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VICON INDUSTRIES INC /NY/
Form 10-K
December 29, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended:
September 30, 2006

Commission File No. 1-7939

VICON INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

NEW YORK

11-2160665

(State or other jurisdiction of
incorporation or organization)

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

89 Arkay Drive, Hauppauge, New York

11788

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code:

(631) 952-2288

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, Par Value \$.01

(Title of class)

American Stock Exchange

(Name of each exchange on which registered)

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

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 X

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 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 X No

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personnel. The Company's products are used in, among others, office buildings, manufacturing plants, apartment complexes, retail stores, government facilities, airports, transportation operations, prisons, casinos, hotels, sports arenas, health care facilities and financial institutions.

Products

The Company's product line consists of various elements of a video system, including network video encoders, decoders, servers and related video management software, analog and IP cameras, digital recorders, display units (monitors), matrix switchers, robotic camera dome systems and system controls. The Company provides a comprehensive line of products due to the many varied climatic and operational environments in which the products are expected to perform. In addition to selling from a standard catalog line, the Company at times produces to specification or will modify an existing product to meet customer requirements.

The Company's products range in price from \$10 for a simple camera mounting bracket to several hundred thousand dollars (depending upon configuration) for a large digital control, transmission, recording, storage and video matrix switching system. The Company's sales are concentrated principally among its digital video systems and dome camera systems product lines.

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Marketing

The Company's marketing emphasizes engineered video system solutions which includes system design, project management, technical training and pre and post sales support. The Company promotes and markets its products through industry trade shows worldwide, product brochures and catalogues, direct marketing and electronic mailings to existing and prospective customers, website promotions, in-house training seminars for customers and end users, road shows which preview new systems and system components, and advertising through trade and end user magazines and the Company's web site (www.vicon-cctv.com). The Company's products are sold principally to over 1,000 independent dealers, system integrators and distributors. Sales are made principally by field sales engineers and inside customer service representatives. The Company's sales effort is supported by in-house customer service coordinators and technical support groups which provide product information, application engineering, design detail, field project management, and hardware and software technical support.

The Company's products are employed in video system installations by: (1) commercial and industrial users, such as office buildings, manufacturing plants, warehouses, apartment complexes, shopping malls and retail stores; (2) federal, state, and local governments for national security purposes, municipal facilities, prisons, and military installations; (3) financial institutions, such as banks, clearing houses, brokerage firms and depositories, for security purposes; (4) transportation departments for highway traffic control, bridge and tunnel monitoring, and airport, subway, bus and seaport security and surveillance; (5) gaming casinos, where video surveillance is often mandated by regulatory authorities; and (6) health care facilities, such as hospitals, particularly psychiatric wards and intensive care units.

The Company's principal sales offices are located in Hauppauge, New York; Fareham, England; Zaventem, Belgium; and Neumunster, Germany.

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International Sales

The Company sells its products in Europe, Scandinavia and the Middle East through its European-based subsidiary and elsewhere outside the U.S. principally by direct export from its U.S. based parent company. In October 2004, the Company acquired all of the operating assets of Videotronic Infosystems GmbH, a 30-year old Germany based video system supplier, to expand its presence into the sizable German video security market. The Company has a few territorial exclusivity agreements with customers but primarily uses a wide range of installation companies and distributors in international markets. In Australia, Japan and Norway, the Company permits independent sales representatives to use the Company's name for marketing purposes.

Direct export sales and sales from the Company's foreign subsidiaries amounted to \$26.0 million, \$27.0 million and \$22.3 million or 46%, 48% and 42% of consolidated net sales in fiscal years 2006, 2005, and 2004, respectively. The Company's principal foreign markets are Europe, the Middle East and the Pacific Rim, which together accounted for approximately 89% of international sales in fiscal 2006.

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Competition

The Company operates in a highly competitive marketplace both domestically and internationally. The Company competes by providing high-end video systems and system components that incorporate broad capability together with high levels of customer service and technical support. Generally, the Company does not compete based on price alone.

The Company's principal engineered video systems competitors include the following companies or their affiliates: Matsushita Electric Corp. (Panasonic), Pelco Sales Company, Bosch Security Systems, Inc., Sensormatic Electronics Corp. (a division of Tyco International), GE Security Systems and Honeywell Security Systems. Many additional companies, both domestic and international, produce products that compete against one or more of the Company's system components. In addition, many consumer video electronic companies or their affiliates, including Matsushita Electric Corp. (Panasonic), Mitsubishi Electric Corporation, Sanyo Electric Co., Ltd. and Sony Corporation, compete with the Company for the sale of video products and systems. Almost all of the Company's principal competitors are larger companies whose financial resources and scope of operations are substantially greater than the Company's.

Engineering and Development

The Company's engineering and development is focused on new and improved video systems and system components. In recent years, the trend of product development and demand within the video security and surveillance market has been toward the application of digital technology, principally relating to the compression, analysis, transmission, storage, manipulation, imaging and display of digital video over IP networks. As the demands of the Company's target market segment require the Company to keep pace with changes in technology, the Company has focused its engineering effort in these developing areas. Development projects are chosen and prioritized based on direct customer feedback, the Company's analysis as to the needs of the marketplace, anticipated technological advances and market research.

At September 30, 2006, the Company employed a total of 41 engineers in the following areas: software development, mechanical design, manufacturing/testing

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and electrical and circuit design. Engineering and development expense amounted to approximately 8% of net sales in fiscal 2006 and 9% of net sales in each of fiscal years 2005 and 2004.

Source and Availability of Raw Materials

The Company relies upon independent manufacturers and suppliers to manufacture and assemble certain of its proprietary products and expects to continue to rely on such entities in the future. The Company's relationships with certain of its independent manufacturers, assemblers and suppliers are not covered by formal contractual agreements.

Raw materials and components purchased by the Company and its suppliers are generally readily available in the market, subject to market lead times at the time of order. The Company is not dependent upon any single source for a significant amount of its raw materials or components.

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Intellectual Property

The Company owns, and has pending, a limited number of design and utility patents expiring at various times. The Company owns certain trademarks and several other trademark applications are pending both in the United States and in Europe. Most of the Company's key products employ proprietary software which is protected by copyright. The Company considers its software products to be unique and is a principal element in the differentiation of the Company's products from its competition. However, the laws of certain foreign countries do not protect intellectual property rights to the same extent or in the same manner as the laws of the U.S. The Company has no significant licenses, franchises or concessions with respect to any of its products or business dealings. In addition, the Company does not believe its limited number of patents or its lack of licenses, franchises and concessions to be of substantial significance. However, the Company is a defendant in a patent infringement suit as discussed in "Item 3 - Legal Proceedings", the outcome of which could possibly have a material effect on the Company's business.

Inventories

The Company generally maintains sufficient finished goods inventory levels to respond to unanticipated customer demand, since most sales are to installing dealers and contractors who normally do not carry any significant inventory. The Company principally builds inventory to known or anticipated customer demand. In addition to normal safety stock levels, certain additional inventory levels may be maintained for products with long purchase and manufacturing lead times. The Company believes that it is important to carry adequate inventory levels of parts, components and products to avoid production and delivery delays that detract from its sales effort.

Backlog

The backlog of orders believed to be firm as of September 30, 2006 and 2005 was approximately \$7.2 million and \$6.7 million, respectively. Orders are generally cancelable without penalty at the option of the customer. The Company prefers that its backlog of orders not exceed its ability to fulfill such orders on a timely basis, since experience shows that long delivery schedules only encourage the Company's customers to look elsewhere for product availability.

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Employees

At September 30, 2006, the Company employed 208 full-time employees, of whom 8 are officers, 44 are in administration, 83 are in sales and technical service capacities, 41 are in engineering and 32 are production employees. At September 30, 2005, the Company employed 218 persons. There are no collective bargaining agreements with any of the Company's employees and the Company considers its relations with its employees to be good.

ITEM 1A - RISK FACTORS

The Company designs, manufactures and markets a wide range of video systems and components worldwide and is subject to all business risks that similar technology companies and all other companies encounter in their operations. Market risks that pertain particularly to the Company are discussed elsewhere in this Form 10-K under Item 1 - Business; Item 3 - Legal Proceedings; Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations; and Item 7A - Quantitative and Qualitative Disclosures about Market Risk.

ITEM 1B - UNRESOLVED STAFF COMMENTS

None.

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ITEM 2 - PROPERTIES

The Company principally operates from an 80,000 square-foot facility located at 89 Arkay Drive, Hauppauge, New York, which it owns. The Company also owns a 14,000 square-foot sales, service and warehouse facility in southern England which services the U.K., Europe and the Middle East. In addition, the Company operates under leases from offices in Yavne, Israel; Neumunster, Germany; and various local sales offices throughout Europe. The Company believes that its facilities are adequate to meet its current and foreseeable operating needs.

ITEM 3 - LEGAL PROCEEDINGS

The Company is one of several defendants in a patent infringement suit commenced by Lectrolarm Custom Systems, Inc. in May 2003 in the United States District Court for the Western District of Tennessee. The alleged infringement by the Company relates to its camera dome systems and other products that represent significant sales to the Company. Among other things, the suit seeks past and enhanced damages, injunctive relief and attorney's fees. In January 2006, the Company received the plaintiff's claim for past damages through December 31, 2005 that approximated \$11.7 million plus pre-judgment interest. The Company and its outside patent counsel believe that the complaint against the Company is without merit. The Company is vigorously defending itself and is a party to a joint defense with certain other named defendants. The Company is unable to reasonably estimate a range of possible loss, if any, at this time. Although the Company believes that it has meritorious defenses to such claims, there is a possibility that an unfavorable outcome could ultimately occur that could result in a liability that is material to the Company's results of operations and financial position. The Company has held discussions with the plaintiff in the interest of settling the case. However, there can be no assurance that any settlement can be reached.

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In connection with this suit, the Company petitioned the U.S. Patent and Trademark Office (USPTO) for reexamination of the plaintiff's patent. In April 2006, the USPTO issued a non-final office action rejecting all of the plaintiff's patent claims asserted against the Company citing the existence of prior art of the Company and another defendant. The plaintiff has appealed the USPTO ruling and has additional appeals available to them in the USPTO and, thereafter, in the Court of Appeals for the Federal Circuit. On June 30, 2006, the Federal District Court granted the defendants' motion for continuance (delay) of the trial, pending the outcome of the USPTO's reexamination office proceedings.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

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PART II

ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's stock is traded on the American Stock Exchange (AMEX) under the symbol (VII). The following table sets forth for the periods indicated, the range of high and low prices for the Company's Common Stock on AMEX:

Quarter Ended	High	Low
-----	----	---
Fiscal 2006		
December	3.68	2.63
March	3.47	2.82
June	3.39	2.60
September	3.65	2.80
Fiscal 2005		
December	5.75	4.33
March	4.74	3.23
June	3.72	2.55
September	4.80	2.50

The last sale price of the Company's Common Stock on December 15, 2006 as reported on AMEX was \$3.59 per share. As of December 15, 2006, there were approximately 200 shareholders of record.

The Company has never declared or paid cash dividends on its Common Stock and anticipates that any earnings in the foreseeable future will be retained to finance the growth and development of its business.

On April 26, 2001, the Company announced that its Board of Directors authorized the repurchase of up to \$1 million of shares of the Company's common stock, which represented approximately 9.8% of shares outstanding on the announcement date. The Company did not repurchase any of its common stock during the three month period ended September 30, 2006.

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ITEM 6 - SELECTED FINANCIAL DATA

FISCAL YEAR	2006	2005	2004	2003	2002
	-----	-----	-----	-----	-----
	(in thousands, except per share data)				
Net sales	\$56,279	\$56,056	\$53,533	\$51,954	\$54,168
Gross profit	22,094	20,996	19,711	19,091	18,218
Operating loss	(367)	(2,931)	(2,226)	(1,677)	(2,180)
Loss before income taxes	(397)	(3,069)	(2,210)	(1,739)	(2,349)
Net loss (1)	(547)	(2,885)	(2,691)	(4,874)	(1,579)
Net loss per share (1):					
Basic and Diluted	(.12)	(.63)	(.59)	(1.05)	(.34)
Total assets	35,955	34,192	38,867	41,893	47,426
Long-term debt	1,740	2,062	2,410	2,732	3,040
Working capital	20,181	19,713	22,793	25,333	27,827
Property, plant and equipment (net)	6,229	6,616	7,090	7,286	7,666

(1) Fiscal 2003 includes the effects of the Company's adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", on October 1, 2002.

