VICON INDUSTRIES INC /NY/
Form 10-Q
February 13, 2007

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended December 31, 2006 Commission File No. 1-7939

Vicon Industries, Inc.

New York State 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

(Former name, address, and fiscal year, if changed since last report)

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

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

Large accelerated filer ___ Accelerated filer ___ Non-accelerated filer X

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

At December 31, 2006, the registrant had outstanding 4,660,711 shares of Common Stock, $.01 par value.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VICON INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended	
	12/31/06	12/31/05
Net sales	$17,883,234	$14,258,950
Cost of sales	10,681,773	8,622,831
Gross profit	7,201,461	5,636,119
Operating expenses:		
Selling, general and administrative expense	4,816,359	4,421,732
Engineering & development expense	1,239,261	1,061,116
	6,055,620	5,482,848
Operating income	1,145,841	153,271
Interest expense	38,790	42,794
Interest and other income	(111,156)	(41,719)
Income before income taxes	1,218,207	152,196
Income tax expense	103,000	5,000
Net income	$ 1,115,207	$ 147,196
Basic and diluted earnings per share	$ .24	$ .03

Shares used in computing earnings per share:

Basic	4,615,704	4,569,584
Diluted	4,711,015	4,663,330

See Accompanying Notes to Condensed Consolidated Financial Statements.

VICON INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	12/31/06	9/30/06
	(Unaudited)	
CURRENT ASSETS		
Cash and cash equivalents	$ 4,469,286	$ 5,639,334
Marketable securities	128,260	126,697
Accounts receivable, net	12,523,363	11,269,529
Inventories:		
Parts, components, and materials	2,767,980	2,809,152
Work-in-process	2,603,501	2,347,354
Finished products	7,291,182	6,812,732
	12,662,663	11,969,238
Prepaid expenses and other current assets	599,523	484,713
TOTAL CURRENT ASSETS	30,383,095	29,489,511
Property, plant and equipment	13,288,153	13,050,211
Less accumulated depreciation and amortization	(7,095,452)	(6,821,126)
	6,192,701	6,229,085
Other assets	149,292	236,521
TOTAL ASSETS	$36,725,088	$35,955,117
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term debt	$ 315,109	$ 331,830
Accounts payable	3,627,530	4,162,263
Accrued compensation and employee benefits	1,952,389	2,427,525
Accrued expenses	1,529,107	1,429,566
Unearned revenue	915,524	806,142
Income taxes payable	264,889	151,323
TOTAL CURRENT LIABILITIES	8,604,548	9,308,649
Long-term debt	1,671,494	1,740,335

Unearned revenue	422,065	457,474
Other long-term liabilities	523,279	429,818
SHAREHOLDERS' EQUITY		
Common stock, par value $.01	48,885	48,609
Additional paid in capital	22,211,567	22,562,126
Retained earnings	2,849,697	1,734,490
	25,110,149	24,345,225
Less treasury stock, at cost	(865,937)	(1,299,999)
Accumulated other comprehensive income	1,259,490	973,615
TOTAL SHAREHOLDERS' EQUITY	25,503,702	24,018,841
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$36,725,088	$35,955,117

See Accompanying Notes to Condensed Consolidated Financial Statements.

VICON INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended	
	12/31/06	12/31/05
Cash flows from operating activities:		
Net income	$ 1,115,207	$ 147,196
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	232,991	236,734
Amortization of deferred compensation	2,675	2,301
Stock compensation expense	45,129	21,838
Change in assets and liabilities:		
Accounts receivable, net	(982,138)	(23,034)
Inventories	(559,006)	(970,828)
Prepaid expenses and other current assets	(100,323)	(92,930)
Other assets	90,170	36,439
Accounts payable	(589,083)	1,136,819
Accrued compensation and employee benefits	(489,817)	33,176
Accrued expenses	85,958	38,598
Unearned revenue	73,972	(58,587)
Income taxes payable	102,855	5,049
Other liabilities	31,448	21,755
Net cash provided by (used in) operating activities	(939,962)	534,526
Cash flows from investing activities:		
Capital expenditures	(130,480)	(188,907)
Net increase in marketable securities	(1,502)	(1,289)

Net cash used in investing activities	(131,982)	(190,196)
Cash flows from financing activities:		
Repayments of long-term debt	(87,620)	(145,678)
Proceeds from exercise of stock options	35,975	-
Net cash used in financing activities	(51,645)	(145,678)
Effect of exchange rate changes on cash	(46,459)	(29,093)
Net increase (decrease) in cash	(1,170,048)	169,559
Cash at beginning of year	5,639,334	5,818,178
Cash at end of period	$ 4,469,286	$ 5,987,737

See Accompanying Notes to Condensed Consolidated Financial Statements.

