BUTLER NATIONAL CORP
Form 10-Q
September 14, 2012

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 31, 2012

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to _____________

Commission File Number 0-1678

BUTLER NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

Kansas (State or other jurisdiction of incorporation or organization)	41-0834293 (I.R.S. Employer Identification No.)

19920 West 161st Street, Olathe, Kansas 66062
(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code: (913) 780-9595

Former name, former address and former fiscal year if changed since last report:
Not Applicable

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve 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 T No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files): Yes T No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer T	Smaller reporting company o

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

The number of shares outstanding of the Registrant's Common Stock, $0.01 par value, as of September 3, 2012 was 58,146,314 shares.

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
As of July 31, 2012 and April 30, 2012
(in thousands except per share data)
(unaudited)

	July 31, 2012	April 30, 2012
ASSETS		
CURRENT ASSETS:		
Cash	$7,769	$7,431
Accounts receivable	5,276	3,589
Inventories		
Raw materials	6,263	6,305
Work in process	1,160	982
Finished goods	305	424
Total inventory	7,728	7,711
Prepaid expenses and other current assets	834	1,493
Total current assets	21,607	20,224
PROPERTY, PLANT AND EQUIPMENT:		
Land and building	3,915	3,915
Aircraft	6,673	6,288
Machinery and equipment	3,714	3,714
Office furniture and fixtures	3,233	3,217
Leasehold improvements	31	31
	17,566	17,165
Accumulated depreciation	(7,267)	(6,688)
Total property, plant and equipment	10,299	10,477
SUPPLEMENTAL TYPE CERTIFICATES (net of amortization of $2,514 at July 31, 2012 and $2,500 at April 30, 2012)	1,663	1,677
OTHER ASSETS:		
Deferred tax asset	1,167	1,167
Other assets (net of accumulated amortization of $671 at July 31, 2012 and $538 at April 30, 2012)	6,884	7,017
Total other assets	8,051	8,184
Total Assets	$41,620	$40,562
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Line of credit	$304	$462
Current maturities of long-term debt and capital lease obligations	3,719	3,757
Accounts payable	1,936	1,169
Customer deposits	1,476	1,015
Gaming facility mandated payment	1,160	1,281
Compensation and compensated absences	1,123	1,342
Accrued income tax	(241)	47

Other	213	207
Total current liabilities	9,690	9,280
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, NET OF CURRENT MATURITIES:	8,386	8,678
Total liabilities	18,076	17,958
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value $5:		
Authorized 50,000,000 shares, all classes		
Designated Classes A and B 200,000 shares		
$1,000 Class A, 9.8%, cumulative if earned liquidation and redemption value $100, no shares issued and outstanding	-	-
$1,000 Class B, 6%, convertible cumulative, liquidation and redemption value $1,000, no shares issued and outstanding	-	-
Common stock, par value $.01:Authorized 100,000,000 shares issued and outstanding 58,146,314 shares at July 31, 2012 and 57,907,564 shares at April 30, 2012	581	579
Common stock, owed but not issued 278,573 shares at July 31, 2012 and at April 30, 2012	3	3
Capital contributed in excess of par	12,698	12,568
Treasury stock at cost, 600,000 shares	(732)	(732)
Retained Earnings	8,438	8,170
Total stockholders’ equity Butler National Corporation	20,988	20,588
Noncontrolling Interest in BHCMC, LLC	2,556	2,016
Total stockholders' equity	23,544	22,604
Total Liabilities and Stockholders' Equity	$41,620	$40,562

The accompanying notes are an integral part of these financial statements

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED JULY 31, 2012 AND 2011
(in thousands, except per share data)
(unaudited)

	THREE MONTHS ENDED July 31, 2012	2011
REVENUES:		
Professional services	$9,807	$8,598
Aerospace products	3,661	3,548
Total revenues	13,468	12,146
COSTS AND EXPENSES:		
Cost of professional services	5,137	4,977
Cost of aerospace products	2,924	2,936
Marketing and advertising	1,120	945
Employee benefits	482	758
Depreciation and amortization	711	463
General, administrative and other	1,809	1,393
Total costs and expenses	12,183	11,472
OPERATING INCOME	1,285	674
OTHER INCOME (EXPENSE):		
Interest expense	(346)	(89)
Other income (expense), net	9	3
Total other income (expense),	(337)	(86)
INCOME BEFORE INCOME TAXES	948	588
PROVISION FOR INCOME TAXES		
Provision for income taxes	140	82
NET INCOME	808	506
Net income attributable to noncontrolling interest in BHCMC, LLC	(540)	(398)
NET INCOME ATTRIBUTABLE TO BUTLER NATIONAL CORPORATION	$268	$108
BASIC EARNINGS PER COMMON SHARE	$.00	$.00
WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION	57,527,949	56,594,262
DILUTED EARNINGS PER COMMON SHARE	$.00	$.00
WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION	57,527,949	56,594,262

The accompanying notes are an integral part of these financial statements.

