

VICON INDUSTRIES INC /NY/
Form 10-Q
May 14, 2012
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, 2012

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

Indicate by check mark 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 No

At May 10, 2012, the registrant had outstanding 4,479,735 shares of Common Stock, \$.01 par value.

VICON INDUSTRIES, INC. AND SUBSIDIARIES
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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	
	3/31/2012	3/31/2011
Net sales	\$ 12,472,200	\$ 12,077,325
Cost of sales	7,517,694	7,374,592
Gross profit	4,954,506	4,702,733
Operating expenses:		
Selling, general and administrative expense	3,923,733	4,131,872
Engineering & development expense	1,311,300	1,472,144
Patent litigation settlement expense	—	169,197
	5,235,033	5,773,213
Operating loss	(280,527)	(1,070,480)
Interest income	(7,031)	(48,140)
Other income	(13,993)	(1,188)
Loss before income taxes	(259,503)	(1,021,152)
Income tax expense (benefit)	19,000	(308,000)
Net loss	\$(278,503)	\$(713,152)
Loss per share:		
Basic	\$(.06)	\$(.16)
Diluted	\$(.06)	\$(.16)
Weighted average shares outstanding:		
Basic	4,475,603	4,480,836
Diluted	4,475,603	4,480,836

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	
	3/31/2012	3/31/2011
Net sales	\$24,824,192	\$23,804,850
Cost of sales	14,940,334	14,293,184
Gross profit	9,883,858	9,511,666
Operating expenses:		
Selling, general and administrative expense	7,795,026	8,144,770
Engineering & development expense	2,672,892	2,913,584
Patent litigation settlement expense	—	249,826
	10,467,918	11,308,180
Operating loss	(584,060)	(1,796,514)
Interest income	(30,759)	(132,448)
Other income	(28,830)	(11,790)
Loss before income taxes	(524,471)	(1,652,276)
Income tax expense (benefit)	38,000	(485,000)
Net loss	\$(562,471)	\$(1,167,276)
Loss per share:		
Basic	\$(.13)	\$(.26)
Diluted	\$(.13)	\$(.26)
Weighted average shares outstanding:		
Basic	4,483,776	4,481,018
Diluted	4,483,776	4,481,018

See Accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	3/31/2012 (Unaudited)	9/30/2011
CURRENT ASSETS		
Cash and cash equivalents	\$4,088,630	\$5,628,156
Marketable securities	402,503	2,035,593
Accounts receivable, net	8,208,216	7,771,356
Inventories:		
Parts, components, and materials	4,774,155	3,969,656
Work-in-process	2,058,457	2,032,176
Finished products	5,870,085	5,392,699
	12,702,697	11,394,531
Recoverable income taxes	92,811	92,811
Prepaid expenses and other current assets	622,624	624,939
TOTAL CURRENT ASSETS	26,117,481	27,547,386
Property, plant and equipment	13,069,803	12,873,127
Less accumulated depreciation and amortization	(8,840,642)	(8,532,990)
	4,229,161	4,340,137
Other assets	1,249,997	1,303,753
TOTAL ASSETS	\$31,596,639	\$33,191,276
 LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$3,344,818	\$4,240,096
Accrued compensation and employee benefits	2,098,983	2,297,575
Accrued expenses	1,032,709	1,022,034
Unearned revenue	506,264	495,612
Income taxes payable	32,589	32,589
TOTAL CURRENT LIABILITIES	7,015,363	8,087,906
Unearned revenue - non current	197,832	234,927
Other long-term liabilities	2,414,662	2,424,516
TOTAL LIABILITIES	9,627,857	10,747,349
 SHAREHOLDERS' EQUITY		
Common stock, par value \$.01	53,450	53,450
Capital in excess of par value	25,194,577	25,041,273
Retained earnings	1,079,249	1,641,720
Less treasury stock, at cost	(4,300,952)	(4,219,502)
Accumulated other comprehensive loss	(57,542)	(73,014)
TOTAL SHAREHOLDERS' EQUITY	21,968,782	22,443,927
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$31,596,639	\$33,191,276