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ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Fiscal Year 2006 Compared with 2005

Net sales for 2006 increased slightly to \$56.3 million compared with \$56.1 million in 2005. Domestic sales increased 4% to \$30.3 million compared with \$29.1 million in 2005. International sales decreased 4% to \$26.0 million compared with \$27.0 million in 2005. The backlog of unfilled orders was \$7.2 million at September 30, 2006 compared with \$6.7 million at September 30, 2005.

Gross profit margins for 2006 increased to 39.3% compared with 37.5% in 2005 due principally to production cost reductions within the Company's digital video product line and a favorable product sales mix.

Operating expenses for 2006 decreased to \$22.5 million or 39.9% of net sales compared with \$23.9 million or 42.7% of net sales in 2005 as a result of cost reduction initiatives spread among all operating expense categories. In 2006 and 2005, the Company incurred \$537,000 and \$661,000, respectively, of legal expense in the defense of a patent infringement suit (\$1.9 million since inception in 2003). In addition, the Company continued to invest in new product development, incurring \$4.5 million of engineering and development expenses in 2006 compared

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with \$4.8 million in 2005.

The Company incurred an operating loss of \$367,000 in 2006 compared with a loss of \$2.9 million in 2005. The \$2.6 million improvement in operating performance in 2006 was due principally to improved gross margins and lower operating expenses. The current year results include a \$525,000 operating loss from the Company's Videotronic subsidiary compared with a \$357,000 loss in 2005. Since its acquisition on October 1, 2004, this subsidiary has incurred operating losses as it continued to transition from former bankruptcy protection.

Interest expense decreased to \$165,000 for 2006 compared with \$181,000 in 2005 principally as a result of the paydown of bank borrowings offset, in part, by the effect of increased interest rates during 2006. Interest and other income increased to \$136,000 for 2006 compared with \$88,000 in 2005 principally as a result of increased interest rates during the current year. During 2005, the Company also liquidated the principal portion of its investment in marketable securities, resulting in a \$45,000 loss for the year.

Income tax expense for 2006 was \$150,000 compared with \$27,000 in 2005 relating principally to profits reported by the Company's U.K. subsidiary. The Company has ceased recognizing tax benefits on its U.S. operating losses due to the uncertainty of their future realization.

An extraordinary gain in the amount of \$211,000 was recorded in 2005 relating to the Company's acquisition of its Videotronic subsidiary. The gain represents the recovery of tangible net assets acquired in excess of their purchase price.

As a result of the foregoing, the Company incurred a net loss of \$547,000 in 2006 compared with a net loss of \$2.9 million in 2005.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Fiscal Year 2005 Compared with 2004

Net sales for 2005 increased 5% to \$56.1 million compared with \$53.5 million in 2004. Net sales for 2005 included \$6.2 million of sales from the Company's German subsidiary, Videotronic, whose operating assets were acquired on October 1, 2004. Domestic sales decreased 7% to \$29.1 million compared with \$31.2 million in 2004. International sales, excluding the Company's Videotronic subsidiary, decreased 7% to \$20.8 million compared with \$22.3 million in 2004. The backlog of unfilled orders was \$6.7 million at September 30, 2005 compared with \$4.7 million at September 30, 2004.

Gross profit margins for 2005 increased to 37.5% compared with 36.8% in 2004. The 2004 margin was negatively impacted by \$1.1 million (2.1%) of charges for the phase out of certain discontinued product lines. Excluding the effects of these year ago period charges, the Company's 2005 margins declined as a result of reduced selling prices on its digital video server/recorder product line.

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Operating expenses for 2005 increased to \$23.9 million or 42.7% of net sales compared with \$21.9 million or 41.0% of net sales in 2004. The increase included \$2.3 million of operating expenses incurred by the Company's Videotronic subsidiary. In 2005 and 2004, the Company incurred \$661,000 and \$562,000, respectively, of legal expense in the defense of a patent infringement suit (\$1.3 million since inception in 2003). In addition, the Company continued to invest in new product development in 2005, incurring \$4.8 million of engineering and development expenses compared with \$4.9 million in 2004.

The Company incurred an operating loss of \$2.9 million in 2005 compared with a loss of \$2.2 million in 2004. The current year results include a \$357,000 operating loss from the Company's Videotronic subsidiary as it transitioned from former bankruptcy protection.

Interest expense decreased to \$181,000 for 2005 compared with \$187,000 in 2004 principally as a result of the paydown of bank borrowings offset, in part, by the effect of increased interest rates during 2005. Interest and other income decreased to \$88,000 for 2005 compared with \$204,000 in 2004 principally as a result of reduced investable funds during the current year. During 2005, the Company also liquidated the principal portion of its investment in marketable securities, resulting in a \$45,000 loss for the year.

Income tax expense for 2005 was \$27,000 compared with \$481,000 in 2004 relating principally to profits reported by the Company's European operation. The Company has ceased recognizing tax benefits on its U.S. operating losses due to the uncertainty of its future realization.

An extraordinary gain in the amount of \$211,000 was recorded in 2005 relating to the Company's acquisition of its Videotronic subsidiary. The gain represents the recovery of tangible net assets acquired in excess of the purchase price of the assets.

As a result of the foregoing, the Company incurred a net loss of \$2.9 million in 2005 compared with a net loss of \$2.7 million in 2004.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was \$722,000 for 2006. The net loss of \$547,000 for the year was more than offset by \$1.1 million of non-cash charges. Increases in accounts receivable of \$872,000 and inventories of \$1.4 million were offset in part by an increase in accounts payable of \$1.6 million. Net cash used in investing activities was \$516,000 for 2006 due principally to \$510,000 of general capital expenditures. Net cash used in financing activities was \$396,000 in 2006, which included \$403,000 of scheduled repayments of bank mortgage loans. As a result of the foregoing, cash decreased by \$179,000 for 2006 after the effect of exchange rate changes on the cash position of the Company.

The Company's European-based subsidiary maintains a bank overdraft facility that provides for maximum borrowings of one million Pounds Sterling (approximately \$1,870,000) to support its local working capital requirements. This facility

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expires in March 2007. At September 30, 2006 and 2005, there were no outstanding borrowings under this facility.

The following is a summary of the Company's long-term debt and material operating lease obligations as of September 30, 2006:

Year	Debt Repayments	Lease Commitments	Total
----	-----	-----	-----
2007	\$ 332,000	\$379,000	\$ 711,000
2008	1,740,000	119,000	1,859,000
2009	-	19,000	19,000

The Company has incurred operating losses in recent years which, if continued, could exhaust the Company's cash reserves and limit its ability to secure additional bank financing, if needed. The Company has instituted certain plans to preserve its cash. The Company believes that it will have sufficient cash to meet its anticipated operating costs, capital expenditures and debt service requirements for at least the next twelve months.

The Company does not have any off-balance sheet transactions, arrangements or obligations (including contingent obligations) that have, or are reasonably likely to have, a material effect on the Company's financial condition, results of operations, liquidity, capital expenditures or capital resources.

The Company is one of several defendants in a patent infringement suit commenced by Lectrolarm Custom Systems, Inc. in May 2003 in the United States District Court for the Western District of Tennessee. The alleged infringement by the Company relates to its camera dome systems and other products that represent significant sales to the Company. Among other things, the suit seeks past and enhanced damages, injunctive relief and attorney's fees. In January 2006, the Company received the plaintiff's claim for past damages through December 31, 2005 that approximated \$11.7 million plus pre-judgment interest. The Company and its outside patent counsel believe that the complaint against the Company is without merit. The Company is vigorously defending itself and is a party to a joint defense with certain other named defendants. The Company is unable to reasonably estimate a range of possible loss, if any, at this time. Although the Company believes that it has meritorious defenses to such claims, there is a possibility that an unfavorable outcome could ultimately occur that could result in a liability that is material to the Company's results of operations and financial position. The Company has held discussions with the plaintiff in the interest of settling the case. However, there can be no assurance that any settlement can be reached.

In connection with this suit, the Company petitioned the U.S. Patent and Trademark Office (USPTO) for reexamination of the plaintiff's patent. In April 2006, the USPTO issued a non-final office action rejecting all of the plaintiff's patent claims asserted against the Company citing the existence of prior art of the Company

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and another defendant. The plaintiff has appealed the USPTO ruling and has additional appeals available to them in the USPTO and, thereafter, in the Court of Appeals for the Federal Circuit. On June 30, 2006, the Federal District Court granted the defendants' motion for continuance (delay) of the trial, pending the outcome of the USPTO's reexamination office proceedings.

Critical Accounting Policies

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The Company's significant accounting policies are fully described in Note 1 to the consolidated financial statements included in Part IV. Management believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility of the resulting receivable is reasonably assured. As it relates to product sales, revenue is generally recognized when products are sold and title is passed to the customer. Shipping and handling costs are included in cost of sales. Advance service billings under a national supply contract with one customer are deferred and recognized as revenues on a pro rata basis over the term of the service agreement. Pursuant to the adoption of EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables", the Company evaluates multiple-element revenue arrangements for separate units of accounting, and follows appropriate revenue recognition policies for each separate unit. Elements are considered separate units of accounting provided that (i) the delivered item has stand-alone value to the customer, (ii) there is objective and reliable evidence of the fair value of the delivered item, and (iii) if a general right of return exists relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially within the control of the Company. As applied to the Company, under arrangements involving the sale of product and the provision of services, product sales are recognized as revenue when the products are sold and title is passed to the customer, and service revenue is recognized as services are performed. For products that include more than incidental software, and for separate licenses of the Company's software products, the Company recognizes revenue in accordance with the provisions of Statement of Position 97-2, "Software Revenue Recognition", as amended.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

The Company provides for the estimated cost of product warranties at the time revenue is recognized. While the Company engages in product quality programs and processes, including monitoring and evaluating the quality of its component suppliers, its warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from its estimates, revisions to the estimated warranty liability may be required.

The Company writes down its inventory for estimated obsolescence and slow moving inventory equal to the difference between the carrying cost of inventory and the estimated net realizable market value based upon assumptions about future demand and market conditions. Technology changes and market conditions may render some of the Company's products obsolete and additional inventory write-downs may be required. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

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The Company assesses the recoverability of the carrying value of its long-lived assets, including identifiable intangible assets with finite useful lives, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The Company evaluates the recoverability of such assets based upon the expectations of undiscounted cash flows from such

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assets. If the sum of the expected future undiscounted cash flows were less than the carrying amount of the asset, a loss would be recognized for the difference between the fair value and the carrying amount.

The Company's ability to recover the reported amounts of deferred income tax assets is dependent upon its ability to generate sufficient taxable income during the periods over which net temporary tax differences become deductible. The Company plans to provide a full valuation allowance against its deferred tax assets until such time that it can achieve a sustained level of profitability or other positive evidence arises that would demonstrate an ability to recover such assets.

The Company is subject to proceedings, lawsuits and other claims related to labor, product and other matters. The Company assesses the likelihood of an adverse judgment or outcomes for these matters, as well as the range of potential losses. A determination of the reserves required, if any, is made after careful analysis. The required reserves may change in the future due to new developments.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes -- an interpretation of FASB Statement No. 109". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 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. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that the adoption of FIN 48 will have a material impact on its consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 clarifies that fair value is the amount that would be exchanged to sell an asset or transfer a liability in an orderly transaction between market participants. Further, the standard establishes a framework for measuring fair value in generally accepted accounting principles and expands certain disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect that the adoption of SFAS 157 will have a material impact on its consolidated financial position, results of operations or cash flows.

In September 2006, the U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years beginning after November 15, 2006. The Company does not expect that the adoption of SAB 108 will have a material impact on its consolidated financial position, results of operations or cash flows.

Foreign Currency Activity

The Company's foreign exchange exposure is principally limited to the relationship of the U.S. dollar to the British pound sterling, the Euro and the Israeli shekel.

Sales by the Company's U.K. and German based subsidiaries to customers in Europe are made in British pounds sterling (pounds) or Eurodollars (Euros). In fiscal 2006, approximately \$5.8 million of products were sold by the Company to its U.K. based subsidiary for resale. The Company attempts to minimize its currency exposure on intercompany sales through the purchase of forward exchange contracts.

The Company's Israeli based subsidiary incurs shekel based operating expenses which are funded by the Company in U.S. dollars. In past years, the Company had purchased forward exchange contracts to minimize its currency exposure on these expenses during periods of favorable fluctuating exchange rates.

