of this pronouncement has an impact on the the presentation of its 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 February 2018, the FASB issued Accounting Standards Update No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This update will be effective for all interim and annual reporting periods beginning after December 15, 2018. The Company does not believe that the adoption of these amendments have an impact on its consolidated financial statements.

In March 2018, the FASB issued Accounting Standards Update No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 ("ASU 2018-05"). ASU 2018-05 adds various SEC paragraphs pursuant to the issuance of the December 2017 SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB No. 118"), which was effective immediately. SAB No.118 provides for a provisional one year measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act. The adoption of ASU 2018-05 had no material impact on the Company's consolidated financial statements as of and for the year ending December 31, 2018. See Note 15, Income Taxes, for disclosures related to this amended guidance.

In June 2018, the FASB issued ASU No. 2018-07, Compensation Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting. This ASU is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share based compensation. The guidance is effective for the Company for the fiscal year beginning January 1, 2020. While the exact impact of this standard is not known, the guidance is not expected to have a material impact on the Company's consolidated financial statements, as non-employee stock compensation is nominal relative to the Company's total expenses as of December 31, 2018.

In October 2018, the FASB issued ASU No. 2018-17, "Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities" ("ASU 2018-17"). This ASU reduces the cost and complexity of financial reporting associated with consolidation of variable interest entities (VIEs). A VIE is an organization in which consolidation is not based on a majority of voting rights. The new guidance supersedes the private company alternative for common control leasing arrangements issued in 2014 and expands it to all qualifying common control arrangements. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company is currently assessing the impact the adoption of ASU 2018-17 will have on the Company's consolidated financial statements.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases and ASU 2018-11 "Leases (Topic 842): Targeted Improvements" (ASU 2018-11). ASU 2018-10 clarifies certain areas within ASU 2016-02. Prior to ASU 2018-11, a modified retrospective transition was required for financing or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. ASU 2018-11 allows entities an additional transition method to the existing requirements whereby an entity could adopt the provisions of ASU 2016-02 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption. ASU 2018-11 also allows a practical expedient that permits lessors to not separate non-lease components from the associated lease component if certain conditions are present. An entity that elects to use the practical expedients will, in effect, continue to account for leases that commenced before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. ASU 2016-02, ASU 2018-10 and ASU 2018-11 will be effective for the Company's fiscal year beginning April 1, 2019 and subsequent interim periods. The Company's current lease arrangements expire through 2021 and the Company is currently evaluating the impact the adoption of these ASUs

will have on the Company's 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.

**Reclassifications**

Reclassifications occurred to certain 2017 amounts to conform to the 2018 classification.

**Note 4. ACCOUNTS RECEIVABLE**

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

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Accounts Receivable Gross | $7,046,000 | $5,958,000 |
| Allowance for Doubtful Accounts | (524,000 ) | (494,000 ) |
| Accounts Receivable Net | $6,522,000 | $5,464,000 |

The allowance for doubtful accounts for the years ended December 31, 2018 and 2017 is as follows:

| | **Balance at Beginning of Year** | **Charged to Costs and Expenses** | **Deductions from Reserves** | **Balance at End of Year** |
|---|---|---|---|---|
| Year ended December 31, 2018 | | | | |
| Allowance for Doubtful Accounts | $ 494,000 | $ 30,000 | $ - | $524,000 |
| Year ended December 31, 2017 | | | | |
| Allowance for Doubtful Accounts | $ 403,000 | $ 91,000 | $ - | $494,000 |

**Note 5. INVENTORY**

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

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Raw Materials | $4,622,000 | $5,346,000 |
| Work In Progress | 17,530,000 | 19,947,000 |
| Finished Goods | 10,915,000 | 10,122,000 |
| Inventory Reserve | (4,016,000 ) | (4,274,000 ) |

| | | |
|---|---|---|
| Total Inventory | $29,051,000 | $31,141,000 |

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 |
|---|---|---|---|---|
| Year ended December 31, 2018 | | | | |
| Reserve for Inventory | $(4,274,000) | $(163,000) | $ 421,000 | $(4,016,000) |
| Year ended December 31, 2017 | | | | |
| Reserve for Inventory | $(3,776,000) | $(503,000) | $ 5,000 | $(4,274,000) |

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**Note 6. PROPERTY AND EQUIPMENT**

