

VICON INDUSTRIES INC /NY/

Form 10-Q

May 15, 2008

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

FORM 10-Q

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

For the quarterly period ended March 31, 2008

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

For the transition period from to

Commission File Number: 1-7939

VICON INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

NEW YORK
(State or other jurisdiction of
incorporation or organization)

11-2160665
(I.R.S. Employer
Identification No.)

89 Arkay Drive, Hauppauge, NEW YORK
(Address of principal executive offices)

11788
(Zip Code)

(631) 952-2288
(Registrant's telephone number, including area code)

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] No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting
company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [
] Yes [x] No

At May 13, 2008, the registrant had outstanding 4,752,019 shares of Common Stock, \$.01 par value.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended	
	3/31/08	3/31/07
Net Sales	\$ 15,335,168	\$ 16,891,998
Cost of Sales	8,538,718	9,743,660
Gross Profit	6,796,450	7,148,338
Operating expenses:		
Selling, general and administrative expense	4,950,571	4,989,225
Engineering & development expense	1,521,272	1,265,955
	6,471,843	6,255,180
Operating income	324,607	893,158
Interest expense	10,614	34,461
Interest and other income	(60,825)	(40,727)
Income before income taxes	374,818	899,424
Income tax expense	169,000	97,000
Net income	\$ 205,818	\$ 802,424
Earnings per share:		
Basic	\$.04	\$.17
Diluted	\$.04	\$.16

Shares used in computing earnings per share:

Basic	4,810,191	4,698,402
Diluted	4,998,260	4,945,012

See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Six Months Ended	
	3/31/08	3/31/07
Net Sales	\$ 30,978,709	\$ 34,775,232
Cost of Sales	17,254,896	20,425,433
Gross Profit	13,723,813	14,349,799
Operating expenses:		
Selling, general and administrative expense	9,967,994	9,805,584
Engineering & development expense	2,914,335	2,505,216
	12,882,329	12,310,800
Operating income	841,484	2,038,999
Interest expense	42,684	73,251
Interest and other income	(148,929)	(151,883)
Income before income taxes	947,729	2,117,631
Income tax expense	397,000	200,000
Net income	\$ 550,729	\$ 1,917,631
Earnings per share:		
Basic	\$.11	\$.41
Diluted	\$.11	\$.40
Shares used in computing earnings per share:		
Basic	4,805,964	4,656,599
Diluted	5,031,780	4,827,559

See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	3/31/08 (Unaudited)	9/30/07
CURRENT ASSETS		
Cash and cash equivalents	\$ 8,756,987	\$ 8,808,110
Marketable securities	229,567	229,668
Accounts receivable, net	10,789,675	12,995,595
Inventories:		
Parts, components, and materials	3,776,715	3,768,972
Work-in-process	2,554,707	2,274,661
Finished products	7,060,050	6,951,619
	13,391,472	12,995,252
Deferred income taxes	1,552,942	1,472,551
Prepaid expenses and other current assets	796,572	596,145
TOTAL CURRENT ASSETS	35,517,215	37,097,321
Property, plant and equipment	13,351,035	13,206,910
Less accumulated depreciation and amortization	(7,750,817)	(7,445,405)
	5,600,218	5,761,505
Deferred income taxes	1,875,748	2,058,177
Other assets	122,045	117,442
TOTAL ASSETS	\$ 43,115,226	\$ 45,034,445
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ -	\$ 1,740,335
Accounts payable	3,704,082	3,404,971
Accrued compensation and employee benefits	1,892,551	2,856,921
Accrued expenses	1,553,808	1,806,989
Unearned revenue	825,653	830,901
Income taxes payable	514,129	416,655
TOTAL CURRENT LIABILITIES	8,490,223	11,056,772
Unearned revenue	331,023	408,229
Other long-term liabilities	792,477	516,088
SHAREHOLDERS' EQUITY		
Common stock, par value \$.01	50,733	50,535
Additional paid in capital	22,978,830	22,874,285
Retained earnings	10,046,501	9,620,772
	33,076,064	32,545,592
Less treasury stock, at cost	(1,139,728)	(1,139,728)
Accumulated other comprehensive income	1,565,167	1,647,492
TOTAL SHAREHOLDERS' EQUITY	33,501,503	33,053,356