As of September 30, 2006, the Company had forward exchange contracts outstanding with notional amounts aggregating \$800,000. The Company also attempts to reduce the impact of an unfavorable exchange rate condition through cost reductions from its suppliers and shifting product sourcing to suppliers transacting in more stable and favorable currencies.

In general, the Company seeks lower costs from suppliers and enters into forward exchange contracts to mitigate short-term exchange rate exposures. However, there can be no assurance that such steps will be effective in limiting long-term foreign currency exposure.

ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk Factors

The Company is exposed to various market risks, including changes in foreign currency exchange rates and interest rates. The Company has a policy that prohibits the use of currency derivatives or other financial instruments for trading or speculative purposes.

The Company enters into forward exchange contracts to hedge certain foreign currency exposures and minimize the effect of such fluctuations on reported earnings and cash flow (see "Foreign Currency Activity", Note 1 "Derivative Instruments" and "Fair Value of Financial Instruments" to the accompanying financial statements). At September 30, 2006, the Company's foreign currency exchange risks included an aggregate \$2.5 million of intercompany account balances between the Company and its subsidiaries, which are short term and will be settled in fiscal 2007. The following sensitivity analysis assumes an instantaneous 10% change in foreign currency exchange rates from year-end levels, with all other variables held constant.

At September 30, 2006, a 10% strengthening or weakening of the U.S. dollar versus the British pound would result in a \$248,000 decrease or increase, respectively, in the intercompany accounts receivable balance. Certain of such foreign currency exchange risk at September 30, 2006 has been hedged by \$800,000 of forward exchange contracts.

At September 30, 2006, the Company had \$1.4 million of outstanding floating rate bank debt which was covered by an interest rate swap agreement that effectively

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converts the foregoing floating rate debt to a stated fixed rate (see "Note 5. Long-Term Debt" to the accompanying financial statements). Thus, the Company has substantially no net interest rate exposures on these instruments. However, the Company had approximately \$589,000 of floating rate bank debt that is subject to interest rate risk as it was not covered by an interest rate swap agreement. The Company does not believe that a 10% fluctuation in interest rates would have a material effect on its consolidated financial position and results of operations.

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Related Party Transactions

Refer to Item 13 and "Note 13. Related Party Transactions" to the accompanying financial statements.

Inflation

The impact of inflation on the Company has been minimal in recent years as the rate of inflation remains low. However, inflation continues to increase costs to the Company. As operating expenses and production costs increase, the Company principally seeks to increase sales and lower its product cost where possible.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of

1995

Statements in this Report on Form 10-K and other statements made by the Company or its representatives that are not strictly historical facts including, without limitation, statements included herein under the captions "Results of Operations" and "Liquidity and Financial Condition" are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995 that should be considered as subject to the many risks and uncertainties that exist in the Company's operations and business environment. The forward-looking statements are based on current expectations and involve a number of known and unknown risks and uncertainties that could cause the actual results, performance and/or achievements of the Company to differ materially from any future results, performance or achievements, express or implied, by the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, and that in light of the significant uncertainties inherent in forward-looking statements, the inclusion of such statements should not be regarded as a representation by the Company or any other person that the objectives or plans of the Company will be achieved. The Company also assumes no obligation to publicly update or revise its forward-looking statements or to advise of changes in the assumptions and factors on which they are based.

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Part IV, Item 15, for an index to consolidated financial statements and financial statement schedules.

ITEM 9A - CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as required by Exchange Act Rule 13a-15. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms.

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Changes in Internal Controls

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation referred to above that occurred during the fourth quarter of the fiscal year ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

The Company's size dictates that it conducts business with a minimal number of financial and administrative employees, which inherently results in a lack of documented controls and segregation of duties within the Company and its operating subsidiaries. Management will continue to evaluate the employees involved and the control procedures in place, the risks associated with such lack of segregation and whether the potential benefits of adding employees to clearly segregate duties justifies the expense associated with such added personnel. In addition, management is aware that many of the internal controls that are in place at the Company are undocumented controls.

Limitations on the Effectiveness of Controls

The Company believes that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

ITEM 9B - OTHER INFORMATION

None.

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PART III

ITEM 10 - DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The Executive Officers and Directors of the Company are as follows:

Name	Age	Position
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Kenneth M. Darby	60	Chairman of the Board, President and Chief Executive Officer
John M. Badke	47	Senior Vice President, Finance and Chief Financial Officer
Peter A. Horn	51	Vice President, Operations
Bret M. McGowan	41	Vice President, U.S. Sales and Marketing
Yacov A. Pshtissky	55	Vice President, Technology and Development
Joan L. Wolf	52	Executive Administrator and Corporate Secretary
Christopher J. Wall	53	Managing Director, Vicon Industries Ltd.
Yigal Abiri	57	General Manager, Vicon Systems Ltd.
Clifton H.W. Maloney	69	Director
Peter F. Neumann	72	Director
W. Gregory Robertson	63	Director
Arthur D. Roche	68	Director

The business experience, principal occupations and employment, as well as period of service, of each of the officers and directors of the Company during at least the last five years are set forth below.

Kenneth M. Darby - Chairman of the Board, President and Chief Executive Officer. Mr. Darby has served as Chairman of the Board since April 1999, as Chief Executive Officer since April 1992 and as President since October 1991. He has served as a director since 1987. Mr. Darby also served as Chief Operating Officer and as Executive Vice President, Vice President, Finance and Treasurer of the Company. He joined the Company in 1978 as Controller after more than nine years at Peat Marwick Mitchell & Co., a public accounting firm. Mr. Darby's current term on the Board ends in May 2008.

John M. Badke - Senior Vice President, Finance and Chief Financial Officer. Mr. Badke has been Senior Vice President, Finance since May 2004 and Chief Financial Officer since December 1999. Previously, he was Vice President, Finance since October 1998 and served as Controller since joining the Company in 1992. Prior to joining the Company, Mr. Badke was Controller for NEK Cable, Inc. and an audit manager with the international accounting firms of Arthur Andersen & Co. and Peat Marwick Main & Co.

Peter A. Horn - Vice President, Operations. Mr. Horn has been Vice President, Operations since June 1999. From 1995 to 1999, he was Vice President, Compliance and Quality Assurance. Prior to that time, he served as Vice President in various capacities since his promotion in May 1990.

Bret M. McGowan - Vice President, U.S. Sales and Marketing. Mr. McGowan has been Vice President, U.S. Sales and Marketing since April 2005. From 2001 to 2005, he served as Vice President, Marketing. Previously, he served as Director of Marketing since 1998 and as Marketing Manager since 1994. He joined the Company in 1993 as a Marketing Specialist.

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Yacov A. Pshtissky - Vice President, Technology and Development. Mr. Pshtissky has been Vice President, Technology and Development since May 1990. Mr. Pshtissky was Director of Electrical Product Development from March 1988 through April 1990.

Joan L. Wolf - Executive Administrator and Corporate Secretary. Ms. Wolf has been Executive Administrator since she joined the Company in 1990 and was appointed to the non-operating officer position of Corporate Secretary in May

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2002.

Christopher J. Wall - Managing Director, Vicon Industries, Ltd. Mr. Wall has been Managing Director, Vicon Industries Ltd. since February 1996. Previously he served as Financial Director, Vicon Industries, Ltd. since joining the Company in 1989. Prior to joining the Company he held a variety of senior financial positions within Westland plc, a UK aerospace company.

Yigal Abiri - General Manager, Vicon Systems Ltd. Mr. Abiri has been General Manager, Vicon Systems Ltd. since joining the Company in August 1999. Previously, he served as President of QSR, Ltd., a developer and manufacturer of remote video surveillance equipment.

Clifton H.W. Maloney - Director. Mr. Maloney has been a director of the Company since May 2004. Mr. Maloney is the President of C.H.W. Maloney & Co., Inc., a private investment firm that he founded in 1981. From 1974 to 1984, he was a Vice President in investment banking at Goldman, Sachs & Co. Mr. Maloney is a Director of Interpool, Inc., Chromium Industries, Inc. and The Wall Street Fund. His current term on the Board ends in May 2007.

Peter F. Neumann - Director. Mr. Neumann has been a director of the Company since 1987. He is the retired President of Flynn-Neumann Agency, Inc., an insurance brokerage firm. Mr. Neumann's current term on the Board ends in May 2009.

W. Gregory Robertson - Director. Mr. Robertson has been a director of the Company since 1991. He is President of TM Capital Corporation, a financial services company which he founded in 1989. From 1985 to 1989, he was employed by Thomson McKinnon Securities, Inc. as head of investment banking and public finance. Mr. Robertson's current term on the Board ends in May 2007.

Arthur D. Roche - Director. Mr. Roche has been a director of the Company since 1992. He served as Executive Vice President and co-participant in the Office of the President of the Company from August 1993 until his retirement in November 1999. For the six months prior to that time, Mr. Roche provided consulting services to the Company. In October 1991, Mr. Roche retired as a partner of Arthur Andersen & Co., an international accounting firm which he joined in 1960. His current term on the Board ends in May 2008.

There are no family relationships between any director, executive officer or person nominated or chosen by the Company to become a director or officer.

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Audit Committee Financial Expert

All independent directors are members of the Audit Committee. The Board of Directors has determined that Arthur D. Roche, Chairman of the Audit Committee, qualifies as an "Audit Committee Financial Expert", as defined by Securities and Exchange Commission Rules, based on his education, experience and background. Mr. Roche is independent as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

Code of Ethics

The Company has adopted a Code of Ethics that applies to all its employees, including its chief executive officer, chief financial and accounting officer, controller, and any persons performing similar functions. Such Code of Ethics is published on the Company's internet website (www.vicon-cctv.com).

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Compliance with Section 16(a) of the Exchange Act

Based solely upon a review of Forms 3 and 4 and amendments thereto furnished to the Company during the year ended September 30, 2006 and certain written representations that no Form 5 is required, no person who, at any time during the year ended September 30, 2006 was a director, officer or beneficial owner of more than 10 percent of any class of equity securities of the Company registered pursuant to Section 12 of the Exchange Act failed to file on a timely basis, as disclosed in the above forms, reports required by Section 16(a) of the Exchange Act during the year ended September 30, 2006.

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ITEM 11 - EXECUTIVE COMPENSATION

The following table sets forth all compensation awarded to, earned by, or paid for all services rendered to the Company during 2006, 2005 and 2004 by the Chief Executive Officer and the Company's most highly compensated executive officers whose total annual salary and bonus exceeded \$100,000 during any such year.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation		Other Annual Compen- sation	Long-Term Compensation			Payouts	All Oth Comp sati
		Salary	Bonus		Awards	Securities Underlying Options (#)	LTIP Payouts		
Kenneth M. Darby Chairman and Chief Executive Officer	2006	\$310,000	\$ 75,000	(1)	-	-	-	-	-
	2005	298,462	75,000	(1)	-	-	-	-	-
	2004	310,000	75,000	(1)	-	-	-	-	-
John M. Badke Senior Vice President and Chief Financial Officer	2006	\$171,923	\$ 35,000	(1)	-	-	5,000	-	-
	2005	165,000	35,000	(1)	-	-	5,000	-	-
	2004	152,000	35,000	(1)	-	-	-	-	-
Christopher J. Wall Managing Director Vicon Industries Ltd.	2006	\$171,000	\$ 35,300	(2)	-	-	5,000	-	-
	2005	176,000	14,000	(2)	-	-	5,000	-	-
	2004	148,000	113,000	(2)	-	-	-	-	-
Bret M. McGowan Vice President, U.S. Sales and Marketing	2006	\$151,923	\$ 32,601	(1)	-	-	5,000	-	-
	2005	132,917	20,831	(6)	-	-	5,000	-	-
	2004	112,000	25,000	(1)	-	-	-	-	-
Yigal Abiri General Manager	2006	\$160,000	\$ -	-	-	-	-	-	\$ -
	2005	160,000	-	-	-	-	-	-	90,

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Vicon Systems Ltd. 2004 160,000 10,725 (3) - - - - 66,

- (1) Represents discretionary cash bonus approved by the Board of Directors upon the recommendation of its Compensation Committee.
- (2) Represents sales and profit related bonus based on financial results of Vicon Industries Ltd.
- (3) Represents discretionary bonus.
- (4) Represents \$43,938 of severance pay paid into a management insurance policy and \$23,008 paid as compensation for accrued vacation.
- (5) Represents performance based compensation associated with the introduction of the Company's new digital video product line.
- (6) Represents sales related commission.