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	
	3/31/2012	3/31/2011
Cash flows from operating activities:		
Net loss	\$(562,471	) \$(1,167,276)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	299,507	333,105
Amortization of deferred compensation	2,390	2,378
Stock compensation expense	150,914	151,287
Deferred income taxes	—	(461,202)
Change in assets and liabilities:		
Accounts receivable, net	(382,657	) 2,193,365
Inventories	(1,271,000	) (484,182)
Recoverable income taxes	—	(23,318)
Prepaid expenses and other current assets	(26,423	) (110,272)
Other assets	53,756	(112,545)
Accounts payable	(939,602	) 1,355
Accrued compensation and employee benefits	(203,127	) (67,391)
Accrued expenses	6,748	(25,643)
Unearned revenue	(26,443	) (140,066)
Other liabilities	(13,547	) 59,942
Net cash provided by (used in) operating activities	(2,911,955	) 149,537
Cash flows from investing activities:		
Net decrease (increase) in marketable securities	1,600,352	(112,896)
Capital expenditures	(167,606	) (239,371)
Net cash provided by (used in) investing activities	1,432,746	(352,267)
Cash flows from financing activities:		
Repurchases of common stock	(81,450	) (74,545)
Proceeds from exercise of stock options	—	21,949
Net cash used in financing activities	(81,450	) (52,596)
Effect of exchange rate changes on cash	21,133	103,356
Net decrease in cash	(1,539,526	) (151,970)
Cash at beginning of year	5,628,156	8,789,967
Cash at end of period	\$4,088,630	\$8,637,997

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, 2012

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 8-03 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, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2012. 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, 2011. 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 principally in federal, state and local government debt securities of \$370,932 and holdings in an equity security of \$31,571. Such mutual fund investments are stated at market value based on quoted market prices (Level 1 inputs) and are classified as available-for-sale under the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320 (FASB Statement of Financial Accounting Standards (SFAS) No. 115), with unrealized gains and losses reported in accumulated other comprehensive income (loss) as a component of shareholders' equity. The cost of such securities at March 31, 2012 was \$399,532, with \$2,971 of cumulative unrealized gains reported at March 31, 2012.

Note 3: Accounts Receivable

Accounts receivable is stated net of an allowance for uncollectible accounts of \$1,101,000 and \$1,089,000 as of March 31, 2012 and September 30, 2011, respectively.

Note 4: Loss per Share

Basic 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 tables provide the components of the basic and diluted EPS computations for the three month and six month periods ended March 31, 2012 and 2011:

	Three Months Ended		Six Months Ended	
	March 31,	2011	March 31,	2011
	2012		2012	
Basic EPS Computation				
Net loss	\$ (278,503)	\$ (713,152)	\$ (562,471)	\$ (1,167,276)
Weighted average shares outstanding	4,475,603	4,480,836	4,483,776	4,481,018
Basic loss per share	\$ (.06)	\$ (.16)	\$ (.13)	\$ (.26)

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	Three Months Ended		Six Months Ended	
	March 31, 2012	2011	March 31, 2012	2011
Diluted EPS Computation				
Net loss	\$(278,503)	\$(713,152)	\$(562,471)	\$(1,167,276)
Weighted average shares outstanding	4,475,603	4,480,836	4,483,776	4,481,018
Stock options	—	—	—	—
Stock compensation arrangements	—	—	—	—
Diluted shares outstanding	4,475,603	4,480,836	4,483,776	4,481,018
Diluted loss per share	\$(.06)	\$(.16)	\$(.13)	\$(.26)

For the three months ended March 31, 2012 and 2011, 10,238 and 58,794 shares, respectively, have been omitted from the calculation of diluted EPS as their effect would have been antidilutive. For the six months ended March 31, 2012 and 2011, 12,111 and 52,103 shares, respectively, have been omitted from the calculation of diluted EPS as their effect would have been antidilutive.

Note 5: Comprehensive Loss

The Company's total comprehensive loss for the three and six months ended March 31, 2012 and 2011 was as follows:

	Three Months Ended		Six Months Ended	
	March 31, 2012	2011	March 31, 2012	2011
Net loss	\$(278,503)	\$(713,152)	\$(562,471)	\$(1,167,276)
Other comprehensive income (loss):				
Unrealized loss on securities, net of tax	(7,578)	(8,089)	(32,738)	(78,522)
Unrealized gain (loss) on derivatives, net of tax	704	(43,565)	(34,904)	18,820
Foreign currency translation adjustment	162,729	311,615	83,114	162,712
Comprehensive loss	\$(122,648)	\$(453,191)	\$(546,999)	\$(1,064,266)

The accumulated other comprehensive loss balances at March 31, 2012 and September 30, 2011 consisted of the following:

	March 31, 2012	September 30, 2011
Foreign currency translation adjustment	\$(107,815)	\$(190,929)
Unrealized gain on derivatives	47,302	82,206
Unrealized gain on securities	2,971	35,709
Accumulated other comprehensive loss	\$(57,542)	\$(73,014)

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Note 6: Derivative Instruments

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. The Company's ongoing foreign currency exchange risks include intercompany sales of product and services between subsidiary companies operating in differing functional currencies.