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDING JULY 31, 2012 AND 2011
(dollars in thousands)
(unaudited)

	THREE MONTHS ENDED July 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$808	$506
Adjustments to reconcile cash flows from operating activities		
Depreciation and amortization	726	473
Stock issued for services	91	-
Stock options issued to employees and directors	37	125
Changes in assets and liabilities		
Accounts receivable	(1,687)	(242)
Inventories	(16)	(189)
Prepaid expenses and other current assets	658	(274)
Accounts payable	768	(567)
Customer deposits	461	-
Accrued liabilities	(508)	(580)
Gaming facility mandated payment	(121)	(397)
Other liabilities	10	(102)
Cash flows from operating activities	1,227	(1,247)
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(402)	(17)
Cash flows from investing activities	(402)	(17)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings line of credit, net	(158)	429
Contributed capital	-	5
Borrowings of promissory notes, long-term debt and capital lease obligations	365	-
Repayments of promissory notes, long-term debt and capital lease obligations	(694)	(470)
Cash flows from financing activities	(487)	(36)
NET INCREASE (DECREASE) IN CASH	338	(1,300)
CASH, beginning of year	7,431	8,475
CASH, end of year	$7,769	$7,175
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid	$344	$89
Income taxes paid	$428	$202

NON CASH OPERATING ACTIVITY		
Non cash stock issued for services	$91	$-
Non cash stock options issued to employees and directors	$37	$125

The accompanying notes are an integral part of these financial statements.

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(unaudited)

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and article 10 of Regulation S-X and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with the annual report on Form 10-K for the fiscal year ended April 30, 2012. In our opinion, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three months ended July 31, 2012 are not indicative of the results of operations that may be expected for the fiscal year ended April 30, 2013.

Certain reclassifications within the condensed financial statement captions have been made to maintain consistency in presentation between years.

2. Net Income (Loss) Per Share: The Company follows ASC 260 that requires the reporting of both basic and diluted earnings (loss) per share. Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. In accordance with ASC 260, any anti-dilutive effects on net earnings (loss) per share are excluded.

3. Research and Development: We invested in research and development activities. The amount invested in the three months ended July 31, 2012 and 2011 was approximately $372 and $408 respectively.

4. Borrowings: At July 31, 2012, the Company had one line of credit totaling $1 million. The unused line at July 31, 2012 was $696. During the current year these funds were primarily used for the purchase of inventory for the modifications and avionics operations.

At July 31, 2012, there were several notes collateralized by aircraft security agreements totaling $2,471. These notes were used for the purchase and modifications of these collateralized aircraft.

There are three notes at a bank totaling $1,878 for real estate located in Olathe, Kansas and Tempe, Arizona. The due date for these notes is in March 2013, and August 2016.

One note totaling $342 remains for real estate purchased in June 2009 in Dodge City, Kansas.

One note with a balance of $392 is collateralized by the first and second position on all assets of the company. There are several other notes collateralized by automobiles and equipment totaling an additional $209.

5. Leases: BHCMC, LLC ("BHCMC") as tenant entered into a lease dated May 1, 2011, and amended via an addendum dated January 1, 2012 (collectively, the "Lease"), with BHC Investment Company, L.C. ("BHCI") as landlord for a total obligation of $7,423. BHCI provided funds to BHCMC for the purchase of certain intangible items and gaming related items related to the Boot Hill Casino and Resort. Commencing on January 1, 2012, BHCMC is obligated to make a minimum payment to BHCI of $177 per month until termination of the Lease on September 30, 2017. The Lease may be terminated early but only in the event BHCMC repays the advance plus a 15% annual return through the early termination date. The remaining balance on the obligation is $6,814.