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 43,115,226	\$ 45,034,445
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See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended	
	3/31/08	3/31/07
Cash flows from operating activities:		
Net income	\$ 550,729	\$ 1,917,631
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	400,547	459,591
Amortization of deferred compensation	5,320	5,292
Stock compensation expense	40,155	89,974
Deferred income taxes	180,781	-
Change in assets and liabilities:		
Accounts receivable, net	2,069,039	950,277
Inventories	(476,337)	(2,122,276)
Prepaid expenses and other current assets	(211,000)	(126,208)
Other assets	(4,603)	74,534
Accounts payable	348,013	(832,561)
Accrued compensation and employee benefits	(952,295)	(234,625)
Accrued expenses	(184,453)	213,077
Unearned revenue	(82,454)	42,464
Income taxes payable	100,111	200,048
Other liabilities	51,389	56,721
Net cash provided by operating activities	1,834,942	693,939
Cash flows from investing activities:		
Capital expenditures	(276,181)	(174,115)
Net decrease (increase) in marketable securities	4,412	(3,053)
Net cash used in investing activities	(271,769)	(177,168)
Cash flows from financing activities:		
Repayments of debt	(1,740,335)	(180,015)
Proceeds from exercise of stock options	59,268	177,877
Net cash used in financing activities	(1,681,067)	(2,138)
Effect of exchange rate changes on cash	66,771	(73,521)
Net increase (decrease) in cash	(51,123)	441,112
Cash at beginning of year	8,808,110	5,639,334
Cash at end of period	\$ 8,756,987	\$ 6,080,446

See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
March 31, 2008

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 six months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2008. 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, 2007. 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 and holdings in an equity security. Such mutual fund investments 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 March 31, 2008 was \$226,640, with \$2,927 of cumulative unrealized gains reported at March 31, 2008.

Note 3: Accounts Receivable

Accounts receivable is stated net of an allowance for uncollectible accounts of \$1,065,000 and \$962,000 as of March 31, 2008 and September 30, 2007, respectively.

Note 4: Earnings per Share

Basic earnings 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.

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The following tables provide the components of the basic and diluted EPS computations for the three month and six month periods ended March 31, 2008 and 2007:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Basic EPS Computation				
Net income	\$ 205,818	\$ 802,424	\$ 550,729	\$ 1,917,631
Weighted average shares outstanding	4,810,191	4,698,402	4,805,964	4,656,599
Basic earnings per share	\$.04	\$.17	\$.11	\$.41

	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Diluted EPS Computation				
Net income	\$ 205,818	\$ 802,424	\$ 550,729	\$ 1,917,631
Weighted average shares outstanding	4,810,191	4,698,402	4,805,964	4,656,599
Stock options	163,984	224,105	200,401	135,747
Stock compensation arrangements	24,085	22,505	25,415	35,213
Diluted shares outstanding	4,998,260	4,945,012	5,031,780	4,827,559
Diluted earnings per share	\$.04	\$.16	\$.11	\$.40

Note 5: Comprehensive Income

The Company's total comprehensive income for the three month and six month periods ended March 31, 2008 and 2007 was as follows:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
Net income	\$ 205,818	\$ 802,424	\$ 550,729	\$ 1,917,631
Other comprehensive income (loss), net of tax:				
Unrealized gain on securities	1,964	313	4,311	373
Unrealized gain (loss) on derivatives	(19,307)	56,270	38,106	(5,743)
Foreign currency translation adjustment	110,564	(21,242)	(124,742)	326,587
Comprehensive income	\$ 299,039	\$ 837,765	\$ 468,404	\$ 2,238,848

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The accumulated other comprehensive income balances at March 31, 2008 and September 30, 2007 consisted of the following:

	March 31, 2008	September 30, 2007
Foreign currency translation adjustment	\$ 1,562,541	\$ 1,687,283
Unrealized loss on derivatives	(301)	(38,407)
Unrealized gain (loss) on securities	2,927	(1,384)
Accumulated other comprehensive income	\$ 1,565,167	\$ 1,647,492

Note 6: Derivative Instruments

At March 31, 2008, the Company had forward exchange contracts outstanding with notional amounts aggregating \$1.0 million, whose aggregate fair value was a liability of approximately \$477. The change in the amount of the asset or liability for these instruments is shown as a component of accumulated other comprehensive income, net of tax.