At March 31, 2012, the Company had forward exchange contracts outstanding with notional amounts aggregating \$2.8 million, whose aggregate fair value was an asset of approximately \$47,302. Such fair value was determined using published market exchange rates. The change in the amount of the asset or liability for these instruments is shown as a component of accumulated other comprehensive loss, 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.

The Company follows ASC 718 (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 grant date fair values and over the requisite service period. For the three month periods ended March 31, 2012 and 2011, the Company recorded non-cash compensation expense of \$74,684 and \$73,319, respectively, (\$.02 and \$.02 per basic and diluted share, respectively) relating to stock compensation. For the six month periods ended March 31, 2012 and 2011, the Company recorded non-cash compensation expense of \$150,914 and \$151,287, respectively, (\$.03 and \$.03 per basic and diluted share, respectively) relating to stock compensation.

Note 8: Litigation

The Company was a defendant in a patent infringement suit commenced by Lectrolarm Custom Systems, Inc. ("Lectrolarm") in May 2003 in the United States District Court for the Western District of Tennessee. The alleged infringement by the Company related to its dome camera and system controller product lines, among other products that collectively represent significant sales to the Company. On July 13, 2011, the Company entered into a settlement and release agreement with Lectrolarm to settle the patent infringement suit. Under the settlement, the Company made a one-time payment of \$5 million to Lectrolarm in exchange for the release of all current and future claims against the Company and the dismissal of Lectrolarm's suit pending in the U.S. District Court. Such settlement amount was recognized as patent litigation settlement expense in the third quarter ended June 30, 2011. Patent litigation settlement expense for the three month and six month periods ended March 31, 2011 represents legal costs incurred in connection with such litigation. Although the Company and its outside patent counsel believed that the suit was without merit and had vigorously defended itself for over eight years, it decided to settle the matter to end years of management distraction and financial uncertainty since the suit was brought in 2003.

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 May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (“IFRS”). ASU 2011-04 clarifies some existing concepts, eliminates wording differences between U.S. GAAP and IFRS, and in some limited cases, changes some principles to achieve convergence between U.S. GAAP and IFRS. ASU 2011-04 results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and IFRS. ASU 2011-04 also expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 became effective for the Company for the quarter ended March 31, 2012 and its adoption did not have a material effect on the Company's operating results or financial position.

In June 2011, the Financial Accounting Standard Board (“FASB”) issued Accounting Standard Update (“ASU”) 2011-05, Presentation of Comprehensive Income, which requires an entity to present the total of comprehensive income, the components

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of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present components of other comprehensive income as part of the statement of shareholders' equity. ASU 2011-05 will be effective for the Company for fiscal years beginning after December 15, 2011. The Company does not expect the adoption of ASU 2011-05 to have a material effect on its operating results or financial position. However, it will impact the presentation of comprehensive income.

Note 10: Income Taxes

Deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities. Deferred tax assets represent items to be used as a tax deduction or credit in future tax returns for which a tax benefit has been recorded in the income statement. In the third quarter ended June 30, 2011, the Company recognized a \$2.6 million income tax charge to provide a valuation allowance against its deferred tax assets due to the uncertainty of future realization. The establishment of such valuation allowance was determined to be appropriate during the period due to updated judgments of future results in light of the Company's operating losses since fiscal year 2010 and the inherent uncertainties of predicting future operating results in periods over which such net tax differences become deductible.

The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in 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 2004 in the U.S. and 2006 in the U.K., Germany and Israel.

Note 11: Fair Value

The majority of the Company's non-financial assets and liabilities are not required to be carried at fair value on a recurring basis, but the Company is required on a non-recurring basis to use fair value measurements when analyzing asset impairment as it relates to long-lived assets. 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 fair value of the Company's foreign currency forward exchange contracts is estimated by obtaining quoted market exchange rates for similar contracts (Level 2 inputs). The contracted exchange rates on committed forward exchange contracts was approximately \$47,302 more favorable than the market rates for similar term contracts at March 31, 2012.