On August 24, 2012, BHCMC and BHCI entered into a second lease ("Second Lease"), which includes an advance of up to $3,250 for tenant improvements related to expansion of the Boot Hill Casino and Resort. Commencing on November 1, 2012, BHCMC is obligated to make a minimum payment to BHCI of approximately $55 per month until termination of the Second Lease on November 30, 2017. Prior to the rent commencement date of November 1, 2012, BHCMC must pay to BHCI the interest that accrues at an annual rate of 12%. The Second Lease may be terminated early but only in the event BHCMC repays the advance plus a 12% annual return through the early termination date. Only $2,500 of the $3,250 available was advanced to the tenant, with the remaining $750 available at the request of BHCMC.

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6. Other Assets: Our other asset account includes intangible assets of $5,500 related to the Kansas Expanded Lottery Act Management Contract privilege fee and JET autopilot intellectual property of $2,055. BHCMC, LLC expects the intangible assets for the Kansas Expanded Lottery Act contract privilege fee of $5,500 to have value over the remaining life of the Management Contract with the State of Kansas which will end in December 2024 (approximately 13 years). There is no assurance of Management Contract renewal. The privilege fee will be fully amortized by the projected end of the Management Contract. Based on the projected sales of the Legacy line of “JET” products it was determined that it would be fully amortized within 15 years.

7. Stockholders’ Equity: On May 8, 2012, the Company issued 238,750 shares of Company common stock to Reign Strategy & Investment Group, LLC (“Reign”). The expense will be amortized over the life of the agreement for a total amount of $90. These shares were issued in consideration for Reign’s marketing and consulting services related to increasing public awareness and shareholder interest in the Company.

The issuance of stock by the Company to Reign is exempt from registration pursuant to Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended. Reign has represented to the Company and the Company believes that Reign is an “accredited investor” as defined in Rule 501(a) of Regulation D.

8. Stock Options: Approximately 7.2 million stock options were issued on December 31, 2010. Previously issued stock options were time-vesting and did not include share price performance targets. All of the newly issued stock options expire December 31, 2015.

The exercise price for the incentive stock options is $0.49 (closing price as of December 31, 2010). The Board of Directors approved the issuance of incentive stock options on December 31, 2010 with the goals of increasing shareholder value, expanding the number of managers participating in the program, and increasing the percentage of compensation tied to share price performance.

The incentive stock options are allocated in three groups with two conditions for vesting. The first condition is stock price and the second condition is time:

Year 1: Target $0.92
§ 2,420,688 options that can be exercised on or after December 31, 2011 if and when the share price reaches $0.92
Year 2: Target $1.41
§ 2,420,688 options that can be exercised on or after December 31, 2012 if and when the share price reaches $1.41
Year 3: Target $1.90
§ 2,420,688 options that can be exercised on or after December 31, 2013 if and when the share price reaches $1.90

At July 31, 2012 we had 7,262,064 outstanding stock options with an average exercise price of $1.42.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS REFERENCE TO EXHIBIT 99 OF THE COMPANY'S ANNUAL REPORT ON FORM 10-K

Statements made in this report, filed with the Securities and Exchange Commission, communications to stockholders, press releases, and oral statements made by representatives of the Company that are not historical in nature, or that state the Company or management intentions, hopes, beliefs, expectations or predictions of the future, may constitute "forward-looking statements" within the meaning of Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements can often be identified by the use of forward-looking terminology, such as "could," "should," "will," "intended," "continue," "believe," "may," "expect," "hope," "anticipate," "goal," "forecast," "plan," "guidance" or "estimate" or the negative of these words, variations thereof or similar expressions. Forward-looking statements are not guarantees of future performance or results. They involve risks, uncertainties, and assumptions. It is important to note that any such performance and actual results, financial condition or business, could differ materially from those expressed in such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the Cautionary Statements and Risk Factors, filed as Exhibit 99 and Item 1A. Risk Factors to the Company's Annual Report on Form 10-K for the year ended April 30, 2012 are incorporated herein by reference. Other unforeseen factors not identified herein could also have such an effect. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results, financial condition or business over time.

Management Overview

Management is focused on increasing long-term shareholder value from increased cash generation, earnings growth, and prudently managing capital expenditures. We plan to do this by continuing to drive increased revenues from product and service innovations, strategic acquisitions, and targeted marketing programs.