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

| | December 31, 2018 | December 31, 2017 | |
|---|---|---|---|
| Land | $300,000 | $300,000 | |
| Buildings and Improvements | 1,708,000 | 1,650,000 | 31.5 years |
| Machinery and Equipment | 11,579,000 | 11,554,000 | 5 - 8 years |
| Capital Lease Machinery and Equipment | 6,495,000 | 6,534,000 | 5 - 8 years |
| Tools and Instruments | 9,882,000 | 8,538,000 | 1.5 - 7 years |
| Automotive Equipment | 177,000 | 172,000 | 5 years |
| Furniture and Fixtures | 303,000 | 311,000 | 5 - 8 years |
| Leasehold Improvements | 520,000 | 528,000 | Term of Lease |
| Computers and Software | 425,000 | 406,000 | 4 - 6 years |
| Total Property and Equipment | 31,389,000 | 29,993,000 | |
| Less: Accumulated Depreciation | (22,612,000) | (19,943,000) | |
| Property and Equipment, net | $8,777,000 | $10,050,000 | |

Depreciation expense for the years ended December 31, 2018 and 2017 was approximately $2,720,000 and $2,548,000, respectively. Assets held under capitalized lease obligations are depreciated over the shorter of their related lease terms or their estimated productive lives. Depreciation of assets under capital leases is included in depreciation expense for 2018 and 2017. Accumulated depreciation on these assets was approximately $4,827,000 and $3,595,000 as of December 31, 2018 and 2017, respectively.

**Note 7. INTANGIBLE ASSETS**

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

| | December 31, 2018 | December 31, 2017 | |
|---|---|---|---|
| Customer Relationships | $4,925,000 | $4,925,000 | 5 to 14 years |

| | | | |
|---|---|---|---|
| Non-Compete | 50,000 | 50,000 | 5 years |
| Total Intangible Assets | 4,975,000 | 4,975,000 | |
| Less: Accumulated Amortization | (4,975,000) | (4,975,000) | |
| Intangible Assets, net | $- | $- | |

The expense for amortization of the intangibles for the years ended December 31, 2018 and 2017 was approximately $0 and $471,000, respectively. As of December 31, 2017 intangible assets had been fully amortized.

**Note 8. ASSETS HELD FOR SALE AND LIABILITES DIRECTLY ASSOCIATED**

**WMI**

As discussed in Note 1, on December 20, 2018, the Company sold all of its outstanding shares of WMI and its subsidiaries to CPI for a purchase price of $9,000,000, reduced by a working capital adjustment of ($1,093,000). At December 31, 2017, the Company reclassified its assets held for sale and the liabilities directly associated to these assets. The components of these assets and liabilities are as follows:

**Components of Assets Held for Sale and Liabilities Directly Associated**

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

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

| **Segment Data** | **2018** | **2017** |
|---|---|---|
| Aerostructures & Electronics | | |
| Net Sales | $13,853,000 | $13,129,000 |
| Gross Profit | 256,000 | 1,884,000 |
| Pre Tax (Loss) Income | (1,042,000) | (6,678,000 ) |
| Assets | - | 10,082,000 |

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

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

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Accounts Payable | $6,782,000 | $8,634,000 |
| Accrued Expenses | 1,941,000 | 2,238,000 |
| | $8,723,000 | $10,872,000 |

**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 $295,000 and $333,000 as of December 31, 2018 and 2017, 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”.

## Note 11. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

Notes payable and capital lease obligations consist of the following:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Revolving credit note payable to PNC Bank N.A. (“PNC”) | $ 14,043,000 | $ 16,455,000 |
| Term loans, PNC | 1,572,000 | 3,471,000 |
| Capital lease obligations | 1,786,000 | 3,073,000 |
| Related party notes payable, net of debt discount | 4,835,000 | 1,912,000 |
| Other notes payable | 2,830,000 | 1,930,000 |
| Subtotal | 25,066,000 | 26,841,000 |
| Less: Current portion of notes and capital obligations | (19,345,000 ) | (23,393,000 ) |
| Notes payable and capital lease obligations, net of current portion | $ 5,721,000 | $ 3,448,000 |

**PNC Bank N.A. (“PNC”)**

The Company has a Loan Facility with PNC that has been amended many times during its term. Substantially all of its assets are pledged as collateral under the Loan Facility. The Company is required to maintain a lockbox account with PNC, into which substantially all of its cash receipts are paid. The Loan Facility provides for a $15,000,000 revolving loan and a term loan with a balance of $1,572,000 at December 31, 2018 (the “Term Loan”). 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 scheduled maturity date.

The terms of the Loan Facility require, among other things, that the Company 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 it can make. The Company is also limited to the amount of dividends it can pay as defined in the Loan Facility.

The Loan Facility has been amended many times during its term, most recently on May 30, 2018 (the "Sixteenth Amendment"), January 2, 2019 (the "Seventeenth Amendment") and February 8, 2019 (the "Eighteenth Amendment").