VICON INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 31, 2006

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended December 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2006. Certain prior year amounts have been reclassified to conform to the current period presentation.

Note 2: 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 at December 31, 2006 was $130,876, with $2,616 of cumulative unrealized losses reported at December 31, 2006.

Note 3: Accounts Receivable

Accounts receivable is stated net of an allowance for uncollectible accounts of $1,030,000 and $1,325,000 as of December 31, 2006 and September 30, 2006, respectively.

Note 4: Earnings per Share

Basic earnings (loss) per share (EPS) is computed based on the weighted average number of common shares outstanding for the period. Diluted EPS reflects the maximum dilution that would have resulted from incremental common shares issuable upon the exercise of stock options and under deferred compensation agreements.

The following table provides the components of the basic and diluted EPS computations for the three month periods ended December 31, 2006 and 2005:

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005
Basic EPS Computation		
Net income.................................	$ 1,115,207	$ 147,196
Weighted average shares outstanding.........	4,615,704	4,569,584
Basic earnings per share....................	$ .24	$ .03

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005
Diluted EPS Computation		
Net income.................................	$ 1,115,207	$ 147,196
Weighted average shares outstanding.......	4,615,704	4,569,584
Stock options............................	47,389	18,258
Stock compensation arrangements...........	47,922	75,488
Diluted shares outstanding.................	4,711,015	4,663,330
Diluted earnings per share.................	$ .24	$ .03

The diluted weighted average shares outstanding do not include the antidilutive impact of 267,008 and 424,916 options for the three month periods ended December 31, 2006 and 2005, respectively, because the exercise price of the stock options exceeded the average market value of the stock in the periods presented.

Note 5: Comprehensive Income (Loss)

The Company's total comprehensive income (loss) for the three month periods ended December 31, 2006 and 2005 was as follows:

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005
Net income	$ 1,115,207	$ 147,196
Other comprehensive income (loss), net of tax:		
Decrease (increase) in unrealized loss on securities	60	(172)
Unrealized loss on derivatives	(62,013)	(14,503)
Foreign currency translation adjustment	347,828	(211,152)
Comprehensive income (loss)	$ 1,401,082	$ (78,631)

The accumulated other comprehensive income balances at December 31, 2006 and September 30, 2006 consisted of the following:

	December 31, 2006	September 30, 2006
Foreign currency translation adjustment	$1,345,960	$ 998,132
Unrealized loss on derivatives	(83,854)	(21,841)
Unrealized loss on securities	(2,616)	(2,676)
Accumulated other comprehensive income	$1,259,490	$ 973,615

Note 6: Derivative Instruments

At December 31, 2006, the Company had interest rate swaps and forward exchange contracts outstanding with notional amounts aggregating $1.4 million and $1.8 million, respectively, whose aggregate fair value was a liability of approximately $84,000. The change in the amount of the liability for these instruments is shown as a component of accumulated other comprehensive income.

-6-

Note 7: Stock-Based Compensation

The Company maintains stock option plans that include both incentive and non-qualified options reserved for issuance to key employees, including officers and directors. All options are issued at fair market value at the grant 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.

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.

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 three-month periods ended December 31, 2006 and 2005, the Company recorded non-cash compensation expense of $45,129 and $21,838, respectively, ($.01 and $.005 per basic and diluted share, respectively) 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 were not restated. The adoption of SFAS No. 123(R) resulted in an immaterial cumulative change in accounting as of the date of adoption.

Note 8: 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.

In January 2005, the Company petitioned the U.S. Patent and Trademark Office (USPTO) to reexamine the plaintiff's patent, believing it to be invalid. 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 it 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 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 9: 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.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Three Months Ended December 31, 2006 Compared with December 31, 2005

Net sales for the quarter ended December 31, 2006 increased 25% to $17.9 million compared with $14.3 million in the year ago period. Domestic sales increased 32% to $9.7 million compared with $7.4 million in the year ago period. International sales for the quarter increased 19% to $8.2 million compared with $6.9 million in the year ago period. The backlog of unfilled orders was $6.9 million at December 31, 2006 compared with $7.2 million at September 30, 2006.

Gross profit margins for the first quarter of fiscal 2007 increased to 40.3% compared with 39.5% in the year ago period due principally to the benefit of fixed production overhead on increased sales.

Total operating expenses for the first quarter of fiscal 2007 increased to $6.1 million compared with $5.5 million in the year ago quarter principally as a result of increases in sales related costs, engineering and development expense and profit related bonus provisions. In addition, the Company continued to invest in new product development in the current quarter, incurring $1.2 million of engineering and development expenses compared with $1.1 million in the year ago period.