Our revenues are primarily derived from two very different business segments; aerospace products and professional services. These segments operate through various Butler National Corporation subsidiaries and affiliates listed on page 58 of the Company’s annual report on form 10K.

Aerospace products derives its revenues by designing, engineering, manufacturing, installing, servicing, and repairing products for classic and current production aircraft. These products include JET autopilot service and repairs, AVCON provisions for special mission equipment installations, KINGS avionics equipment sales and installation, and BUTLER National electronic controls and safety equipment manufacture and sales. Aerospace customers range in size from owners and operators of small single engine airplanes to owners and operators of large commercial and military aircraft. Aerospace products are sold to and serviced for customers located in many countries of the world.

Aerospace is the legacy part of the Butler National business. Organized over 50 years ago, this business is based upon design engineering and installation innovations to enhance and support products related to airplanes and ground support equipment. These new products included: in the 1960’s, aircraft electronic load sharing and system switching equipment, a number of airplane electronic navigation instruments, radios and transponders; in the 1970’s, ground based VOR navigation equipment sold worldwide and military GPS equipment as we know it today in civilian use; in the 1980’s, special mission modifications to business jets for aerial surveillance and conversion of passenger configurations to cargo; in the 1990’s, classic aviation support of aging airplanes with enhanced protection of electrical systems through transient suppression devices (TSD), control electronics for military weapon systems and improved aerodynamic control products (Avcon Fins) allowing stability at higher gross weights for additional special mission applications; in the 2000’s, improved accuracy of the airspeed and altimeter systems to allow less vertical separation between flying airplanes (RVSM) and acquisition of the JET autopilot product line to support and replace aged electronic equipment in the classic fleet of Learjet airplanes; and in the 2010's, the acquisition of Kings Avionics to provide additional classic airplane support by retrofit of avionics from the past 40 years to modern state of the art equipment for sale worldwide using FAA supplemental type certification to make the installations (STC) acceptable to foreign governments for installation abroad.

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Aerospace continues to be the focus for new product design and development. We expect this segment will continue to grow in the future. To address the three to five year business cycles related to the aerospace industry, in the 1990’s, we began providing professional services to markets outside the aerospace industry.

Professional services derives its revenues from (a) professional management services in the gaming industry through Butler National Service Corporation (“BNSC”) and BHCMC, LLC (“BHCMC”), (b) licensed architectural and civil engineering services to the business community through BCS Design, and (c) monitoring services to owners and operators of intelligence gathering systems through Butler National Services, Inc. (“BNSI”).

Professional services grew from the experiences gained from the BNSI monitoring products and services of the 1980’s including SCADA systems and products including digital voice technology for the telephone industry and nuclear plant and civil defense warning systems. BNSI sold these professional services and products to utilities and municipalities resulting in relatively stable revenue streams. The defense warning products were sold in the 1980’s to a third party leaving only the current BNSI service business in Florida.

In the early 1990’s, management determined that more revenue stable business units were needed to sustain the Company. Members of the Board of Directors had contacts with several American Indian tribes, others members were associated with gaming operators in Las Vegas and the 1988 Indian Gaming Regulatory Act (IGRA) which was relatively new to the industry. We reached out to various Indian tribes with land in the area to explore the opportunities for operations under IGRA. This resulted in the “Stables” an Indian owned casino on Modoc Indian land opened in September 1988 developed and managed by BNSC. A copy of the original management agreement with the Modoc and Miami Indian tribes dated December 12, 1996, (the “Stables Management Agreement”) is attached to this quarterly report on Form 10-Q as Exhibit 10.1 and incorporated herein by reference. The Stables Management Agreement has been available on the website maintained by the National Indian Gaming Commission (“NIGC”). The Stables Management Agreement was subsequently amended by various amendments dated April 30, 2003 (the “First Amendment”), November 30, 2006 (the “Second Amendment”), October 19, 2009 (the “Third Amendment”) and September 22, 2011 (the “Fourth Amendment”). The result of the First Amendment, Second Amendment, Third Amendment and Fourth Amendment is to provide that twenty (20%) of Net Profits from The Stables are distributed to BNSC, to eliminate the participation of the Miami Indian tribe from the business and to extend the duration of the Stables Management Agreement through September 30, 2018. A copy of the First Amendment, Second Amendment, Third Amendment and Fourth Amendment are attached to this quarterly report on Form 10-Q as Exhibits 10.2, 10.3, 10.4 and 10.5 respectively, and are incorporated herein by reference. BCS Design has also assisted with the design, construction and continued refurbishment of this venture.