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OPTION GRANTS IN LAST FISCAL YEAR

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
	No. of Options Granted	% of Total Employees in Fiscal Year	Exercise Price Per Share	Expiration Date	5%	10%
John Badke	5,000	12.5%	\$3.17	12/10	\$ 4,379	\$ 9,677
Christoper Wall	5,000	12.5%	\$3.17	12/11	\$ 5,391	\$ 12,229
Bret McGowan	5,000	12.5%	\$3.17	12/11	\$ 5,391	\$ 12,229

Options granted in the year ended September 30, 2006 were issued under the 1996 Incentive Stock Option Plan, the 1999 Non-Qualified Stock Option Plan and the 2002 Non-Qualified Stock Option Plan. Options issued under the 1996 Incentive Stock Option Plan are exercisable as follows: up to 30% on the grant date, an additional 30% on the first anniversary of the grant date, and the balance on the second anniversary of the grant date, except that no option is exercisable after the expiration of five years from the date of grant. Options issued under the 1999 and 2002 Non-Qualified Stock Option Plans are exercisable as follows: up to 30% of the shares on the second anniversary of the grant date, an additional 30% of the shares on the third anniversary of the grant date, and the balance of the shares on the fourth anniversary of the grant date, except that no option is exercisable after the expiration of six years from the date of grant.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR

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 AND FISCAL YEAR-END OPTION VALUES

Name	Shares Acquired On Exercise	Value Realized (1)	At September 30, 2006	
			Number of Securities Underlying Unexercised Options	Value of Unexercised In-the-money Options (2)
			Exercisable/ Unexercisable	Exercisable/ Unexercisable
Kenneth M. Darby	-0-	-0-	64,545/35,455	\$15,030/\$9,470
John M. Badke	-0-	-0-	32,500/18,500	8,430/4,810
Christopher J. Wall	-0-	-0-	12,000/18,000	2,940/4,010
Bret M. McGowan	-0-	-0-	15,077/14,423	3,954/3,451
Yigal Abiri	-0-	-0-	26,000/4,000	7,600/-0-

- (1) Calculated based on the difference between the closing quoted market prices per share at the dates of exercise and the exercise prices.
- (2) Calculated based on the difference between the closing quoted market price (\$3.29) and the exercise price.

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Compensation Arrangements

On November 10, 2006, the Company entered into a new one-year employment agreement with Kenneth M. Darby, the Company's Chief Executive Officer, to expire on September 30, 2007. The terms of the new agreement provide for a \$15,000 increase in Mr. Darby's annual base salary to \$325,000 effective October 1, 2006. In conjunction with his new employment agreement, Mr. Darby entered into a stock lock-up agreement whereby he agreed not to sell more than 100,000 shares (50,000 per year) of his Company stock holdings in open market transactions through September 30, 2008 without Board of Director approval. Such lock-up agreement provisions terminate under certain conditions, including Mr. Darby's death, disability, termination without cause and a Company change in control as defined. Mr. Darby's previous employment agreement, which expired on September 30, 2006, entitled him to receive a \$620,000 severance benefit and deferred compensation in the form of 70,647 shares of the Company's Common Stock upon its expiration. Such amounts have been earned by Mr. Darby over his many years of service with the Company in varying capacities and have been paid subsequent to year end.

In addition, the Compensation Committee of the Board of Directors ("the Committee") approved a performance-based bonus plan for Mr. Darby for fiscal year 2007, whereby he can earn a minimum of \$175,000 for achievement of a certain minimum annual profit target as defined by the Board. For fiscal year

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2006, the Committee approved a \$75,000 discretionary bonus for Mr. Darby. The Company also granted Mr. Darby 10,000 stock options at the closing price on October 25, 2006.

On November 13, 2006, the Company executed an amendment to the January 1, 2006 employment agreement with John M. Badke, the Company's Chief Financial Officer, to provide him with a \$5,000 increase in annual base salary to \$180,000 effective October 1, 2006 and includes provisions to comply with the requirements of Section 409A of the Internal Revenue Code. The agreement, which expires on December 31, 2007, provides Mr. Badke a lump sum payment in the amount of three times his average annual compensation for the previous five years if there is a change in control of the Company without Board of Director approval as defined. The agreement also provides Mr. Badke a severance/retirement benefit of \$350,000 payable under certain occurrences.

In addition, a performance based bonus plan for fiscal year 2007 was adopted for Mr. Badke whereby he will receive a bonus equal to 3% of a certain minimum annual profit target as defined by the Committee. For the fiscal year 2006, the Committee approved a \$35,000 discretionary bonus for Mr. Badke. The Company also granted Mr. Badke 15,000 stock options at the closing price on October 25, 2006.

On November 1, 2006, the Company entered into a new employment agreement with Christopher J. Wall, Managing Director of Vicon Industries Ltd. (Europe), to expire on September 30, 2007. The new agreement provides Mr. Wall with a \$5,000 increase in annual base salary to approximately \$185,000 (97,850 Pounds Sterling) and provides a performance based bonus plan for fiscal year 2007 whereby he will receive an amount equal to between 2% and 6% (based on achievement levels) of the combined pretax operating profits of the Company's Europe based subsidiaries. For fiscal year 2006, Mr. Wall received a bonus of approximately \$35,300 based upon his achievement of certain sales and profit targets. The new agreement also provides Mr. Wall a severance/retirement benefit of approximately \$190,000 (100,000 Pounds Sterling) under certain occurrences. The Company also granted Mr. Wall 5,000 stock options at the closing price on October 25, 2006.

On August 7, 2006, the Company entered into an employment agreement with Mr. Bret M. McGowan, the Company's Vice President of U.S. Sales and Marketing, providing him an annual base salary of \$155,000. The agreement, which expires on September 30, 2007, provides Mr. McGowan a lump sum payment in the amount of three times his average annual compensation for the previous five years if

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there is a change in control of the Company without Board of Director approval as defined. The agreement also provides Mr. McGowan a severance/retirement benefit of \$290,000 payable under certain occurrences. Effective October 1, 2006, Mr. McGowan's annual base salary was increased to \$170,000.

In addition, a performance based bonus plan for fiscal year 2007 was established for Mr. McGowan whereby he earns variable compensation upon achieving certain U.S. sales targets. For the fiscal year 2006, the Committee approved a \$30,000 discretionary bonus for Mr. McGowan. The Company also granted Mr. McGowan 13,500 stock options at the closing price on October 25, 2006.

Directors' Compensation and Term

During the fiscal year ending September 30, 2006, directors were compensated at an annual rate of \$16,000 for regular Board meetings and \$1,000 per committee meeting attended in person or by teleconference. Effective October 1, 2006, the Board of Directors approved an increase in non-employee director compensation to

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an annual rate of \$20,000 for regular Board meetings and \$1,200 per committee meeting. The Chairman of the Audit Committee also receives an additional annual retainer of \$8,000. Employee directors are not compensated for Board or committee meetings. Directors may not stand for reelection after age 70, except that any director may serve one additional three-year term after age 70 with the unanimous consent of the Board of Directors.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee of the Board of Directors consists of Messrs. Maloney, Neumann, Robertson and Roche, none of whom has ever been an officer of the Company except for Mr. Roche, who served as Executive Vice President from August 1993 until his retirement in November 1999.

Board Compensation Committee Report

The Compensation Committee's compensation policies applicable to the Company's officers for 2006 were to pay a competitive market price for the services of such officers, taking into account the overall performance and financial capabilities of the Company and the officer's individual level of performance.

Mr. Darby makes recommendations to the Compensation Committee as to the base salary and incentive compensation of all officers other than himself. The Committee reviews these recommendations with Mr. Darby and, after such review, determines compensation. In the case of Mr. Darby, the Compensation Committee makes its determination after direct negotiation with him. For each officer, the committee's determinations are based on its conclusions concerning each officer's performance and comparable compensation levels for similarly situated officers at comparable companies. The overall level of performance of the Company is taken into account but is not specifically related to the base salary of these officers. Also, the Company has established an incentive compensation plan for certain officers, which provides for a specified bonus upon the Company's achievement of certain annual sales and/or profitability targets.

The Compensation Committee grants options to officers to link compensation to the performance of the Company. Options are exercisable in the future at the fair market value at the time of grant, so that an officer granted an option is rewarded by the increase in the price of the Company's stock. The committee grants options to officers based on significant contributions of such officer to the performance of the Company. In addition, in determining Mr. Darby's salary and bonus for service as Chief Executive Officer, the committee considers the responsibility assumed by him in formulating, implementing and managing the operational and strategic objectives of the Company.

Submitted by the Compensation Committee,

Peter F. Neumann, Chairman
W. Gregory Robertson

Clifton H.W. Maloney
Arthur D. Roche

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This graph compares the return of \$100 invested in the Company's stock on October 1, 2001, with the return on the same investment in the AMEX U.S. Market Index and the AMEX Technology Index.

(The following table was represented by a chart in the printed material)

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Date	Vicon Industries, Inc.	AMEX U.S. Market Index	AMEX Technology Index
10/01/01	100	100	100
10/01/02	91	88	62
10/01/03	122	113	89
10/01/04	138	131	102
10/01/05	91	155	104
10/01/06	97	168	113

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ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth the beneficial ownership of the Company's Common Stock as of December 15, 2006 by (i) those persons known by the Company to be beneficial owners of more than 5% of the Company's outstanding Common Stock; (ii) each current executive officer named in the Summary Compensation Table; (iii) each director; and (iv) all directors and executive officers as a group.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned (1)	% of Class
CBC Co., Ltd. and affiliates 2-15-13 Tsukishima, Chuo-ku, Tokyo, Japan 104	543,715	10.9%
Leviticus Partners, L.P. 405 Lexington Ave., 45th Floor New York, NY 10174	300,000	6.0%
Dimensional Fund Advisors 1299 Ocean Avenue Santa Monica, CA 90401	297,237 (11)	5.9%
Al Frank Asset Management, Inc. 32392 Coast Highway, Suite 260 Laguna Beach, CA 92651	277,299 (10)	5.5%

C/O Vicon Industries, Inc.		
Kenneth M. Darby	404,610 (2)	8.1%
Arthur D. Roche	149,654 (3)	3.0%
John M. Badke	40,819 (4)	*
Peter F. Neumann	37,072 (5)	*
W. Gregory Robertson	31,900 (5)	*
Christopher J. Wall	28,300 (6)	*
Yigal Abiri	16,000 (6)	*
Bret M. McGowan	15,154 (7)	*
Clifton H.W. Maloney	15,000 (8)	*
Total all Executive Officers and Directors as a group (12 persons)	836,950 (9)	16.7%

* Less than 1%.

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- (1) Unless otherwise indicated, the Company believes that all persons named in the table have sole voting and investment control over the shares of stock owned.
- (2) Includes currently exercisable options to purchase 83,871 shares.
- (3) Includes 50,000 shares held by Mr. Roche's wife and currently exercisable options to purchase 20,000 shares.
- (4) Includes currently exercisable options to purchase 27,500 shares.
- (5) Includes currently exercisable options to purchase 20,000 shares.
- (6) Includes currently exercisable options to purchase 16,000 shares.
- (7) Includes currently exercisable options to purchase 15,154 shares.
- (8) Includes currently exercisable options to purchase 15,000 shares.
- (9) Includes currently exercisable options to purchase 267,325 shares.
- (10) Al Frank Asset Management, Inc. had voting control over 179,047 shares and investment control over 277,299 shares.
- (11) Dimensional Fund Advisors had voting control over 291,637 shares and investment control over 297,237 as investment advisor and manager for various mutual funds and other clients. These shares are beneficially owned by such mutual funds or other clients.

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EQUITY COMPENSATION PLAN INFORMATION

at September 30, 2006

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
-----	-----	-----	-----
Equity compensation plans approved by security holders	545,283	\$3.28	73,933
Equity compensation plans not approved by security holders	-	-	-
Total	545,283	\$3.28	73,933

EQUITY COMPENSATION GRANTS NOT APPROVED BY SECURITY HOLDERS

Through September 30, 2006, the Company had granted certain of its officers with deferred compensation benefits aggregating 103,898 shares of common stock currently held by the Company in treasury. Such shares vest upon retirement or, in the case of 70,647 shares, the expiration of Mr. Darby's employment agreement in September 2006. Such shares were distributed to Mr. Darby in November 2006. All shares vest earlier under certain occurrences including death, involuntary

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termination or a change in control of the Company.

ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company and CBC Co., Ltd. (CBC), a Japanese corporation which beneficially owns 10.9% of the outstanding shares of the Company, have been conducting business with each other for approximately twenty-seven years. During this period, CBC has served as a lender, a product supplier and sourcing agent, and a private label reseller of the Company's products. CBC has also acted as the Company's sourcing agent for the purchase of certain video products. In fiscal 2006, the Company purchased approximately \$404,000 of products and components from or through CBC. CBC competes with the Company in various markets, principally in the sale of video products and systems. Sales of all products to CBC were \$205,000 in 2006.

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ITEM 14 - PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table details: the aggregate fee arrangements with BDO Seidman, LLP for professional services rendered for the audit of the Company's consolidated annual financial statements and review of the financial statements included in the Company's quarterly reports on Form 10-Q; the aggregate fees billed by BDO Seidman, LLP for audit related matters and; the aggregate fees billed by BDO Seidman, LLP for tax compliance, tax advice and tax planning during fiscal years ended September 30, 2006 and 2005:

	2006	2005
	----	----
Audit fees	\$171,000	\$158,000
Audit related fees	\$ 4,000	\$ -
Tax fees	\$ 39,000	\$ 46,000

Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, audit related services, tax services and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent auditors. Under the policy, pre-approval generally is provided for an annual period and any pre-approval is detailed as to the particular service or category of services and is subject to a specific limit. In addition, the Audit Committee may also pre-approve particular services on a case-by-case basis, which must be accompanied by a detailed explanation for each proposed service. The Audit Committee may delegate pre-approval authority to one or more of its members. Such member must report any decisions to the Audit Committee at the next scheduled meeting.

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ITEM 15 - EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements

Included in Part IV, Item 15:

Report of Independent Registered Public Accounting Firm

Financial Statements:

Consolidated Statements of Operations, fiscal years ended
September 30, 2006, 2005, and 2004

Consolidated Balance Sheets at September 30, 2006 and 2005

Consolidated Statements of Shareholders' Equity, fiscal years
ended September 30, 2006, 2005, and 2004

Consolidated Statements of Cash Flows, fiscal years ended
September 30, 2006, 2005, and 2004

Notes to Consolidated Financial Statements, fiscal years ended
September 30, 2006, 2005, and 2004

(a) (2) Financial Statement Schedule

Included in Part IV, Item 15:

Schedule II - Valuation and Qualifying Accounts for the years
ended September 30, 2006, 2005, and 2004

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are not applicable and, therefore, have been omitted.

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15(a) (3) Exhibit Numbers -----	Exhibits ----- Description -----	Exhibit Number or Incorporation by Reference to -----
3	(.1) Articles of Incorporation and By-Laws, as amended	Incorporated by reference to the 1985 Annual Report on Form 10-K; Form S-2 filed in Registration Statement No. 33-10435 and Exhibit A, B and C of the 1987 Proxy Statement
	(.2) Amendment of the Certificate of Incorporation dated May 7, 2002	Incorporated by reference to the 2002 Annual Report on Form 10-K

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4 Instruments defining the rights of security holders

(.1) Rights Agreement dated December 4, 2001 between the Registrant and Computershare Investor Services Incorporated by reference to the 2001 Annual Report on Form 10-K

10 Material Contracts

(.1) Employment Agreement dated November 10, 2006 between the Registrant and Kenneth M. Darby Incorporated by reference to the Current Report on Form 8-K dated November 16, 2006

(.2) Common Stock Lock-up Agreement dated November 10, 2006 between the Registrant and Kenneth M. Darby Incorporated by reference to the Current Report on Form 8-K dated November 16, 2006

(.3) 1994 Incentive Stock Option Plan Incorporated by reference to the 1994 Annual Report on Form 10-K

(.4) 1994 Non-Qualified Stock Option Plan for Outside Directors Incorporated by reference to the 1994 Annual Report on Form 10-K

(.5) 1996 Incentive Stock Option Plan Incorporated by reference to the 1997 Annual Report on Form 10-K

(.6) 1996 Non-Qualified Stock Option Plan for Outside Directors Incorporated by reference to the 1997 Annual Report on Form 10-K

(.7) Commercial fixed rate loan agreement between the Registrant and National Westminster Bank PLC dated April 8, 1997 Incorporated by reference to the June 30, 1997 filing on Form 10-Q

(.8) Loan Agreement between the Registrant and The Dime Savings Bank of New York, FSB dated January 29, 1998 Incorporated by reference to the December 31, 1997 filing on Form 10-Q

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Exhibit Numbers -----	Description -----	Exhibit Number or Incorporation by Reference to -----
	(.9) Mortgage Note between the Registrant and The Dime Savings Bank of New York, FSB dated January 29, 1998	Incorporated by reference to the December 31, 1997 filing on Form 10-Q

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- | | | |
|-------|---|--|
| (.10) | Mortgage and Security Agreement in the amount of \$2,512,000 between the Registrant and The Dime Savings Bank of New York, FSB dated January 29, 1998 | Incorporated by reference to the December 31, 1997 filing on Form 10-Q |
| (.11) | Interest rate master swap agreement between the Registrant and KeyBank National Association dated December 11, 1997 | Incorporated by reference to the December 31, 1997 filing on Form 10-Q |
| (.12) | Schedule to the master agreement between the Registrant and KeyBank National Association dated December 11, 1997 | Incorporated by reference to the December 31, 1997 filing on Form 10-Q |
| (.13) | Swap transaction confirmation with a notional amount of \$2,512,000 between the Registrant and KeyBank National Association dated December 30, 1997 | Incorporated by reference to the December 31, 1997 filing on Form 10-Q |
| (.14) | Advice of borrowing terms between the Registrant and National Westminster Bank PLC dated March 6, 2006 | Incorporated by reference to the March 31, 2006 filing on Form 10-Q |
| (.15) | Loan Agreement between the Registrant and The Dime Savings Bank of New York, FSB dated October 12, 1999 | Incorporated by reference to the 1999 Annual Report on Form 10-K |
| (.16) | Mortgage Note between the Registrant and The Dime Savings Bank of New York, FSB dated October 12, 1999 | Incorporated by reference to the 1999 Annual Report on Form 10-K |
| (.17) | Mortgage and Security Agreement in the amount of \$1,200,000 between the Registrant and The Dime Savings Bank of New York, FSB dated October 12, 1999 | Incorporated by reference to the 1999 Annual Report on Form 10-K |
| (.18) | 1999 Incentive Stock Option Plan | Incorporated by reference to the 1999 Annual Report on Form 10-K |
| (.19) | 1999 Non-Qualified Stock Option Plan | Incorporated by reference to the 1999 Annual Report on Form 10-K |
| (.20) | 2002 Incentive Stock Option Plan | Incorporated by reference to the 2002 Annual Report on Form 10-K |

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Exhibit Numbers -----	Description -----	Exhibit Number or Incorporation by Reference to -----
-----------------------------	----------------------	--

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(21)	2002 Non-Qualified Stock Option Plan	Incorporated by reference to the 2002 Annual Report on Form 10-K
(22)	Employment and Deferred Compensation Agreement dated January 1, 2006 between the Registrant and John M. Badke	Incorporated by reference to the Current Report on Form 8-K dated March 6, 2006
(23)	Amendment 1 to the Employment and Deferred Compensation Agreement dated November 13, 2006 between the Registrant and John M. Badke	Incorporated by reference to the Current Report on Form 8-K dated November 16, 2006
(24)	Employment Agreement dated August 7, 2006 between the Registrant and Bret M. McGowan	10.24
(25)	Employment Agreement dated November 1, 2006 between the Registrant and Christopher J. Wall	Incorporated by reference to the Current Report on Form 8-K dated November 16, 2006
(26)	Amendment 1 to the Employment Agreement dated November 1, 2006 between the Registrant and Christopher J. Wall	Incorporated by reference to the Current Report on Form 8-K dated November 16, 2006
21	Subsidiaries of the Registrant	Incorporated by reference to the Notes to the Consolidated Financial Statements
23	Consent of BDO Seidman, LLP	23.1
31	Rule 13a-14(a)/15d-14(a) Certifications	
	(1) Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	31.1
	(2) Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	31.2
32	Section 1350 Certifications	
	(1) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	32.1
	(2) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	32.2

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No other exhibits are required to be filed.

Other Matters - Form S-8 and S-2 Undertaking

For the purposes of complying with the amendments to the rules governing Form S-8 (effective July 13, 1990) under the Securities Act of 1933, the undersigned registrant hereby undertakes as follows, which undertaking shall be incorporated by reference into registrant's Registration Statements on Form S-8 Nos. 33-7892 (filed June 30, 1986), 33-34349 (filed April 1, 1990), 33-90038 (filed February 24, 1995), 333-30097 (filed June 26, 1997), 333-71410 (filed October 11, 2001) and 333-116361 (filed June 10, 2004) and on Form S-2 No. 333-46841 (effective May 1, 1998):

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Vicon Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Vicon Industries, Inc. as of September 30, 2006 and 2005 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years ended September 30, 2006. In connection with our audit of the consolidated financial statements, we also have audited the financial statement schedule as listed in Part IV, item 15(a)(2) for the fiscal years ended September 30, 2006, 2005 and 2004. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedule are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that

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are appropriate in the circumstances, 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Vicon Industries, Inc. at September 30, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedule presents fairly, in all material respects, the information set forth therein.

/s/ BDO Seidman, LLP

Melville, New York
December 1, 2006

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VICON INDUSTRIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS Fiscal Years Ended September 30, 2006, 2005 and 2004

	2006 ----	2005 ----	2004 ----
Net sales	\$56,278,971	\$56,055,715	\$53,532,631
Cost of sales	34,184,675	35,060,060	33,821,618
	-----	-----	-----
Gross profit	22,094,296	20,995,655	19,711,013
Operating expenses:			
Selling, general and administrative expense	17,930,872	19,152,692	17,058,460
Engineering and development expense	4,530,806	4,773,516	4,878,981
	-----	-----	-----
	22,461,678	23,926,208	21,937,441
	-----	-----	-----
Operating loss	(367,382)	(2,930,553)	(2,226,428)
Other expense (income):			
Interest expense	164,827	181,126	187,390
Interest and other income	(135,654)	(88,026)	(204,224)
Loss on sale of marketable securities	-	44,936	-

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Loss before income taxes	(396,555)	(3,068,589)	(2,209,594)
Income tax expense	150,000	27,000	481,000
Loss before extraordinary gain	(546,555)	(3,095,589)	(2,690,594)
Extraordinary gain (Note 14)	-	210,968	-
Net loss	\$ (546,555)	\$ (2,884,621)	\$ (2,690,594)

Basic and diluted loss per share:

Loss before extraordinary gain	\$ (.12)	\$ (.68)	\$ (.59)
Extraordinary gain	-	.05	-
Net loss	\$ (.12)	\$ (.63)	\$ (.59)

See accompanying notes to consolidated financial statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
September 30, 2006 and 2005

ASSETS	2006	2005
Current Assets:		
Cash and cash equivalents	\$ 5,639,334	\$ 5,818,178
Marketable securities	126,697	121,830
Accounts receivable (less allowance of \$1,325,000 in 2006 and \$1,297,000 in 2005)	11,269,529	10,125,967
Inventories:		
Parts, components, and materials	2,809,152	2,277,415
Work-in-process	2,347,354	2,782,761
Finished products	6,812,732	5,406,593
Prepaid expenses and other current assets	484,713	419,942
Total current assets	29,489,511	26,952,686
Property, plant and equipment:		
Land	1,235,950	1,217,450
Buildings and improvements	5,844,093	5,730,548
Machinery, equipment, and vehicles	5,970,168	5,942,803

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	13,050,211	12,890,801
Less accumulated depreciation and amortization	6,821,126	6,274,975
	-----	-----
	6,229,085	6,615,826
Other assets	236,521	623,393
	-----	-----
Total assets	\$35,955,117	\$34,191,905
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:

Current maturities of long-term debt	\$ 331,830	\$ 409,343
Accounts payable	4,162,263	2,462,671
Accrued compensation and employee benefits	2,427,525	2,353,849
Accrued expenses	1,429,566	1,403,734
Unearned revenue	806,142	566,065
Income taxes payable	151,323	44,306
	-----	-----
Total current liabilities	9,308,649	7,239,968
Long-term debt	1,740,335	2,061,825
Unearned revenue	457,474	582,679
Other long-term liabilities	429,818	328,953
Commitments and contingencies - Note 11		
Shareholders' equity:		
Common stock, par value \$.01 per share		
authorized - 25,000,000 shares		
issued - 4,860,901 and 4,857,401 shares	48,609	48,574
Capital in excess of par value	22,562,126	22,391,815
Retained earnings	1,734,490	2,281,045
	-----	-----
	24,345,225	24,721,434
Treasury stock at cost, 287,817 shares		
in 2006 and 2005	(1,299,999)	(1,299,999)
Accumulated other comprehensive income	973,615	557,045
	-----	-----
Total shareholders' equity	24,018,841	23,978,480
	-----	-----
Total liabilities and shareholders' equity	\$35,955,117	\$34,191,905
	=====	=====