The Company generated operating income of $1.1 million in the first quarter of fiscal 2007 compared with operating income of $153,000 in the year ago period.

Interest expense decreased to $39,000 for the first quarter of fiscal 2007 compared with $43,000 in the year ago period principally as a result of the paydown of bank borrowings offset, in part, by the effect of increased interest rates during the current quarter. Interest and other income increased to $111,000 for the first quarter of fiscal 2007 compared with $42,000 in the year ago period. The increase was principally the result of a $72,000 gain from life insurance proceeds on the death of a retired executive.

Income tax expense for the first quarter of fiscal 2007 increased to $103,000 compared with $5,000 in the year ago period relating principally to results reported by the Company's European operations. No U.S. tax provision was recognized in the current quarter as the Company is utilizing the benefit of previously reserved and unrecognized net operating loss carryforwards. The Company continues to provide a full valuation allowance against its deferred tax assets until such time that it can achieve a sustained level of profitability.

As a result of the foregoing, the Company reported net income of $1.1 million for the first quarter of fiscal 2007 compared with net income of $147,000 in the year ago period.

Liquidity and Capital Resources

Net cash used in operating activities was $940,000 for the first quarter of fiscal 2007. The $1.1 million of net income and $281,000 of non-cash charges for the quarter were fully offset by increases in accounts receivable and inventories of $982,000 and $559,000, respectively. Both inventories and accounts receivable increased as a result of higher sales. The Company further experienced decreases in accounts payable and accrued compensation of $589,000 and $490,000, respectively. Net cash used in investing activities was $132,000 for the first quarter of fiscal 2007 due principally to $130,000 of general capital expenditures. Net cash used in financing activities was $52,000, which consisted of $88,000 of scheduled repayments of bank mortgage loans, offset in part by $36,000 of proceeds received from exercise of stock options. As a result of the foregoing, cash decreased by $1.2 million for the first quarter of fiscal 2007 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 $1,960,000) to support its local working capital requirements. This facility expires in March 2007. At December 31, 2006 and September 30, 2006, there were no outstanding borrowings under this facility.

The following is a summary of the Company's long-term debt and material lease obligations as of December 31, 2006:

Payments Due By Period	Debt Repayments	Lease Commitments	Total
Less than 1 year	$ 315,000	$346,000	$ 661,000
1-3 years	1,672,000	87,000	1,759,000
3-5 years	-	-	-
Total	$1,987,000	$433,000	$2,420,000

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.

In January 2005, the Company petitioned the U.S. Patent and Trademark Office (USPTO) to reexamine the plaintiff's patent, believing it to be invalid. 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 it 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 proceedings.

Critical Accounting Policies

The Company's significant accounting policies are fully described in Note 1 to the Company's consolidated financial statements included in its September 30, 2006 Annual Report on Form 10-K. 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 equipment maintenance agreements are deferred and recognized as revenues on a pro rata basis over the term of the service agreements. The Company evaluates multiple-element revenue arrangements for separate units of accounting pursuant to EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables", 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 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.

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 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.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

Statements in this Report on Form 10-Q 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", "Liquidity and Capital Resources" and "Critical Accounting Policies" 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 update its forward-looking statements or to advise of changes in the assumptions and factors on which they are based.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

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 Note 6 "Derivative Instruments" to the accompanying condensed consolidated financial statements). The Company's ongoing foreign currency exchange risks include intercompany sales of product and services between subsidiary companies operating in differing functional currencies.

At December 31, 2006, the Company had $1.4 million of outstanding floating rate bank debt which was covered by an interest rate swap agreement that effectively converts the foregoing floating rate debt to a stated fixed rate (see "Note 5. Long-Term Debt" to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended September 30, 2006). Thus, the Company has substantially no net interest rate exposures on these instruments. However, the Company had approximately $568,000 of floating rate bank debt that is subject to interest rate risk as it was not covered by interest rate swap agreements. 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.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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.

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 quarter ended December 31, 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.

PART II - OTHER INFORMATION

ITEM 1 - 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.

In January 2005, the Company petitioned the U.S. Patent and Trademark Office (USPTO) to reexamine the plaintiff's patent, believing it to be invalid. 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 it 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 proceedings.

ITEM 1A - RISK FACTORS

There have been no material changes with respect to the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

ITEM 2 - CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

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 December 31, 2006.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5 - OTHER INFORMATION

None

ITEM 6 - EXHIBITS

31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	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.
32.2	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.

Signatures

Pursuant to the requirements of the Securities and 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.

February 13, 2007

/s/ Kenneth M. Darby	/s/ John M. Badke
---------------------	---------------------
Kenneth M. Darby	John M. Badke
Chairman and	Senior Vice President, Finance
Chief Executive Officer	Chief Financial Officer