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.

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 March 31, 2008 and 2007, the Company recorded non-cash compensation expense of \$19,388 and \$44,845, respectively, (\$.004 and \$.01 per basic and diluted share, respectively) relating to stock options. For the six-month periods ended March 31, 2008 and 2007, the Company recorded non-cash compensation expense of \$40,155 and \$89,974, respectively, (\$.01 and \$.02 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.

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.

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. 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 February 2007, the USPTO issued a Final Rejection of the six claims in the plaintiff's patent asserted against the Company, which was reaffirmed in June 2007 after the plaintiff filed a response with the USPTO requesting reconsideration of its Final Rejection. The plaintiff has appealed the examiner's decision to the USPTO Board of Patent Appeals and Interferences and has an additional appeal available to it thereafter in the Court of Appeals for the Federal Circuit.

The Company is unable to reasonably estimate a range of possible loss, if any, at this time. Although the Company has received favorable rulings from the USPTO with respect to the reexamination proceedings, there is always the possibility that the plaintiff's patent claims could be upheld in appeal and the matter would proceed to trial. Should this occur and the Company receives an unfavorable outcome at trial, it could result in a liability that is material to the Company's results of operations and financial position.

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 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. In February 2008, the FASB provided a one-year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. 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 February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," which gives companies the option to measure eligible financial assets, financial liabilities and firm commitments at fair value (i.e., the fair value option), on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes in fair value must be recorded in earnings. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not expect that the adoption of SFAS 159 will have a material impact on its consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS 141 (revised 2007), “Business Combinations (“SFAS 141R”). SFAS 141R will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, IPR&D and restructuring costs. In addition, under SFAS 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS 141R is effective for fiscal years beginning after December 15, 2008. The Company has not yet evaluated the impact, if any, of adopting this pronouncement.

In December 2007, the FASB issued SFAS 160, “Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests (NCI) and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company has not yet evaluated the impact, if any, of adopting this pronouncement.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement 133” (“SFAS 161”). SFAS 161 will change the disclosure requirements for derivative instruments and hedging activities. Entities will be required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company has not yet evaluated the impact, if any, of adopting this pronouncement.

Note 10: Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, “Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109” (“FIN 48”) effective as of October 1, 2007. The adoption of FIN 48 did not have a material impact on the Company’s consolidated financial statements.

It is Company’s policy to include applicable interest and penalties related to uncertain tax positions as a component of income tax expense.

The Company files U.S. Federal and State income tax returns and foreign tax returns in the United Kingdom, Germany and Israel. The Company is generally no longer subject to tax examinations in such jurisdictions for fiscal years prior to 2003 in the U.S, 2001 in the U.K., 2005 in Germany and 2002 in Israel.

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

Results of Operations

Three Months Ended March 31, 2008 Compared with March 31, 2007

Net sales for the quarter ended March 31, 2008 decreased 9% to \$15.3 million compared with \$16.9 million in the year ago period. Domestic sales decreased 13% to \$7.6 million compared with \$8.7 million in the year ago period. International sales for the quarter decreased 5% to \$7.7 million compared with \$8.2 million in the year ago period. The sales decreases in these segments were due in part to weakening economic conditions in certain of the Company's markets. The backlog of unfilled orders was \$4.8 million at March 31, 2008 compared with \$3.8 million at September 30, 2007.

Gross profit margins for the second quarter of fiscal 2008 increased to 44.3% compared with 42.3% in the year ago period. The margin increase included the benefit of favorable exchange rate changes in Europe and reduced product component costs on the Company's digital video product line.