See accompanying notes to consolidated financial statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Fiscal Years Ended September 30, 2006, 2005, and 2004

	Common	Capital in	Retained	Treasury
Shares	Stock	excess of	earnings	Stock
-----	-----	-----	-----	-----

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Balance September 30, 2003	4,832,576	\$48,326	\$22,218,644	\$ 7,856,260	\$(980,199)
Comprehensive income (loss):					
Net loss	-	-	-	(2,690,594)	-
Foreign currency translation adjustment	-	-	-	-	-
Unrealized gain on derivatives	-	-	-	-	-
Unrealized loss on marketable securities	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	-	-
Repurchases of common stock (64,400 shares)	-	-	-	-	(298,685)
Exercise of stock options	16,470	164	38,359	-	-
Stock-based compensation	-	-	27,104	-	-
Deferred compensation amortization	-	-	76,727	-	-
	-----	-----	-----	-----	-----
Balance September 30, 2004	4,849,046	48,490	22,360,834	5,165,666	(1,278,884)
Comprehensive income (loss):					
Net loss	-	-	-	(2,884,621)	-
Foreign currency translation adjustment	-	-	-	-	-
Unrealized gain on derivatives	-	-	-	-	-
Change in unrealized loss on marketable securities	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	-	-
Repurchases of common stock (4,500 shares)	-	-	-	-	(21,115)
Exercise of stock options	8,355	84	22,096	-	-
Stock-based compensation	-	-	(67,718)	-	-
Deferred compensation amortization	-	-	76,603	-	-
	-----	-----	-----	-----	-----
Balance September 30, 2005	4,857,401	48,574	22,391,815	2,281,045	(1,299,999)
Comprehensive income (loss):					
Net loss	-	-	-	(546,555)	-
Foreign currency translation adjustment	-	-	-	-	-
Unrealized loss on derivatives	-	-	-	-	-
Change in unrealized loss on marketable securities	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	-	-
Exercise of stock options	3,500	35	7,665	-	-
Stock-based compensation	-	-	152,413	-	-
Deferred compensation amortization	-	-	10,233	-	-
	-----	-----	-----	-----	-----
Balance September 30, 2006	4,860,901	\$48,609	\$22,562,126	\$ 1,734,490	\$(1,299,999)
	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

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	2006 ----	2005 ----	2004 ----
Cash flows from operating activities:			
Net loss	\$ (546,555)	\$ (2,884,621)	\$ (2,690,594)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	973,535	999,942	1,046,553
Amortization of deferred compensation	10,233	76,603	76,727
Stock compensation expense	152,413	(67,718)	27,104
Extraordinary gain on acquisition	-	(210,968)	-
Loss on sale of marketable securities	-	44,936	-
Change in assets and liabilities:			
Accounts receivable, net	(871,872)	133,959	1,728,523
Inventories	(1,357,802)	2,605,961	(470,812)
Recoverable income taxes	-	239,402	1,813,260
Prepaid expenses and other current assets	(52,070)	(36,549)	325,889
Other assets	390,364	6,434	(98,919)
Accounts payable	1,641,824	(847,762)	688,172
Accrued compensation and employee benefits	57,959	277,966	4,462
Accrued expenses	13,761	(137,935)	(900,647)
Unearned revenue	114,872	(48,048)	(595,074)
Income taxes payable	102,964	(299,358)	233,309
Other liabilities	92,774	(366,684)	254,731
Net cash provided by (used in) operating activities	----- 722,400	----- (514,440)	----- 1,442,684
Cash flows from investing activities:			
Capital expenditures	(510,375)	(556,643)	(730,102)
Acquisition, net of cash acquired	-	(868,000)	-
Net decrease (increase) in marketable securities	(5,492)	1,998,458	1,165,053
Net cash provided by (used in) investing activities	----- (515,867)	----- 573,815	----- 434,951
Cash flows from financing activities:			
Repayments of long-term debt	(403,419)	(286,470)	(324,639)
Proceeds from exercise of stock options	7,700	22,180	38,523
Repurchases of common stock	-	(21,115)	(298,685)
Net cash used in financing activities	----- (395,719)	----- (285,405)	----- (584,801)
Effect of exchange rate changes on cash	10,342	(18,990)	(65,784)
Net increase (decrease) in cash	(178,844)	(245,020)	1,227,050
Cash at beginning of year	5,818,178	6,063,198	4,836,148
Cash at end of year	=====	=====	=====
Cash at end of year	\$ 5,639,334	\$ 5,818,178	\$ 6,063,198
Cash paid during the fiscal year for:			
Income taxes	\$ 35,802	\$ 345,396	\$ 309,780
Interest	\$ 169,356	\$ 176,435	\$ 233,898

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See accompanying notes to consolidated financial statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Fiscal Years ended September 30, 2006, 2005, and 2004

NOTE 1. Summary of Significant Accounting Policies

Nature of Business

The Company designs, manufactures, assembles and markets video systems and system components for use in security, surveillance, safety and control purposes by end users. The Company markets its products worldwide primarily to installing dealers, systems integrators, government entities and distributors.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Vicon Industries, Inc. (the Company) and its wholly owned subsidiaries: Vicon Industries Limited and subsidiary (Videotronic Infosystems GmbH) and TeleSite U.S.A., Inc. and subsidiary (Vicon Systems Ltd.), after elimination of intercompany accounts and transactions.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility of the resulting receivable is reasonably assured. As it relates to product sales, revenue is generally recognized when products are sold and title is passed to the customer. Shipping and handling costs are included in cost of sales. Advance service billings under a national supply contract with one customer are deferred and recognized as revenues on a pro rata basis over the term of the service agreement. The Company evaluates multiple-element revenue arrangements for separate units of accounting, and follows appropriate revenue recognition policies for each separate unit. Elements are considered separate units of accounting provided that (i) the delivered item has stand-alone value to the customer, (ii) there is objective and reliable evidence of the fair value of the delivered item, and (iii) if a general right of return exists relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially within the control of the Company. As applied to the Company, under arrangements involving the sale of product and the provision of services, product sales are recognized as revenue when the products are sold and title is passed to the customer, and service revenue is recognized as services are performed. For products that include more than incidental software, and for separate licenses of the Company's software products, the Company recognizes revenue in accordance with the provisions of Statement of Position 97-2, "Software Revenue Recognition", as amended.

Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit and amounts invested in highly liquid money market funds.

Marketable Securities

Marketable securities consist of mutual fund investments in U.S. government debt securities. Such securities are stated at market value and are classified as available-for-sale under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 115, with unrealized gains and losses reported in other comprehensive income as a component of shareholders' equity. The cost of such securities was \$129,373 and \$123,881 at September 30, 2006 and 2005, respectively, with \$2,676 and \$2,051 of unrealized losses included in the carrying amounts at September 30, 2006 and 2005, respectively.

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Allowances for Doubtful Accounts

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories are valued at the lower of cost (on a moving average basis which approximates a first-in, first-out method) or market. When it is determined that a product or product line will be sold below carrying cost, affected on hand inventories are written down to their estimated net realizable values.

Long-Lived Assets

Property, plant, and equipment are recorded at cost. Depreciation and amortization of assets under capital leases, is computed by the straight-line method over the estimated useful lives of the related assets. Machinery, equipment and vehicles are being depreciated over periods ranging from 2 to 10 years. The Company's buildings are being depreciated over periods ranging from 25 to 40 years and leasehold improvements are amortized over the lesser of their estimated useful lives or the remaining lease term. Fully depreciated fixed assets are retired from the balance sheet when they are no longer in use.

The Company reviews its long-lived assets for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If the sum of the expected cash flows, undiscounted and without interest, is less than the carrying amount of the asset, an impairment loss is recognized as the amount by which the carrying amount of the asset exceeds its fair value.

Engineering and Development

Product engineering and development costs are charged to expense as incurred, and amounted to approximately \$4,500,000, \$4,800,000 and \$4,900,000 in fiscal

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2006, 2005, and 2004, respectively.

Earnings (Loss) Per Share

Basic EPS is computed based on the weighted average number of common shares outstanding. Diluted EPS reflects the maximum dilution that would have resulted from the exercise of stock options, warrants and incremental shares issuable under a deferred compensation agreement (see Note 10). In periods when losses are incurred, the effects of these securities are antidilutive and, therefore, are excluded from the computation of diluted EPS.

Foreign Currency Translation

The Company translates the financial statements of its foreign subsidiaries by applying the current rate method under which assets and liabilities are translated at the exchange rate on the balance sheet date, while revenues, costs, and expenses are translated at the average exchange rate for the reporting period. The resulting cumulative translation adjustment of \$998,000 and \$573,000 at September 30, 2006 and 2005, respectively, is recorded as a component of shareholders' equity in accumulated other comprehensive income (loss).

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Income Taxes

The Company accounts for income taxes under the provisions of SFAS No. 109, "Accounting for Income Taxes", which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred U.S. income taxes are not provided on undistributed earnings of foreign subsidiaries as the Company presently intends to reinvest such earnings indefinitely, and any plan to repatriate any of such earnings in the future is not expected to result in a material incremental tax liability to the Company. In fiscal 2006 and 2005, the Company recognized a valuation allowance against its entire net deferred tax asset balance due to the uncertainty of future realization (see Note 4 for further discussion).

Product Warranties

The Company provides for the estimated cost of product warranties at the time revenue is recognized (see Note 3). While the Company engages in product quality programs and processes, including monitoring and evaluating the quality of its component suppliers, its warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from its estimates, revisions to the estimated warranty liability may be required.

Derivative Instruments

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities",

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establishes accounting and reporting standards for derivative instruments as either assets or liabilities in the statement of financial position based on their fair values. Changes in the fair values are required to be reported in earnings or other comprehensive income depending on the use of the derivative and whether it qualifies for hedge accounting. Derivative instruments are designated and accounted for as either a hedge of a recognized asset or liability (fair value hedge) or a hedge of a forecasted transaction (cash flow hedge). For derivatives designated as effective cash flow hedges, changes in fair values are recognized in other comprehensive income. Changes in fair values related to fair value hedges as well as the ineffective portion of cash flow hedges are recognized in earnings.

The Company does not use derivative instruments for speculative or trading purposes. Derivative instruments are primarily used to manage exposures related to transactions with the Company's Europe and Israel based subsidiaries and interest rate risk on certain variable rate bank indebtedness. To accomplish this, the Company uses certain contracts, primarily foreign currency forward contracts ("forwards") and interest rate swaps, which minimize cash flow risks from changes in foreign currency exchange rates and interest rates, respectively. These derivatives have been designated as cash flow hedges for accounting purposes.

As of September 30, 2006, the Company had an interest rate swap and currency forwards outstanding with notional amounts aggregating \$1.4 million and \$800,000, respectively, whose aggregate fair value was a liability of approximately \$22,000. The change in the fair value of these derivatives is reflected in other comprehensive income in the accompanying statement of shareholders' equity, net of tax where applicable. The forwards have maturities of less than one year and require the Company to exchange currencies at specified dates and rates. The interest rate swap matures in the same amounts and over the same periods as the related debt. The Company considers the credit risk related to the interest rate swaps and the forwards to be low because such instruments are entered into with financial institutions having high credit ratings and are generally settled on a net basis. There were no gains or losses recognized in operations due to hedge ineffectiveness during the three-year period ended September 30, 2006. The Company does not expect that the amounts currently classified in accumulated other comprehensive income that will be recognized in operations in the next fiscal year will be material.

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Fair Value of Financial Instruments

The carrying amounts for trade accounts and other receivables, accounts payable and accrued expenses approximate fair value due to the short-term maturity of these instruments. The carrying amounts of the Company's long-term debt instruments approximate fair value. The Company's interest rate swap agreement is carried at its fair market value (which was a liability of approximately \$20,000 at September 30, 2006). This value represents the estimated amount the Company would need to pay if such agreement was terminated before maturity, principally resulting from market interest rate decreases. The fair value of the Company's foreign currency forward exchange contracts is estimated by obtaining quoted market prices. The contracted exchange rates on committed forward exchange contracts was approximately \$2,000 less favorable than the market rates for similar term contracts at September 30, 2006.