The Sixteenth Amendment waived Fixed Charge Coverage Ratio covenant violations for the periods ending September 30, 2017, December 31, 2017 and March 31, 2018. The Sixteenth Amendment imposes minimum EBITDA (as defined in the Loan Agreement) covenants of not less than (i) $75,000 for the three-month period ending March 31, 2018, (ii) $485,000 for the six month period ending June 30, 2018, and (iii) $1,200,000 for the nine-month period ending September 30, 2018. The Company complied with these new covenants for the three-months ended March 31, 2018, the six-month period ended June 30, 2018 and the nine-month period ended September 30, 2018. In addition, the Company is prohibited from paying dividends to its stockholders and limits capital expenditures.

Under the terms of the Seventeenth Amendment, the revolving loan and the Term Loan bear interest at a rate equal to the sum of the Alternate Base Rate (as defined in the Loan Agreement) plus four percent (4%). In addition to the amounts available as revolving loans secured by inventory and receivables pursuant to the formula set forth in the Loan Agreement, PNC has agreed to permit the revolving advances to exceed the formula amount by $1,000,000 as of December 31, 2018, provided that we reduce the "Out-of-Formula Loan" by $25,000 per week commencing April 1, 2019, with the unpaid balance payable in full on December 31, 2019. The indebtedness under the revolving loan and the Term Loan are classified with the current portion of notes and capital lease obligations.

Both the revolving loan, inclusive of the Out-of Formula Loan, and the Term Loan mature on December 31, 2019. As a condition to its agreement to extend the maturity of the obligations due under the Loan Agreement (the "Obligations"), we are obligated to pay PNC an extension fee of (i) $250,000 on the earlier of (a) the date the Obligations are indefeasibly paid in full or (b) June 30, 2019, (ii) $125,000 on the earlier of (a) the date the Obligations are indefeasibly paid in full or (b) December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of July 1, 2019, (iii) $125,000 on the earlier of (a) the date the Obligations are indefeasibly paid in full or (b) December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of October 1, 2019 (iv) $500,000 on December 31, 2019, which amount is deemed earned in full if the Obligations have not been satisfied as of December 31, 2019. As a further condition to PNC's agreement to extend the maturity of the Obligations, Michael and Robert Taglich purchased $2,000,000 principal amount of our Senior Subordinated Convertible Notes and arranged a financing giving purchasers a right to receive a pro rata portion of the AMK Revenue Stream Payments resulting in gross proceeds of $800,000, including $275,000 from Michael and Robert Taglich.

The Eighteenth Amendment requires us to maintain a minimum EBITDA of not less than (i) $1,500,000 for the twelve-month period ending December 31, 2018, (ii) $655,000 for the three-month period ending March 31, 2019, (iii) $1,860,000 for the six-month period ending June 30, 2019 and (iv) $3,110,000 for the nine-month period ending September 30, 2019. At December 31, 2018 we were in compliance with the minimum EBIDA covenant.

As of December 31, 2018, our debt to PNC in the amount of $15,615,000 consisted of the revolving credit loan in the amount of $14,043,000 and the term loan in the amount of $1,572,000. The revolver balance was increased to include the Company's negative general ledger balances of its controlled disbursement cash accounts. As of December 31, 2017, our debt to PNC in the amount of $19,926,000 consisted of the revolving credit note due to PNC in the amount of $16,455,000 and the term loan due to PNC in the amount of $3,471,000. In addition, as of December 31, 2018 we had capitalized lease obligations to third parties of $1,786,000, as compared to capitalized lease obligations to third parties of $3,073,000 as of December 31, 2017.

As of December 31, 2018 the future minimum principal payments for the term loans are as follows:

| **For the year ending** | **Amount** |
|---|---|
| December 31, 2019 | $1,478,000 |
| December 31, 2020 | 94,000 |
| | |
| PNC Term Loans payable | 1,572,000 |
| Less: Current portion | 1,572,000 |
| Long-term portion | $- |

Interest expense related to these credit facilities amounted to approximately $1,775,000 and $2,122,000 for the years ended December 31, 2018 and 2017, respectively.

**Capital Leases Payable – Equipment**

The Company is committed under several capital leases for manufacturing and computer equipment. All leases have bargain purchase options exercisable at the termination of each lease. Capital lease obligations totaled $1,786,000 and $3,073,000 as of December 31, 2018 and 2017, respectively, with various interest rates ranging from approximately 4% to 14%.

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

| **For the year ending** | **Amount** |
|---|---|
| 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 | 1,873,000 |
| Less: imputed interest | (87,000) |
| Less: current portion | (1,196,000) |
| Total Long Term Portion | $590,000 |

**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 as individuals in the Company a total of $ 8,860,000 through various debt and equity financings.