Total operating expenses for the second quarter of fiscal 2008 increased to \$6.5 million compared with \$6.3 million in the year ago quarter principally as a result of increased engineering and development expense. The Company continued to invest in new product development in the current quarter, incurring \$1.5 million of engineering and development costs compared with \$1.3 million in the year ago period. Sales and marketing expense for the current quarter was the same as the year ago period of \$4 million despite a 9% decrease in sales. The Company has increased its investment in sales infrastructure in the current period to better position itself for potential market opportunities.

The Company generated operating income of \$325,000 in the second quarter of fiscal 2008 compared with operating income of \$893,000 in the year ago period.

Interest expense decreased to \$11,000 for the second quarter of fiscal 2008 compared with \$34,000 in the year ago period principally as a result of the paydown of bank borrowings. Interest and other income increased to \$61,000 for the second quarter of fiscal 2008 compared with \$41,000 in the year ago period due to increased cash balances in the current year period.

Income tax expense for the second quarter of fiscal 2008 increased to \$169,000 compared with \$97,000 in the year ago period. The current quarter tax expense includes a \$58,000 provision for U.S. income taxes as compared with no tax provision in the year ago period. The Company now records income tax expense on its U.S. income as a result of the recognition of previously unrecorded net deferred tax assets in the fourth quarter of fiscal 2007. No U.S. income tax expense was recognized in the prior year quarter as the Company was utilizing the benefit of previously reserved and unrecognized net operating loss carryforwards.

As a result of the foregoing, the Company reported net income of \$206,000 for the second quarter of fiscal 2008 compared with net income of \$802,000 in the year ago period. Net income for the year ago period would have been \$532,000 based upon the application of a normalized effective tax rate for the period.

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Results of Operations

Six Months Ended March 31, 2008 Compared with March 31, 2007

Net sales for the six months ended March 31, 2008 decreased 11% to \$31.0 million compared with \$34.8 million in the year ago period. Domestic sales decreased 15% to \$15.7 million compared with \$18.4 million in the year ago period while international sales decreased 6% to \$15.3 million compared with \$16.4 million in the year ago period. The sales decreases in these segments were due in part to weakening economic conditions in certain of the Company's markets.

Gross profit margins for the first six months of fiscal 2008 increased to 44.3% compared with 41.3% in the year ago period. The margin increase included the benefit of favorable exchange rate changes in Europe and reduced product component costs on the Company's digital video product line.

Total operating expenses for the first six months of fiscal 2008 increased to \$12.9 million compared with \$12.3 million in the year ago period principally as a result of increases in sales related costs in Europe that included translation effects of strengthening European currencies and increased engineering and development expense. The Company continued to invest in new product development in the current year period, incurring \$2.9 million of engineering and development costs compared with \$2.5 million in the year ago period.

The Company generated operating income of \$841,000 in the first six months of fiscal 2008 compared with operating income of \$2.0 million in the year ago period.

Interest expense decreased to \$43,000 for the first six months of fiscal 2008 compared with \$73,000 in the year ago period principally as a result of the paydown of bank borrowings. Interest and other income decreased to \$149,000 for the first six months of fiscal 2008 compared with \$152,000 in the year ago period. The year ago period included a \$72,000 gain from life insurance proceeds upon the death of a retired executive. Excluding the effect of this gain, interest and other income increased \$69,000 principally as a result of increased cash balances during the current year period.

Income tax expense for the first six months of fiscal 2008 increased to \$397,000 compared with \$200,000 in the year ago period. The current year period tax expense includes a \$220,000 provision for U.S. income taxes as compared with no tax provision in the year ago period. The Company now records income tax expense on its U.S. income as a result of the recognition of previously unrecorded net deferred tax assets in the fourth quarter of fiscal 2007. No U.S. income tax expense was recognized in the prior year period as the Company was utilizing the benefit of previously reserved and unrecognized net operating loss carryforwards.

As a result of the foregoing, the Company reported net income of \$551,000 for the first six months of fiscal 2008 compared with net income of \$1.9 million in the year ago period. Net income for the year ago period would have been \$1.3 million based upon the application of a normalized effective tax rate for the period.