From this experience with IGRA and the success of the Indian gaming industry, we determined that the IGRA model may be applicable for state owned gaming. We spent Butler National Corporation innovation, legal and market development funds to design and encourage the use of an Indian owned gaming model in the State of Kansas. From these efforts, Kansas enacted the Kansas Expanded Lottery Act (KELA) in 2007 allowing four state owned casinos to be developed in Kansas. In 2007, BNSC made application to manage a state owned casino. In 2008, BNSC was awarded a fifteen year term to manage the Boot Hill Casino and Resort in Dodge City, Kansas pursuant to a Lottery Gaming Facility Management Contract (the “Boot Hill Casino Management Contract”). A copy of the Boot Hill Casino Management Contract and related supporting documents between BNSC and BHCMC, LLC are attached to this quarterly report on Form 10-Q as Exhibit 10.6 and is incorporated herein by reference. The Boot Hill Casino Management Contract was amended on December 29, 2009 (the “First Amendment to the Boot Hill Casino Management Contract”) to bring the definition of “Fiscal Year” in line with the fiscal year of BNSC (May 1 to April 30). A copy of the First Amendment to the Boot Hill Casino Management Contract is attached to this quarterly report on Form 10-Q as Exhibit 10.7 and is incorporated herein by reference. BHCMC was organized to be the manager of the casino in Dodge City. The casino opened in December 2009.

By 2009, Butler National Corporation was clearly established into two segments; the professional services and aerospace products business segments.

Results Overview

Our first quarter fiscal 2013 revenues increased 11% to $13.5 million compared to $12.1 million in the first quarter fiscal 2012. The quarter to quarter increase in revenue reflects additional professional services revenues (up 14%) driven by increased revenues from gaming activities and an increase in aerospace products revenues (up 3%) attributable to increased military support products. We anticipate future domestic military spending reductions and continued slow growth of the United States economy.

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Our first quarter fiscal 2013 net income increased 148% to $268 compared to $108 in the first quarter fiscal 2012. Diluted earnings per share remained the same at $0.00 from first quarter fiscal 2012 to the first quarter fiscal 2013. The growth in net earnings and diluted earnings per share was driven primarily by strong revenue growth and continued progress with our margin expansion initiatives, including efficiencies in our implementation and operational processes and controlling general and administrative expenses. Our first quarter fiscal 2013 operating margin was 10%, an increase of four percentage points from our margin of 6% in first quarter fiscal 2012.

RESULTS OF OPERATIONS

FIRST QUARTER FISCAL 2013 COMPARED TO FIRST QUARTER FISCAL 2012

(dollars in thousands)	Three Months Ended July 31, 2012	Percent of total revenue	Three Months Ended July 31, 2011	Percent of total revenue	Percent Change 2011-2012
Revenues:					
Professional services	$ 9,807	73 %	$ 8,598	71 %	14 %
Aerospace products	3,661	27 %	3,548	29 %	3 %
Total revenues	13,468	100 %	12,146	100 %	11 %
Costs and expenses:					
Cost of professional services	5,137	38 %	4,977	41 %	3 %
Cost of aerospace products	2,924	22 %	2,936	24 %	0 %
Marketing and advertising	1,120	8 %	945	8 %	19 %
Employee benefits	482	4 %	758	6 %	(36)%
Depreciation and amortization	711	5 %	463	4 %	54 %
General, administrative and other	1,809	13 %	1,393	11 %	30 %
Total costs and expenses	12,183	90 %	11,472	94 %	6 %
Operating income	$ 1,285	10 %	$ 674	6 %	91 %

Revenues:

Revenues increased 11% to $13.5 million in the three months ended July 31, 2012, as compared to $12.1 million in the three months ended July 31, 2011.

- Professional services derives its revenues from professional management services in the gaming industry through BNSC and BHCMC, licensed architectural and civil engineering services to the business community through BCS Design and monitoring services to owners and operator of SCADA through BNSI. Revenues from professional services increased 14% to $9.8 million in the three months ended July 31, 2012 from $8.6 million in the three months ended July 31, 2011. The increase in professional services revenues was driven by increased revenues from gaming activities.