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

In November 2017, Michael Taglich and Robert Taglich purchased 144,927 shares and 72,463 shares, respectively, of common stock, together with warrants to purchase an additional 48,000 shares and 24,000 shares, respectively, of common stock, for a purchase price of $200,000 and $100,000, respectively, in a private placement of the Company's equity securities completed in January 2018 from which the Company received gross proceeds of $2,000,000. Taglich Brothers, Inc., which as placement agent for the sale of the shares and warrants, received a placement agent fee equal to $160,000 (8% of the amounts invested), payable at the Company's option, in cash or additional shares of common stock and warrants having the same terms and conditions as the shares and warrants issued in the offering. See Note 12 below.

Private Placement of Subordinated Notes due May 31, 2019, together with Shares of Common Stock

On March 29, 2018 and April 4, 2018, Michael Taglich and Robert Taglich advanced $1,000,000 and $100,000, respectively, to the Company for use as working capital. The Company subsequently issued its Subordinated Notes due May 31, 2019 to Michael Taglich and Robert Taglich, together with shares of common stock, in the financing described below, to evidence its obligation to repay the foregoing advances.

In May 2018, the Company issued $1,200,000 of Subordinated Notes due May 31, 2019 (the "2019 Notes"), together with a total of 214,762 shares of common stock (the "Shares"), to Michael Taglich, Robert Taglich and another accredited investor. As part of the financing, the Company issued to Michael Taglich $1,000,000 principal amount of 2019 Notes and 178,571 shares of common stock for a purchase price of $1,000,000 and the Company issued to Robert Taglich $100,000 principal amount of 2019 Notes and 17,857 shares of common stock. The Company issued and sold a 2019 Note in the principal amount of $100,000, plus 18,334 shares of common stock, to the other accredited investor for a purchase price of $100,000. Seventy percent (70%) of the total purchase price for the 2019 Notes and Shares purchased by each investor has been allocated to the 2019 Notes with the remaining thirty percent (30%) allocated to the Shares purchased with the 2019 Notes. The number of Shares purchased by Michael Taglich and Robert Taglich was calculated based upon $1.68, the closing price of the common stock on May 20, 2018, the trading day immediately preceding the date they purchased the 2019 Notes and shares of common stock.

Interest on the 2019 Notes is payable on the outstanding principal amount thereof at the rate of one percent (1%) per month, payable monthly commencing June 30, 2018. Upon the occurrence and continuation of a failure to pay accrued interest, interest shall accrue and be payable on such amount at the rate of 1.25% per month; provided that upon the occurrence and continuation of a failure to timely pay the principal amount of the 2019 Note, interest shall accrue and be payable on such principal amount at the rate of 1.25% per month and shall no longer be payable on interest accrued but unpaid. The 2019 Notes are subordinate to the Company's obligations to PNC.

Taglich Brothers acted as placement agent for the offering and received a commission in the aggregate amount of 4% of the amount invested which was paid in kind.

Related party advances and notes payable, net of debt discounts to Michael and Robert Taglich, and their affiliated entities, totaled $4,835,000 and $1,912,000, as of December 31, 2018 and December 31, 2017, respectively.

The gross proceeds of $1,200,000 was completed in the following closings:

| Date | Gross Proceeds | Promissory Note | $ | Common Stock Price | Shares |
|---|---|---|---|---|---|
| 3/29/2018 | 1,000,000 | 700,000 | 300,000 | 1.68 | 178,571 |
| 4/4/2018 | 100,000 | 70,000 | 30,000 | 1.68 | 17,857 |
| 5/21/2018 | 100,000 | 70,000 | 30,000 | 1.64 | 18,334 |
| Total | 1,200,000 | 840,000 | 360,000 | | 214,762 |

Private Placements of 8% Subordinated Convertible Notes and Amendments Thereto

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, 2018, we issued $297,000 principal amount of 8% Notes in lieu of cash payment of accrued interest. As of September 30, 2018, we had outstanding $4,775,000 principal amount of 8% Notes, of which $2,575,000 principal amount was due on November 30, 2018 and $2,200,000 principal amount was due on February 28, 2019.

In September 2018, holders of a majority of the outstanding principal amount of the 8% Notes consented to an amendment to the terms of the 8% Notes to extend the maturity date to December 31, 2020 and to provide that interest on the 8% Notes, as amended (the “Amended Notes”), shall accrue and be paid on the due date of the Amended Notes or, if earlier, upon conversion of the Amended Notes into shares of common stock.