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Liquidity and Capital Resources

Net cash provided by operating activities was \$1.8 million for the first six months of fiscal 2008, which included \$551,000 of net income and \$627,000 of non-cash charges for the period. In addition, the \$2.1 million decrease in accounts receivable resulting from lower sales was offset in part by increases in other current assets and decreases in certain other current liabilities. Net cash used in investing activities was \$272,000 for the first six months of fiscal 2008 due principally to \$276,000 of general capital expenditures. Net cash used in financing activities was \$1.7 million for the first six months of fiscal 2008, which included a \$1.7 million scheduled repayment of bank mortgage loans offset by \$59,000 of proceeds received from the exercise of stock options. As a result of the foregoing, cash decreased by \$51,000 for the first six months of fiscal 2008 after the effect of exchange rate changes on the cash position of the Company.

The Company's U.K. based subsidiary maintains a bank overdraft facility that provides for maximum borrowings of one million Pounds Sterling (approximately \$2,000,000) to support its local working capital requirements. At March 31, 2008 and September 30, 2007, there were no outstanding borrowings under this facility.

The following is a summary of the Company's debt and material lease obligations as of March 31, 2008:

Payments Due By Period	Debt		Lease	Total
	Repayments	Commitments		
Less than 1 year	\$ -	\$ 593,000	\$ 593,000	\$ 593,000
1-3 years	-	453,000	453,000	453,000
3-5 years	-	10,000	10,000	10,000
Total	\$ -	\$ 1,056,000	\$ 1,056,000	\$ 1,056,000

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 used its cash reserves to repay its \$1.7 million mortgage obligation in January 2008.

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.

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. 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 February 2007, the USPTO issued a Final Rejection of the six claims in the plaintiff's patent asserted against the Company, which was reaffirmed in June 2007 after the plaintiff filed a response with the USPTO requesting reconsideration of its Final Rejection. The plaintiff has appealed the examiner's decision to the USPTO Board of Patent Appeals and Interferences and has an additional appeal available to it thereafter in the Court of Appeals for the Federal Circuit.

The Company is unable to reasonably estimate a range of possible loss, if any, at this time. Although the Company has received favorable rulings from the USPTO with respect to the reexamination proceedings, there is always the possibility that the plaintiff's patent claims could be upheld in appeal and the matter would proceed to trial. Should this occur and the Company receives an unfavorable outcome at trial, it could result in a liability that is material to the Company's results of operations and financial position.

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, 2007 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 undelivered 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 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 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. In February 2008, the FASB provided a one-year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. 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 February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," which gives companies the option to measure eligible financial assets, financial liabilities and firm commitments at fair value (i.e., the fair value option), on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes in fair value must be recorded in earnings. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not expect that the adoption of SFAS 159 will have a material impact on its consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS 141 (revised 2007), "Business Combinations ("SFAS 141R"). SFAS 141R will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, IPR&D and restructuring costs. In addition, under SFAS 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS 141R is effective for fiscal years beginning after December 15, 2008. The Company has not yet evaluated the impact, if any, of adopting this pronouncement.

In December 2007, the FASB issued SFAS 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests (NCI) and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company has not yet evaluated the impact, if any, of adopting this pronouncement.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement 133" ("SFAS 161"). SFAS 161 will change the disclosure requirements for derivative instruments and hedging activities. Entities will be required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company has not yet evaluated the impact, if any, of adopting this pronouncement.

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.

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 March 31, 2008 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.

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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, 2007.

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. As of March 31, 2008, the Company had repurchased a total of \$546,000 of shares under this program and did not repurchase any of its common stock during the three month period ended March 31, 2008. Subsequent to March 31, 2008, the Company repurchased an additional \$303,000 of shares, bringing its cumulative repurchases to \$849,000 at the date of this filing.

On May 9, 2008, the Company announced that its Board of Directors authorized the repurchase of up to an additional \$1 million of shares of the Company's common stock.

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

Exhibit Number	Description
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.

TABLE OF CONTENTS

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.

May 15, 2008

/s/ Kenneth M. Darby
Kenneth M. Darby
Chairman and
Chief Executive Officer

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