Fair value estimates are made at a specific point in time based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in

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assumptions could significantly affect the estimates.

Accounting for Stock-Based Compensation

Prior to October 1, 2005, the Company followed Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations in accounting for its employee stock-based compensation. Under APB No. 25, compensation expense was recorded if, on the date of grant, the market price of the underlying stock exceeded its exercise price. As permitted by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure - An Amendment of FASB Statement No. 123" ("SFAS No. 148"), the Company had retained the accounting prescribed by APB No. 25 and presented the disclosure information prescribed by SFAS No. 123 and SFAS No. 148.

Had compensation expense for stock option grants issued been determined under the fair value method of SFAS No. 123, the Company's net loss and loss per share (EPS) for the fiscal years ended September 30, 2005 and 2004 would have been:

	2005	2004
	-----	-----
Reported net loss	\$ (2,884,621)	\$ (2,690,594)
Stock-based compensation cost, net of tax	(194,935)	(227,113)
	-----	-----
Pro forma net loss	\$ (3,079,556)	\$ (2,917,707)
	=====	=====
Reported basic and diluted EPS	\$ (.63)	\$ (.59)
Pro forma basic and diluted EPS	\$ (.67)	\$ (.63)

Effective October 1, 2005, the Company adopted SFAS No. 123(R), "Share-Based Payment", which requires that all share based payments to employees, including stock options, be recognized as compensation expense in the consolidated financial statements based on their fair values and over the requisite service period. For the year ended September 30, 2006, the Company recorded non-cash compensation expense of \$152,413 (\$.03 per basic and diluted share) relating to stock options. The Company elected to utilize the modified-prospective application method, whereby compensation expense is recorded for all awards granted after October 1, 2005 and for the unvested portion of awards granted prior to this date. Accordingly, prior period amounts have not been restated. The adoption of SFAS No. 123(R) resulted in an immaterial cumulative change in accounting as of the date of adoption.

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The fair value for options granted during the fiscal years ended September 30, 2006, 2005 and 2004 was determined at the date of grant using a Black-Scholes valuation model and the straight-line attribution approach using the following weighted average assumptions:

2006	2005	2004
----	----	----

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Risk-free interest rate	4.4%	3.8%	3.5%
Dividend yield	0.0%	0.0%	0.0%
Volatility factor	75.9%	62.2%	67.9%
Weighted average expected life	5 years	4 years	4 years

The risk-free interest rate used in the Black-Scholes valuation method is based on the implied yield currently available in U.S. Treasury securities at maturity with an equivalent term. The Company has not recently declared or paid any dividends and does not currently expect to do so in the future. Expected volatility is based on the annualized daily historical volatility of the Company's stock over a representative period. The weighted-average expected life represents the period over which stock-based awards are expected to be outstanding and was determined based on a number of factors, including historical weighted average and projected holding periods for the remaining unexercised shares, the contractual terms of the Company's stock-based awards, vesting schedules and expectations of future employee behavior.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to, provisions for doubtful accounts receivable, net realizable value of inventory, warranty obligations, deferred tax valuation and assessments of the recoverability of the Company's long-lived assets. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

NOTE 2. Short-Term Borrowings

The Company's European based subsidiary maintains a bank overdraft facility that provides for maximum borrowings of one million Pounds Sterling (\$1,870,000) and is secured by all the assets of the subsidiary. This facility expires in March 2007. During fiscal 2006 and 2005, there were no outstanding borrowings under this facility.

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NOTE 3. Accrued Warranty Obligation

The Company recognizes the estimated cost associated with its standard warranty

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on products at the time of sale. The estimate is based on historical warranty claim cost experience. The following is a summary of the changes in the Company's accrued warranty obligation (which is included in accrued expenses) for the years ended September 30, 2006 and 2005:

Balance as of September 30, 2004	\$ 541,000
Deduct: Expenditures	(302,000)
Add: Provision	213,000

Balance as of September 30, 2005	\$ 452,000
Deduct: Expenditures	(268,000)
Add: Provision	218,000

Balance as of September 30, 2006	\$ 402,000
	=====

NOTE 4. Income Taxes

The components of income tax expense for the fiscal years indicated are as follows:

	2006 ----	2005 ----	2004 ----
Federal:			
Current	\$ -	\$ -	\$ -
Deferred	-	-	-
	-----	-----	-----
	-	-	-
State	-	8,805	12,015
Foreign	150,000	18,195	468,985
	-----	-----	-----
Total income tax expense	\$ 150,000	\$ 27,000	\$ 481,000
	=====	=====	=====

A reconciliation of the U.S. statutory tax rate to the Company's effective tax rate follows:

	2006 ----		2005 ----		2004 ----	
	Amount	Percent	Amount	Percent	Amount	Percent
U.S. statutory tax	(135,000)	(34.0)%	\$ (972,000)	(34.0)%	\$ (751,000)	(34.0)%
Increase in valuation allowance	423,000	106.5	1,019,000	35.6	1,408,000	63.7
Unrecognized prior year foreign operating losses	(121,000)	(30.6)	-	-	-	-
Foreign tax rate difference	42,000	10.6	-	-	-	-
Permanent differences	(41,000)	(10.2)	-	-	-	-
State tax, net of federal benefit	-	-	6,000	0.2	8,000	0.4
Dissolution of subsidiary	-	-	-	-	(192,000)	(8.7)

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Other	(18,000)	(4.5)	(26,000)	(0.9)	8,000	0.4
	-----	-----	-----	-----	-----	-----
Effective Tax Rate	\$ 150,000	37.8%	\$ 27,000	0.9%	\$ 481,000	21.8%
	=====	=====	=====	=====	=====	=====

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The tax effects of temporary differences that give rise to deferred tax assets and liabilities at September 30, 2006 and 2005 are presented below:

	2006	2005
	----	----
Deferred tax assets:		
Inventories	\$ 619,000	\$ 797,000
Accrued compensation	666,000	488,000
Warranty accrual	147,000	166,000
Depreciation	394,000	240,000
Allowance for doubtful accounts receivable	421,000	414,000
Unearned revenue	378,000	268,000
U.S. net operating loss carryforwards	2,372,000	2,621,000
Foreign net operating loss carryforwards	300,000	-
U.S. capital loss carryforward	17,000	-
Unrealized loss on derivatives	8,000	5,000
Other	1,000	1,000
	-----	-----
Gross deferred tax assets	5,323,000	5,000,000
Deferred tax liabilities:		
Other	37,000	137,000
	-----	-----
Gross deferred tax liabilities	37,000	137,000
	-----	-----
Total deferred tax assets and liabilities	\$ 5,286,000	\$ 4,863,000
Less valuation allowance	(5,286,000)	(4,863,000)
	-----	-----
Net deferred tax assets and liabilities	\$ -	\$ -
	=====	=====

The Company maintains a valuation allowance against its deferred tax assets due to the uncertainty of future realization. The establishment of such valuation allowance in 2003 was determined to be appropriate due to recent operating losses and the inherent uncertainties of predicting future operating results in periods over which such net tax differences become deductible. Deferred U.S. income taxes are not provided on undistributed earnings of foreign subsidiaries as the Company presently intends to reinvest such earnings indefinitely, and any plan to repatriate any of such earnings in the future is not expected to result in a material incremental tax liability to the Company.

The Company has approximately \$6.9 million of U.S. federal income tax loss carryforwards that expire in 2023 through 2026.

Pretax domestic loss amounted to approximately \$(189,000), \$(2,767,000) and \$(3,856,000) in fiscal years 2006, 2005 and 2004, respectively. Pretax foreign

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income (loss) amounted to approximately \$(208,000), \$(91,000) and \$1,646,000 in fiscal years 2006, 2005 and 2004, respectively.

NOTE 5. Long-Term Debt

Long-term debt is comprised of the following at September 30, 2006 and 2005:

	2006 ----	2005 ----
U.S. bank mortgage loans	\$2,010,201	\$2,266,867
U.K. bank term loan	54,540	140,124
Other	7,424	64,177
	-----	-----
	2,072,165	2,471,168
Less current maturities	331,830	409,343
	-----	-----
	\$1,740,335	\$2,061,825
	=====	=====

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In January 1998, the Company entered into an aggregate \$2.9 million mortgage and term loan agreement with a bank to finance the purchase of its principal operating facility. Such agreement included a \$2,512,000 ten-year mortgage loan payable in monthly installments through January 2008, with a \$1,188,000 payment due at the end of the term. The mortgage loan bears interest at the bank's prime rate minus 1.35% (6.90% and 5.40% at September 30, 2006 and 2005, respectively) and is secured by all the assets of the Company. At the same time, the Company entered into interest rate swap agreements with the same bank at the time to effectively convert the foregoing floating rate long-term loans to fixed rate loans. Subsequently, such bank sold its local operations, including the Company's loans, to another bank while retaining the Company's interest rate swap agreements. These agreements effectively fixed the Company's interest rate on its \$2,512,000 mortgage loan at 7.79%. The interest rate swap agreement matures in the same amounts and over the same periods as the related mortgage loan.

In October 1999, the Company entered into a \$1.2 million mortgage loan agreement with its bank to finance the expansion of its principal operating facility. The loan is payable in equal monthly principal installments through January 2008, with a \$460,000 payment due at the end of the term. The loan bears interest at the bank's prime rate minus 160 basis points (6.65% and 5.15% at September 30, 2006 and 2005, respectively) or, at the Company's option, LIBOR plus 100 basis points (6.37% and 5.06% at September 30, 2006 and 2005, respectively).

In April 1997, the Company's Europe based subsidiary entered into a ten-year 500,000 pound sterling (approximately \$935,000) bank term loan. The term loan is payable in equal monthly installments with interest at a fixed rate of 9%. The loan is secured by a first mortgage on the subsidiary's property and contains restrictive covenants that, among other things, require the subsidiary to maintain certain levels of net worth, earnings and debt service coverage.

Current and long-term debt maturing in each of the fiscal years subsequent to September 30, 2006 approximates \$332,000 in 2007 and \$1,740,000 in 2008.

NOTE 6. Other Comprehensive Income

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 The accumulated other comprehensive income balances at September 30, 2006 and 2005 consisted of the following:

	2006	2005
	-----	-----
Foreign currency translation adjustment	\$ 998,132	\$ 572,846
Unrealized loss on derivatives	(21,841)	(13,750)
Unrealized loss on securities	(2,676)	(2,051)
	-----	-----
Accumulated other comprehensive income	\$ 973,615	\$ 557,045
	=====	=====

NOTE 7. Segment and Geographic Information

The Company operates in one business segment which encompasses the design, manufacture, assembly and marketing of video systems and system components for the electronic protection segment of the security industry. Its U.S. based operations consist of Vicon Industries, Inc., the Company's corporate headquarters and principal operating entity. Its Europe-based operations consist of Vicon Industries Limited and its Videotronic subsidiary, which market and distribute the Company's products principally within Europe and the Middle East.

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Net sales and long-lived assets related to operations in the United States and other foreign countries for the fiscal years ended September 30, 2006, 2005, and 2004 are as follows:

	2006	2005	2004
	----	----	----
Net sales			
U.S.	\$35,358,000	\$36,035,000	\$36,530,000
Foreign	20,921,000	20,021,000	17,003,000
	-----	-----	-----
Total	\$56,279,000	\$56,056,000	\$53,533,000
Long-lived assets			
U.S.	\$ 4,518,000	\$ 4,710,000	\$ 5,059,000
Foreign	1,711,000	1,906,000	2,031,000
	-----	-----	-----
Total	\$ 6,229,000	\$ 6,616,000	\$ 7,090,000

U.S. sales include \$5,040,000, \$6,969,000 and \$5,310,000 for export in fiscal years 2006, 2005, and 2004, respectively. Foreign sales principally represent sales from the Company's Europe based subsidiaries.

NOTE 8. Stock Option Plans

The Company maintains stock option plans which include both incentive and non-qualified options covering a total of 616,881 shares of common stock reserved for issuance to key employees, including officers and directors, as of September 30, 2006. All options are issued at fair market value at the grant

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date and are exercisable in varying installments according to the plans. The plans allow for the payment of option exercises through the surrender of previously owned mature shares based on the fair market value of such shares at the date of surrender. There were 73,933 shares available for grant at September 30, 2006.