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 assumptions could significantly affect the estimates.

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

General

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses the Company's consolidated financial statements for the periods indicated, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition, bad debts, product warranties, inventories, long lived assets, income taxes and contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors including general market conditions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Results for the periods reported herein are not necessarily indicative of results that may be expected in future periods.

Overview

The Company designs, assembles and markets video management systems and system components for use in security, surveillance, safety and communication applications by a broad group of end users worldwide. The Company's product line consists of various elements of a video system, including digital video and network video recorders, video encoders, decoders, servers and related video management software, data storage units, analog, HD and IP fixed and robotic cameras, virtual and analogue matrix video switchers and controls, and system peripherals.

The Company sells video systems and system components in a highly competitive worldwide marketplace principally to authorized security dealers and system integrators. Such dealers and integrators typically resell the Company's products directly to end users, among other services. The Company's sales are principally project based and are largely dependent upon winning projects, construction activities and the timing of funding. Sales will vary from period to period depending upon many factors including seasonal and geographic trends in construction activities and the timing of deliveries due to changes in project schedules and funding. The Company usually does not have a large backlog as its customer orders are typically deliverable within three months or often upon receipt of order.

Since fiscal year 2009, the Company's sales levels have been impacted by the worldwide economic downturn as capital expenditures for new construction, expansion and renovation projects have weakened. Such sales declines have had an adverse impact on the Company's financial results for these periods. The Company's operating cost structure has been principally fixed and therefore profitability has been largely dependent upon sales levels. For the most part, the Company has maintained its selling, general and administrative cost structure in anticipation of improving market conditions. In the second half of fiscal 2011, the Company recognized \$200,000 of severance charges on certain staff reductions and may consider additional cost cutting measures in fiscal 2012.

The Company competes in a market of rapid technology shifts which influence the performance capability of security systems. As a result, the Company spends a significant amount on new product development. In fiscal 2011 and 2010, the Company incurred \$5.9 million and \$5.5 million of engineering and development expense or 13% and 11% of net sales, respectively. The Company's expenditures for product development are substantially less than its larger competitors. In recent years, the rapid pace of technology changes has placed increased burden on the Company's development resources which has necessitated an increase in annual expense for product development. Further, the Company's sales effort requires a high level of customer service and technical support for its products. Customer support levels were maintained during fiscal 2011 despite a reduction in sales and such expenditure levels are expected to continue in fiscal 2012. The Company has considered various strategic initiatives that may augment or supplement its present product offerings and technology platforms, among other benefits.

The Company has a foreign sales and distribution subsidiary in Europe that conducts business in British pounds and Euros that represented approximately 28% of the Company's consolidated sales for fiscal 2011. It also has an Israel based engineering and development subsidiary that incurs a majority of its operating expenses in Shekels that represented approximately 21% of the Company's recurring operating expenses for fiscal 2011. During fiscal 2009, there were material changes in exchange rates between world currencies that affected the Company's financial statements. In 2009, U.S. dollar gained on average 21% against the British pound, 10% against the Euro and 8% against the Shekel compared with 2008. This served to reduce the Company's consolidated reported sales and costs in these currencies on a translation basis, increase the cost of European subsidiaries U.S. dollar based sourced product costs and incur company-wide negative result impacts on the settlements of transactional balances between

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companies. Since fiscal 2009, European currency exchange rate changes has moderated, which significantly lessened the Company's currency impacts. However, in fiscal 2011, the U.S. dollar weakened against the shekel by an average of 6% compared with 2010, thus increasing the Company's Israel based subsidiary's operating costs. The Company has historically entered into selected forward currency exchange contracts to help stabilize the impact of changing exchange rates and will continue to do so in fiscal 2012. However, nothing can totally eliminate the long term effects of foreign currency exchange movements.

Results of Operations

Three Months Ended March 31, 2012 Compared with March 31, 2011

Net sales for the quarter ended March 31, 2012 increased 3% to \$12.5 million compared with \$12.1 million in the year ago period. Domestic sales increased 5% to \$7.4 million compared with \$7.1 million in the year ago period while international sales increased 1% to \$5.1 million compared with \$5.0 million in the year ago period. Order intake for the quarter ended March 31, 2012 increased 12% to \$13.5 million compared with \$12.1 million in the year ago period. In the current quarter, the Company experienced a significant improvement in its North American sales and order rates and persistent soft sales and order rates in Europe. The backlog of unfilled orders increased \$1.2 million to \$5.9 million at March 31, 2012 compared with \$4.7 million at September 30, 2011.