At September 30, 2018, Michael Taglich, Robert Taglich and Taglich Brothers (collectively, the “Taglich Parties”) owned $1,300,000, $650,000 and $382,000, respectively, principal amount of 8% Notes, with accrued interest thereon from the date of issuance through September 30, 2018 of $203,613, $120,097 and $68,294, respectively. In consideration for waiving all defaults in payment of principal and accrued interest on the 8% Notes through the date of the amendment, the conversion price of the Amended Notes owned by the Taglich Parties and the other holders of the Amended Notes has been reduced to $1.50 per share, subject to the anti-dilution adjustments set forth in the Amended Notes and the 8% Notes, and the Company issued to the Taglich Parties and the other holders of the 8% Notes such number of shares of common stock calculated based upon a value of $1.39 per share, the closing market price of common stock on the NYSE American on September 28, 2018, the date immediately prior to the date the holders of a majority of the outstanding principal amount of the 8% Notes approved the amendment as is equal to the interest accrued on their 8% Notes from the date of issuance through September 30, 2018. As a result, the Company issued to Michael Taglich, Robert Taglich and Taglich Brothers 146,484 shares, 86,401 shares and 49,132 shares, respectively, of common Stock. From and after September 30, 2018, interest on the unpaid principal amount of the Amended Notes shall accrue and be paid at the rate of six (6%) percent per annum, if paid in cash, or at the rate of eight (8%) percent per annum if converted into common stock.

For soliciting noteholders in connection with the adoption of the amendments, the Company agreed to pay Taglich Brothers $95,550, representing a fee equal to 2% of the outstanding principal amount of Notes whose registered holders (other than Taglich Brothers) received shares of common stock in lieu of cash payment of accrued interest on the 8% Notes as of September 30, 2018.

**Note 12. STOCKHOLDERS’ EQUITY**

Issuance of Series A Preferred Stock and Related Financings.

**Preferred Stock**

During 2016 we issued shares of our Series A Convertible Preferred Stock (“Series A Preferred Stock”) in a series of private financings. The shares were converted into shares of our common stock in connection with the public offering of our common stock in July 2017 (the “Public Offering”).

The shares of Series A Preferred Stock had a stated value of $10.00 per share and are were 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 additional shares of Series A Preferred Stock ("PIK Shares") in lieu of payment of cash dividends payable until June 15, 2018, and to 16% per annum after June 2018, 19% per annum to the extent dividends were paid in additional shares of Series A Preferred Stock ("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 (a conversion rate of 6.6667 shares of common stock per share of Series A Preferred Stock), 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, which was subsequently obtained on October 3, 2017 at the Company's 2017 Annual Meeting of Stockholders., 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.

On October 3, 2017, holders of 1,294,551 outstanding shares of the Company's Series A Preferred Stock automatically converted into 8,629,606 shares of common stock.

As of December 31, 2018 and 2017, the Company had no outstanding shares of Series A Preferred Stock.

**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, 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 was completed in four closings for gross proceeds of $2,000,000 as follows:

| | Total | Shares | | Warrants | |
|---|---|---|---|---|---|
| Date | Investment | # 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 | |

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

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

In connection with the Offering completed from November 2017 through January 2018, Taglich Brothers, Inc., a related party, which acted as placement agent for the sale of the Shares and Warrants, is entitled to a placement agent fee equal to $104,000 (8% of the amounts invested), payable at the Company's option, in cash or additional shares of common stock and warrants having the same terms and conditions as the Shares and Warrants. Michael Taglich and Robert Taglich, directors of the Company, are principals of Taglich Brothers, Inc.

On July 19, 2018, the Company issued and sold a total of 322,000 shares of common stock for gross proceeds of $460,460, or a $1.43 per share, to four accredited investors pursuant to subscription agreements.

For acting as placement agent of the offering, Taglich Brothers, Inc. is entitled to a placement agent fee equal to $27,627 (6% of the gross proceeds of the offering), payable at the Company's option, in cash or shares of Common Stock on the terms sold to the purchasers.

On October 1, 2018, the Company sold 800,000 shares of common stock and warrants to purchase 280,000 additional shares of common stock for gross proceeds of $1,000,000 to an accredited investor within the meaning of Rule 501(a) of Regulation D under the Securities Act ("Regulation D"), in a private offering exempt from the registration requirements of the Securities Act under Rule 506 of Regulation D and Section 4(a)(2) of the Securities Act. The Company agreed to pay Taglich Brothers $70,000 (7% of the gross proceeds of the offering) for acting as placement agent for the offering.

During year ended December 31, 2018, the Company issued 123,456 shares of common stock in lieu of cash payment for various services provided to the Company and 253,071 shares of common stock in payment of directors' fees.