Changes in outstanding stock options for the three years ended September 30, 2006 are as follows:

	Number of Options -----	Weighted Average Exercise Price -----	Weighted Average Remaining Contractual Term (in years) -----	Aggregate Intrinsic Value -----
Balance at September 30, 2003	562,537	\$3.34		
Options granted	35,000	\$5.40		
Options exercised	(16,470)	\$2.34		
Options forfeited	(25,747)	\$3.33		

Balance at September 30, 2004	555,320	\$3.50		
Options granted	86,000	\$3.00		
Options exercised	(8,355)	\$2.65		
Options forfeited	(50,224)	\$4.58		

Balance at September 30, 2005	582,741	\$3.35		
Options granted	39,975	\$3.17		
Options exercised	(3,500)	\$2.20		
Options forfeited	(73,933)	\$3.79		

Balance at September 30, 2006	545,283	\$3.28	2.6	\$150,544
Exercisable at September 30, 2006	332,927	\$3.32	2.0	\$100,387

The weighted-average grant date fair value of options granted during the years ended September 30, 2006, 2005 and 2004 was \$2.05, \$1.52 and \$2.90, respectively. The total intrinsic value of options exercised during the years ended September 30, 2006, 2005 and 2004 was \$3,150, \$12,475 and \$50,265, respectively.

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A summary of the status of the Company's nonvested shares as of September 30, 2006 and changes during the year is as follows:

Nonvested Shares -----	Shares -----	Weighted-Average Grant-Date Fair Value -----
Nonvested at October 1, 2005	294,253	\$1.79
Granted	39,975	\$2.05
Vested	(88,372)	\$1.79
Forfeited	(33,500)	\$2.40

Nonvested at September 30, 2006	212,356	\$1.74

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As of September 30, 2006, there was \$205,678 of total unrecognized compensation cost, net of estimated forfeitures, related to nonvested share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 1.1 years. The total fair value of shares vested during the years ended September 30, 2006, 2005 and 2004 was \$158,299, \$252,062 and \$178,965, respectively.

NOTE 9. Shareholder Rights Plan

On November 14, 2001, the Company's Board of Directors adopted a Shareholder Rights Plan, which declared a dividend of one Common Stock Purchase Right (a Right) for each outstanding share of common stock of the Company to shareholders of record on December 21, 2001. Each Right entitles the holder to purchase from the Company one share of common stock at a purchase price of \$15 per share. In the event of the acquisition of or tender offer for 20% or more of the Company's outstanding common stock by certain persons or group without the Board of Directors' consent, such purchase price will be adjusted to equal fifty percent of the average market price of the Company's common stock for a period of thirty consecutive trading days immediately prior to the event. Until the Rights become exercisable, they have no dilutive effect on the Company's earnings per share.

The Rights, which are non-voting and exercisable until November 30, 2011, can be redeemed by the Company in whole at a price of \$.001 per Right at any time prior to the acquisition by certain persons or group of 50% of the Company's common stock. Separate certificates for the Rights will not be distributed, nor will the Rights be exercisable, until either (i) a person or group acquires beneficial ownership of 20% or more of the Company's common stock or (ii) the tenth day after the commencement of a tender or exchange offer for 20% or more of the Company's common stock. Following an acquisition of 20% or more of the Company's common shares, each Right holder, except for the 20% or more stockholder, can exercise their Right(s), unless the 20% or more stockholder has offered to acquire all of the outstanding shares of the Company under terms that a majority of the independent Directors of the Company have determined to be fair and in the best interest of the Company and its stockholders. On May 7, 2002, the Company's shareholders approved an amendment of the Company's Certificate of Incorporation to increase the total number of shares of common stock authorized to issue from 10,000,000 to 25,000,000 shares.

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NOTE 10. Earnings (Loss) Per Share

The following table provides the components of the basic and diluted loss per share (EPS) computations:

	2006 ----	2005 ----	2004 ----
Basic and Diluted EPS Computation			
Net loss	\$ (546,555)	\$ (2,884,621)	\$ (2,690,594)
Weighted average shares outstanding	4,571,905	4,566,621	4,597,961
Basic and diluted loss per share	\$ (.12) =====	\$ (.63) =====	\$ (.59) =====

In 2006, 2005 and 2004, 103,218, 148,645 and 238,717 shares, respectively, have

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been omitted from the calculation of diluted EPS as their effect would have been antidilutive.

NOTE 11. Commitments and Contingencies

The Company leases vehicles and occupies certain facilities under operating leases that expire at various dates through 2009. The leases, which cover periods from three to eight years, generally provide for renewal options at specified rental amounts. The aggregate operating lease commitment at September 30, 2006 was \$517,000 with minimum rentals for the fiscal years shown as follows: 2007 - \$379,000; 2008 - \$119,000; and 2009 - \$19,000.

The Company is a party to employment agreements with certain of its officers that provide for, among other things, the payment of compensation if there is a change in control without Board of Director approval (as defined in the agreements). The contingent liability under such change in control provisions at September 30, 2006 was approximately \$2.0 million. Certain of the Company's employment agreements with its officers provide for a severance benefit upon certain occurrences or at a specified date of retirement, absent a change in control, aggregating \$2.1 million at September 30, 2006. The Company is amortizing such obligation to expense on the straight-line method through the specified dates of retirement. Such expense amounted to approximately \$93,000 and \$289,000 in fiscal 2006 and 2005, respectively.

The Company has agreements with certain of its officers to provide a deferred compensation benefit in the form of 103,898 shares of common stock currently held by the Company in treasury. Such shares vest upon retirement or, in the case of 70,647 shares, the expiration of one officer's employment agreement in September 2006. All shares vest earlier under certain occurrences including death, involuntary termination or a change in control of the Company. The market value of such shares approximated \$630,000 at the dates of grant, which is being amortized on the straight-line method through the specified dates of retirement or over the term of the employment agreement.

NOTE 12. Litigation

The Company is one of several defendants in a patent infringement suit commenced by Lectrolarm Custom Systems, Inc. in May 2003 in the United States District Court for the Western District of Tennessee. The alleged infringement by the Company relates to its camera dome systems and other products that represent significant sales to the Company. Among other things, the suit seeks past and enhanced damages, injunctive relief and attorney's fees. In January 2006, the Company received the plaintiff's claim for past damages through December 31, 2005 that approximated \$11.7 million plus pre-judgment interest. The Company and its outside patent counsel believe that the complaint against the Company is without merit. The Company is vigorously defending itself and is a party to a joint defense with certain other named defendants. The Company is unable to reasonably estimate a range of possible loss, if any, at this time. Although the Company believes that it has meritorious defenses to such claims, there is a possibility that an unfavorable outcome could ultimately occur that could result in a liability that is material to the Company's results of operations and financial position. The Company has held discussions with the plaintiff in the interest of settling the case. However, there can be no assurance that any settlement can be reached.

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In connection with this suit, the Company petitioned the U.S. Patent and Trademark Office (USPTO) for reexamination of the plaintiff's patent. In April

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2006, the USPTO issued a non-final office action rejecting all of the plaintiff's patent claims asserted against the Company citing the existence of prior art of the Company and another defendant. The plaintiff has appealed the USPTO ruling and has additional appeals available to them in the USPTO and, thereafter, in the Court of Appeals for the Federal Circuit. On June 30, 2006, the Federal District Court granted the defendants' motion for continuance (delay) of the trial, pending the outcome of the USPTO's reexamination office proceedings.

In the normal course of business, the Company is a party to certain other claims and litigation. Management believes that the settlement of such claims and litigation, considered in the aggregate, will not have a material adverse effect on the Company's financial position and results of operations.

NOTE 13. Related Party Transactions

As of September 30, 2006, CBC Co., Ltd. and affiliates ("CBC") owned approximately 11.9% of the Company's outstanding common stock. The Company, which has been conducting business with CBC for approximately twenty-seven years, imports certain finished products and components through CBC and also sells its products to CBC. The Company purchased approximately \$404,000, \$566,000 and \$651,000 of products and components from CBC in fiscal years 2006, 2005, and 2004, respectively, and the Company sold \$205,000, \$362,000 and \$712,000 of products to CBC for distribution in fiscal years 2006, 2005, and 2004, respectively. At September 30, 2006 and 2005, the Company owed \$11,000 and \$37,000, respectively, to CBC and CBC owed \$5,000 and \$32,000, respectively, to the Company resulting from purchases of products.

Note 14: Asset Purchase

On October 1, 2004, the Company entered into an agreement to purchase all of the operating assets of Videotronic Infosystems GmbH ("Videotronic"), a Germany based video system supplier which was operating under insolvency protection, for 700,000 Eurodollars (approximately \$868,000). The purchase was ratified by Videotronic's Creditors on November 26, 2004. During the year ended September 30, 2005, the Company recognized a \$211,000 extraordinary gain on the recovery of Videotronic net assets in excess of their allocated purchase price. Such gain includes adjustments to assigned values of accounts receivable, inventories, trade payables and severance liabilities. Pro forma results of operations have not been presented due to the relative insignificance of the operating assets acquired.

Note 15: Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes -- an interpretation of FASB Statement No. 109". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 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. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that the adoption of FIN 48 will have a material impact on its consolidated financial position, results of operations or cash flows.

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 clarifies that fair value is the amount that would be exchanged to sell an asset or transfer a liability in an orderly transaction between market participants. Further, the standard establishes a framework for measuring fair value in generally accepted accounting principles and expands certain disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect that the adoption of SFAS 157 will have a material impact on its consolidated financial position, results of operations or cash flows.

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In September 2006, the U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years beginning after November 15, 2006. The Company does not expect that the adoption of SAB 108 will have a material impact on its consolidated financial position, results of operations or cash flows.

NOTE 16. Quarterly Financial Data (unaudited)

Quarter Ended	Net Sales	Gross Profit	Net Income (Loss)	Earnings (Loss) Per Share	
				Basic	Diluted
Fiscal 2006					
December	\$14,259,000	\$5,636,000	\$ 147,000	\$.03	\$.03
March	12,223,000	4,578,000	(848,000)	(.19)	(.19)
June	14,675,000	5,914,000	37,000	.01	.01
September	15,122,000	5,966,000	117,000	.03	.03
Total	\$56,279,000	\$22,094,000	\$ (547,000)	\$ (.12)	\$ (.12)
Fiscal 2005					
December	\$15,582,000	\$5,868,000	\$ (740,000)	\$ (.16)	\$ (.16)
March	12,802,000	4,708,000	(1,169,000)	(.26)	(.26)
June	13,991,000	5,319,000	(548,000)	(.12)	(.12)
September	13,681,000	5,101,000	(428,000)	(.09)	(.09)
Total	\$56,056,000	\$20,996,000	\$ (2,885,000)	\$ (.63)	\$ (.63)

The Company has not declared or paid cash dividends on its common stock for any of the foregoing periods.

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Because of changes in the number of common shares outstanding and market price fluctuations affecting outstanding stock options, the sum of quarterly earnings per share may not equal the earnings per share for the full year.

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SCHEDULE II

VICON INDUSTRIES, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

Years ended September 30, 2006, 2005, and 2004

Description -----	Balance at beginning of period -----	Charged to costs and expenses -----	Deductions -----	Balance at end of period -----
Allowance for uncollectible accounts:				
September 30, 2006	\$1,297,000 =====	\$ 48,000 =====	\$ 20,000 =====	\$1,325,000 =====
September 30, 2005	\$1,162,000 =====	\$198,000 =====	\$ 63,000 =====	\$1,297,000 =====
September 30, 2004	\$1,135,000 =====	\$192,000 =====	\$165,000 =====	\$1,162,000 =====

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SIGNATURES

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

VICON INDUSTRIES, INC.

By /s/ Kenneth M. Darby

Kenneth M. Darby
Chairman and
Chief Executive Officer

December 29, 2006

By /s/ John M. Badke

John M. Badke
Senior Vice President, Finance
and Chief Financial Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the dates indicated:

VICON INDUSTRIES, INC.

/s/ Kenneth M. Darby ----- Kenneth M. Darby	Chairman and CEO	December 29, 2006 ----- Date
/s/ Clifton H.W. Maloney ----- Clifton H.W. Maloney	Director	December 29, 2006 ----- Date
/s/ Peter F. Neumann ----- Peter F. Neumann	Director	December 29, 2006 ----- Date
/s/ W. Gregory Robertson ----- W. Gregory Robertson	Director	December 29, 2006 ----- Date
/s/ Arthur D. Roche ----- Arthur D. Roche	Director	December 29, 2006 ----- Date

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