Gross profit margins for the second quarter of fiscal 2012 increased to 39.7% compared with 38.9% in the year ago period. The increase in current quarter margins was the result of lower indirect expenses relative to sales for the quarter.

Total operating expenses for the second quarter of fiscal 2012 decreased \$538,000 to \$5.2 million compared with \$5.8 million in the year ago quarter. Selling, general and administrative expenses for the second quarter of fiscal 2012 decreased to \$3.9 million compared with \$4.1 million in the year ago quarter. Engineering and development expense in the current quarter was \$1.3 million compared with \$1.5 million in the year ago period. The prior year quarter operating costs included \$169,000 of patent litigation expense (see Note 8).

The Company incurred an operating loss of \$281,000 in the second quarter of fiscal 2012 compared with an operating loss of \$1.1 million in the year ago period.

Interest income decreased \$41,000 to \$7,000 for the second quarter of fiscal 2012 compared with \$48,000 in the year ago quarter due principally to reduced cash balances and marketable security investments in the current quarter. Other income was \$14,000 for the second quarter of 2012 compared with \$1,000 in the year ago quarter. The current quarter amount represents gains realized on the liquidation of certain marketable securities and changes in the market value of certain equity securities held.

The Company recorded income tax expense of \$19,000 for the second quarter of fiscal 2012 compared with a tax benefit of \$308,000 in the year ago quarter. In the third quarter of fiscal 2011, the Company recognized a \$2.6 million income tax charge to provide a valuation allowance against its deferred tax assets due to the uncertainty of future realization and, thus, no tax benefit has been recognized on reported pretax losses for the current quarter (see Note 10: Income Taxes).

As a result of the foregoing, the Company reported a net loss of \$279,000 for the second quarter of fiscal 2012 compared with a net loss of \$713,000 in the year ago period.

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Results of Operations

Six Months Ended March 31, 2012 Compared with March 31, 2011

Net sales for the six months ended March 31, 2012 increased 4% to \$24.8 million compared with \$23.8 million in the year ago period. Domestic sales increased 8% to \$15.5 million compared with \$14.4 million in the year ago period while international sales decreased 2% to \$9.3 million compared with \$9.4 million in the year ago period. Order intake for the six months ended March 31, 2012 increased 3% to \$26.1 million compared with \$25.4 million in the year ago period. In the current year period, the Company experienced a significant improvement in its North American sales and order rates and persistent soft sales and order rates in Europe.

Gross profit margins for the first six months of fiscal 2012 decreased to 39.8% compared with 40.0% in the year ago period. Both period margins were weakened by continuing competitive pressures in markets served by the Company's U.K. based subsidiary.

Total operating expenses for the first six months of fiscal 2012 decreased \$840,000 to \$10.5 million compared with \$11.3 million in the year ago period. Selling, general and administrative expenses for the first six months of fiscal 2012 decreased to \$7.8 million compared with \$8.1 million in the year ago period. Engineering and development expense in the current year period was \$2.7 million compared with \$2.9 million in the year ago period. The prior year period operating costs included \$250,000 of patent litigation expense (see Note 8).

The Company incurred an operating loss of \$584,000 for the first six months of fiscal 2012 compared with an operating loss of \$1.8 million in the year ago period.

Interest income decreased to \$31,000 for the first six months of fiscal 2012 compared with \$132,000 in the year ago period due principally to reduced cash balances and marketable security investments in the current year period. Other income was \$29,000 for the first six months of 2012 compared with \$12,000 in the year ago period. These amounts represent gains realized on the liquidation of certain marketable securities and changes in the market value of certain equity securities held.

The Company recorded income tax expense of \$38,000 for the first six months of fiscal 2012 compared with a tax benefit of \$485,000 in the year ago period. In the third quarter of fiscal 2011, the Company recognized a \$2.6 million income tax charge to provide a valuation allowance against its deferred tax assets due to the uncertainty of future realization and, thus, no tax benefit has been recognized on reported pretax losses for the current year period (see Note 10: Income Taxes).

As a result of the foregoing, the Company reported a net loss of \$562,000 for the first six months of fiscal 2012 compared with a net loss of \$1.2 million in the year ago period.