**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 Agreement was renewed as of December 31, 2018 and expires

on December 31, 2021 and covers all of AIM's production personnel, of which there are approximately 104 people. AIM is required to make a monthly contribution to each of the Union's United Welfare Fund and the United Services Worker's Security Fund. This is the only pension benefit required by the Agreement and the Company is not obligated for any future defined benefit to retirees. The Agreement contains a "no-strike" clause, whereby, during the term of the Agreement, the Union will not strike and AIM will not lockout its employees. 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 $172,000 and 136,000 for the years ended December 31, 2018 and 2017, 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 $1,668,000 and $1,544,000 for the years ended December 31, 2018 and 2017, respectively. The Company is responsible for paying all operating costs under the terms of the leases. As of December 31, 2018, the aggregate future minimum lease payments are as follows:

| For the year ending | Fifth Avenue Annual Rent | Lamar Street Annual Rent | Motor Parkway Annual Rent | Porter Street Annual Rent | Total Rents |
|---|---|---|---|---|---|
| December 31, 2019 | $ 792,000 | $ 196,000 | $ 113,000 | $ 48,000 | $ 1,149,000 |
| December 31, 2020 | 817,000 | 202,000 | 116,000 | - | 1,135,000 |
| December 31, 2021 | 842,000 | 173,000 | 103,000 | - | 1,118,000 |
| December 31, 2022 | 868,000 | - | - | - | 868,000 |
| December 31, 2023 | 895,000 | - | - | - | 895,000 |
| Thereafter | 2,604,000 | - | - | - | 2,604,000 |
| **Total Rents** | $ 6,818,000 | $ 571,000 | $ 332,000 | $ 48,000 | $ 7,769,000 |

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.

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On December 20, 2018, the Company sold all of the stock of WMI and WMI has relocated from this facility. The facility has been sublet and payments are to be made by the new tenant directly to the landlord.

**Loss Contingencies**

A number of actions have been commenced against us 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 us. 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. We believes that we have a meritorious defense, and there was no lease on the property and that our subsidiary Compac Development Corp was a hold-over tenant occupying the space on month-to-month tenancy. We recently submitted our response to plaintiff's motion for summary judgement.

An employee of our 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. We believe we are not liable to the employee and any amount we might have to pay in excess of our deductible would be covered by insurance.

An employee of our 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. We believe we are not liable to the employee and any amount we might have to pay would be covered by insurance.

Contract Pharmacal Corp. commenced an action on October 2, 2018, relating to a Sublease entered into between us and Contract Pharmacal in May 2018 with respect to the property we at 110 Plant Avenue, Hauppauge, New York. In the action Contract Pharmacal seeks damages for an amount in excess of $1,000,000 for our failure to make the entire premises available by the Sublease commencement date. We dispute the validity of the claims asserted by Contract Pharmacal and believe we have has meritorious defenses to those claims and have recently submitted a motion in opposition to its motion for summary judgement.

On October 15, 2018, a complaint was filed by a stockholder of our company in the United States District Court for the Eastern District of New York (Michael Kishmoian vs. Air Industries et al Case No. 18cv5757) naming the Company and certain of its directors and a former director. The Complaint alleges that the proxy statement for our 2017 Annual Meeting contained false and misleading misstatements relating to whether brokers had discretionary authority to vote the shares of their customers in connection with the proposal to increase the number of shares we are authorized to issue (the "2017 Charter Amendment"). In the Complaint the plaintiff seeks to void the amendment and rescind any shares issued using the shares authorized by the amendment. Our Board of Directors has adopted an amendment to further increase the number of shares of Common Stock we are authorized to issue (the "2019 Charter Amendment"), subject to stockholder approval at our 2019 Annual Meeting of Stockholders, which we anticipate will be held in May or June of 2019. Counsel to our insurance carrier has advised counsel to the plaintiff of the proposed amendment. We believe that approval of the 2019 Charter Amendment will remove any issues concerning our ability to issue shares of Common Stock, or the validity of shares issued in excess of the 25,000,000 authorized pursuant to the adoption of the 2017 Charter Amendment and that any amount we may pay to resolve this action will not be material.

From time to time we also may be engaged in various lawsuits and legal proceedings in the ordinary course of our business. We are currently not aware of any legal proceedings the ultimate outcome of which, in our judgment based on information currently available, would have a material adverse effect on our business, financial condition or operating results. We, however, have had claims brought against us by a number of vendors due to our liquidity constraints. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial stockholder of our common stock, is an adverse party or has a material interest adverse to our interest.