- Aerospace products derives it revenues by designing, engineering, manufacturing, installing, servicing and repairing products for classic and current production aircraft. Aerospace products revenues increased 3% for the three months from $3.7 million at July 31, 2012 compared to $3.5 million at July 31, 2011. This increase is attributable to increased military support products. We anticipate future domestic military spending reductions and the continued slow growth of the United States economy.

Costs and expenses:

Costs and expenses related to Professional services and Aerospace products include the cost of engineering, labor, materials, equipment utilization, control systems, security and occupancy.

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Costs and expenses increased 6% in the three months ended July 31, 2012 to $12.2 million compared to $11.5 million in the three months ended July 31, 2011. Costs and expenses were 90% of total revenues in the three months ended July 31, 2012, as compared to 94% of total revenues in the three months ended July 31, 2011. The lower costs and expenses as a percent of total revenues in fiscal 2012 were primarily driven by lower engineering costs in aerospace products and maintaining a lower percent of professional services costs as professional services revenues increased.

Marketing and advertising expenses as a percent of total revenues were 8% in the three months ended July 31, 2012, as compared to 8% in three months ended July 31, 2011. These expenses increased 19% to $1.1 million in the three months ended July 31, 2012, from $945 thousand in the three months ended July 31, 2011. Marketing and advertising expenses include advertising, sales and marketing labor, gaming development costs, and casino and product promotions. The increase in these expenses was primarily attributable to growth in the professional services business reflecting a marketing plan to target specific marketing sectors in the Wild West market to increase destination casino revenues. The Boot Hill Casino and Resort definition of the Wild West market includes the area east from the Rocky Mountains to the Mississippi River and the southern Canadian border to the northern border of Mexico.

Employee benefits expenses as a percent of total revenues were 4% in the three months ended July 31, 2012, compared to 6% in the three months ended July 31, 2011. These expenses decreased 36% to $482 thousand in the three months ended July 31, 2012, from $758 thousand in the three months ended July 31, 2011. These expenses include the employers' share of all federal, state and local taxes, paid time off for vacation, holidays and illness, employee health and life insurance programs and employer matching contributions to retirement plans. The decreased expenses are related to a decrease in the number of employees in professional services.

Depreciation and amortization expenses as a percent of total revenues were 5% in the three months ended July 31, 2012, compared to 4% in the three months ended July 31, 2011. These expenses increased 54% to $711 thousand in the three months ended July 31, 2012, from $463 thousand in the three months ended July 31, 2011. These expenses include depreciation related to owned assets being depreciated over various useful lives and amortization of intangible items including the Kansas privilege fee related to the Boot Hill Casino and Resort being expensed over the term of the gaming contract with the State of Kansas. BHCMC, LLC depreciation and amortization expense for the three months ended July 31, 2012 was $226 compared to $10 at July 31, 2011.

General, administrative and other expenses as a percent of total revenues were 13% in the three months ended July 31, 2012, compared to 11% in the three months ended July 31, 2011. These expenses increased 30% to $1.8 million in fiscal 2012, from $1.4 million in fiscal 2011. The increase reflects the increase in number of administrative personnel in professional services, the increased legal fees and expenses and the outside professional consulting fees related to working within the Kansas gaming regulations.

Other income (expense):

Interest and other expenses were $337 thousand in the three months ended July 31, 2012 compared with interest and other expenses of $86 thousand in the three months ended July 31, 2011, an increase of $251 thousand, 292%, from the three months ended July 31, 2011 to the three months ended July 31, 2012. Interest of $262 thousand was related to obligations of BHCMC, LLC.

Operations by Segment

We have two operating segments, professional services and aerospace products. The professional services segment includes revenue contributions and expenditures associated with monitoring services for SCADA systems owned by others, professional architectural services and casino management services. Aerospace products derives its revenues by designing, engineering, manufacturing, installing, servicing and repairing products for classic and current production aircraft.

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The following table presents a summary of our operating segment information for the three months ended July 31, 2012 and July 31, 2011:

(dollars in thousands)	Three Months Ended July 31, 2012	Percent of Revenue		Three Months Ended July 31, 2011	Percent of Revenue		Percent Change 2011-2012	
Professional Services Revenues								
Boot Hill Casino and Resort	$7,701	78	%	$ 6,623	77	%	16	%
Management/Professional Services	2,106	22	%	1,975	23	%	7	%
Net Revenue	9,807	100	%	8,598				