**Note 15. INCOME TAXES**

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

| | 2018 | 2017 |
|---|---|---|
| Current | | |
| Federal tax refund | $ - | $ (178,000) |
| State | 3,000 | 8,000 |
| Prior Year overaccruals | | |
| Federal | - | - |
| State | - | (27,000) |
| | | |
| Total Expense (Benefit) | 3,000 | (197,000) |
| Deferred Tax Benefit | (921,000) | (2,025,000) |
| Valuation Allowance | 921,000 | 2,025,000 |
| Net Provision for (Benefit from) Income Taxes | $ 3,000 | $ (197,000) |

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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,

| | 2018 | 2017 |
|---|---|---|
| U.S. statutory income tax rate | 21.00 % | 34.00 % |
| State taxes | -0.12 % | 0.09 % |
| Permanent differences, overaccruals and non-deductible items | 5.71 % | -0.22 % |
| Rate change and provision to return true-up | -18.36 % | -22.60 % |
| Expired stock options | 0.00 % | -0.19 % |
| Deferred tax valuation allowance | -8.38 % | -10.09 % |
| Total | -0.15 % | 0.99 % |

The components of net deferred tax assets at December 31, 2018 and December 31, 2017 are set forth below:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Deferred tax assets | | |
| Current: | | |
| Net operating losses | $6,811,000 | $7,730,000 |
| Bad debts | 124,000 | 135,000 |
| Inventory - 263A adjustment | 248,000 | 591,000 |
| Accounts payable, accrued expenses and reserves | - | - |
| Total current deferred tax assets before valuation allowance | 7,183,000 | 8,456,000 |
| Valuation allowance | (7,183,000) | (8,456,000) |
| Total current deferred tax assets after valuation allowance | - | - |
| | | |
| Non-current: | | |
| Stock based compensation - options and restricted stock | 161,000 | 124,000 |
| Capitalized engineering costs | 809,000 | 281,000 |
| Deferred rent | 248,000 | 299,000 |
| Amortization - NTW Transaction | 810,000 | 519,000 |
| Inventory reserves | 942,000 | 960,000 |
| Deferred gain on sale of real estate | 80,000 | 80,000 |
| Accrued Expenses | 49,000 | - |
| Disallowed interest | 918,000 | - |
| Other | 314,000 | 114,000 |
| Total non-current deferred tax assets before valuation allowance | 4,331,000 | 2,377,000 |
| Valuation allowance | (2,952,000) | (758,000) |
| Total non-current deferred tax assets after valuation allowance | 1,379,000 | 1,619,000 |
| | | |
| Deferred tax liabilities: | | |

| | | |
|---|---|---|
| Property and equipment | (1,379,000) | (1,619,000) |
| Amortization – NTW Goodwill | - | - |
| Amortization – Welding Transaction | - | - |
| Total non-current deferred tax liabilities | (1,379,000) | (1,619,000) |
| | | |
| Net non-current deferred tax asset | $- | $- |

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During the years ended December 31, 2018 and December 31, 2017, 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, 2018 and 2017, the Company provided a valuation allowance on its deferred tax assets of $10,135,000 and $9,214,000, respectively.

At December 31, 2018 and 2017, 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, 2018 and 2017, 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 2015 through 2018 tax years generally remain subject to examination by federal and state tax authorities.

## Note 16. STOCK OPTIONS AND WARRANTS

**Stock-Based Compensation**

Stock Options

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, 2018, the Company granted options to purchase 88,000 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 2.69%; expected

volatility factor of 66%; expected dividend yield of 0%; and estimated option term of 5 years.

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.

The Company recorded stock based compensation expense of $293,000 and $323,000 in its consolidated statement of operations for the years ended December 31, 2018 and 2017, 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-Scholes option-pricing model with the following assumptions for the years ended December 31:

| | 2018 | 2017 |
|---|---|---|
| Risk-free interest rates | 2.69% | 1.72% - 1.81 % |
| Expected life (in years) | 4.9 | 4.9 |
| Expected volatility | 66 % | 82% - 85 % |
| Dividend yield | 0.0 % | 0.0 % |
| Weighted-average grant date fair value per share | $0.72 | $0.90 |

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, 2018 and 2017, and changes during the two years then ended are presented below.

| | Options | Wtd. Avg. Exercise Price |
|---|---|---|
| Balance, January 1, 2017 | 636,342 | $ 7.01 |
| Granted during the period | 695,000 | 1.45 |
| Exercised during the period | - | - |
| Terminated/Expired during the period | (282,715 ) | 7.66 |
| Balance, December 31, 2017 | 1,048,627 | 3.20 |
| Granted during the period | 88,000 | 1.56 |
| Exercised during the period | - | - |
| Terminated/Expired during the period | (298,478 ) | 3.04 |
| Balance, December 31, 2018 | 838,149 | $ 3.08 |

| | | |
|---|---|---|
| Exercisable at December 31, 2018 | 598,149 | $ 3.73 |

The following table summarizes information about stock options at December 31, 2018:

| Range of Exercise Prices | Number Outstanding | **Wtd. Avg. Life** | **Wtd. Avg. Exercise Price** |
|---|---|---|---|
| $0.00 - $5.00 | 646,000 | 5.2 years | $ 8.18 |
| $5.01 - $20.00 | 192,149 | 1.6 years | 1.56 |
| $0.00 - $20.00 | 838,149 | 4.4 years | $ 3.08 |

As of December 31, 2018, there was $98,000 of unrecognized compensation cost related to non-vested stock option awards, which is to be recognized over the remaining weighted average vesting period of 1.3 years.

The aggregate intrinsic value at December 31, 2018 was based on the Company's closing stock price of $0.72 was $0. 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, 2018 was 0.

The weighted average fair value of options granted during the years ended December 31, 2018 and 2017 was $0.72 and $0.90 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2018 and 2017 was $0 and $0, respectively. The total fair value of shares vested during the years ended December 31, 2018 and 2017 was $224,718 and $235,550, respectively.

**Warrants**

During the year ended December 31, 2018 and 2017, the Company issued 535,600 and 971,611 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, 2018 and changes during the two years then ended:

| | Warrants | **Wtd. Avg. Exercise Price** | Wtd. Ave. Remaining Contractual Life (years) |
|---|---|---|---|
| Balance, January 1, 2017 | 840,276 | $ 5.13 | 4.01 |
| Granted during the period | 971,611 | 2.61 | 4.42 |
| Exercised during the period | - | - | - |
| Terminated/Expired during the period | (107,785 ) | 3.62 | - |
| Balance, December 31, 2017 | 1,704,102 | 2.66 | 4.04 |
| Granted during the period | 535,600 | 1.45 | 4.35 |
| Terminated/Expired during the period | - | - | - |
| Balance, December 31, 2018 | 2,239,702 | $ 3.10 | 3.35 |
| | | | |
| Exercisable at December 31, 2018 | 2,239,702 | $ 3.10 | 3.35 |

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

| | 2018 | 2017 |
|---|---|---|
| Risk-free interest rates | 2.33 % | 1.85% - 2.20 % |
| Expected life (in years) | 4.9 | 5 |
| Expected volatility | 116 % | 63% - 115 % |
| Dividend yield | - % | - % |
| Weighted-average grant date fair value per share | $ 1.24 | $1.10 - $2.89 |

**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 two operating segments: Complex Machining which consists of AIM and NTW and Turbine Engine Components which consists of Sterling and AMK for the period January 1, 2017 until AMK was disposed of on January 27, 2017. We also separately report our corporate segment (which was comprised of certain operating costs that were not directly attributable to a particular segment).

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 were allocated to segments through March 31, 2018. These costs include corporate costs such as legal, audit, tax and other professional fees including those related to being a public company.

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

| | **Year Ended December 31,** | |
|---|---|---|
| | **2018** | **2017** |
| ***COMPLEX MACHINING*** | | |
| Net Sales | $ 39,745,000 | $ 38,489,000 |
| Gross Profit | 5,871,000 | 4,906,000 |
| Pre Tax Loss | (75,000) | (2,839,000) |
| Assets | 41,947,000 | 43,207,000 |
| ***AEROSTRUCTURES & ELECTRONICS*** | | |
| Net Sales | 1,779,000 | 4,574,000 |
| Gross (Loss) Profit | (31,000) | 507,000 |
| Pre Tax Loss | (1,380,000) | (4,233,000) |
| Assets | 110,000 | 1,021,000 |
| ***TURBINE ENGINE COMPONENTS*** | | |
| Net Sales | 4,785,000 | 6,806,000 |

| | | |
|---|---|---|
| Gross Loss | (426,000 ) | (546,000 ) |
| Pre Tax Loss | (1,385,000 ) | (7,599,000 ) |
| Assets | 5,243,000 | 6,157,000 |
| | | |
| ***CORPORATE*** | | |
| Net Sales | - | - |
| Gross Profit | - | - |
| Pre Tax Loss | (6,766,000 ) | (1,599,000 ) |
| Assets | 456,000 | 288,000 |
| | | |
| ***CONSOLIDATED*** | | |
| Net Sales | 46,309,000 | 49,869,000 |
| Gross Profit | 5,414,000 | 4,867,000 |
| Pre Tax Loss | (9,606,000 ) | (16,270,000 ) |
| (Benefit from) provision for Income Taxes | 3,000 | (197,000 ) |
| Loss from Discontinued Operations | (1,383,000 ) | (6,478,000 ) |
| Assets Held for Sale | - | 10,082,000 |
| Net Loss | (10,992,000 ) | (22,551,000 ) |
| Assets | $ 47,756,000 | $ 50,673,000 |