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Liquidity and Capital Resources

Net cash used in operating activities was \$2.9 million for the first six months of fiscal 2012 relating principally to increases in inventories and accounts receivable of \$1.3 million and \$383,000, respectively, and decreases in accounts payable and accrued expenses aggregating \$1.1 million. Inventory increases for the period included additional stocks held for the introduction of certain new product lines. The reported loss of \$562,000 was substantially offset by \$453,000 of non-cash charges. Net cash provided by investing activities was \$1.4 million for the first six months of fiscal 2012 consisting of \$1.6 million of net marketable security liquidations principally used for operating activities and \$168,000 of general capital expenditures. The marketable security liquidations consisted of mutual fund investments principally in federal, state and local government debt securities. Net cash used in financing activities was \$81,000 for the first six months of fiscal 2012 consisting of common stock repurchases. As a result of the foregoing, cash (exclusive of marketable securities) decreased by \$1.5 million for the first six months of fiscal 2012 after the minimal effect of exchange rate changes on the cash position of the Company.

The Company believes that it will have sufficient cash to meet its anticipated operating costs and capital expenditure 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 was a defendant in a patent infringement suit commenced by Lectrolarm Custom Systems, Inc. ("Lectrolarm") in May 2003 in the United States District Court for the Western District of Tennessee. The alleged infringement by the Company related to its dome camera and system controller product lines, among other products that collectively represent significant sales to the Company. On July 13, 2011, the Company entered into a settlement and release agreement with Lectrolarm to settle the patent infringement suit. Under the settlement, the Company made a one-time payment of \$5 million to Lectrolarm in exchange for the release of all current and future claims against the Company and the dismissal of Lectrolarm's suit pending in the U.S. District Court. Such settlement amount was recognized as patent litigation settlement expense in the third quarter ended June 30, 2011. Patent litigation settlement expense for the six months ended March 31, 2011 represents legal costs incurred in connection with such litigation. Although the Company and its outside patent counsel believed that the suit was without merit and had vigorously defended itself for over eight years, it decided to settle the matter to end years of management distraction and financial uncertainty since the suit was brought in 2003.

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, 2011 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.

Revenue is generally recognized when products are sold and title is passed to the customer. Advance service billings are deferred and recognized as revenues on a pro rata basis over the term of the service agreement. Pursuant to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605-25-05 (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 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 FASB Accounting Standards Update (ASU) 2009-13, "Revenue Recognition (Topic 605) — Multiple-Deliverable Revenue Arrangements" (ASU 2009-13). ASU 2009-13, which was adopted by the Company effective October 1, 2010 on a prospective basis, provides revenue recognition guidance for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable in the arrangement based on the fair value of the elements. The fair value for each deliverable is based on vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or best estimate of selling price ("BESP") if neither VSOE nor TPE is available. BESP must be determined in a manner that is consistent with that used to determine the price to sell the specific elements on a standalone basis.

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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.

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. In the third quarter of fiscal 2011, the Company recognized a \$2.6 million charge to provide a valuation allowance against all deferred tax assets due to the uncertainty of future realization. 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 accrues liabilities for identified tax contingencies that result from positions that are being challenged or could be challenged by tax authorities. The Company believes that its accrual for tax liabilities is adequate for all open years, based on Management's assessment of many factors, including its interpretations of the tax law and judgments about potential actions by tax authorities. However, it is possible that the ultimate resolution of any tax audit may be materially greater or lower than the amount accrued.

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.

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 Management's Discussion and Analysis captions "Overview", "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.

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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 and such information is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures.

Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of its Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting in accordance with accounting principles generally accepted in the United States of America. Management evaluates the effectiveness of the Company's internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of March 31, 2012 and concluded that it is effective.

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, 2012 that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

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 controls issues and instances of fraud, if any, within a Company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and the Company's Chief Executive Officer and Chief Financial Officer have concluded that such controls and procedures are effective at the "reasonable assurance" level.

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PART II – OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None

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, 2011.

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In December 2008, the Company's Board of Directors authorized the purchase of up to \$1 million worth of shares of the Company's outstanding common stock. In December 2009, the Board of Directors authorized the purchase of an additional \$1.5 million worth of shares of the Company's outstanding common stock.

The following table summarizes the Company's purchases of common stock in open market transactions or otherwise for the three month period ended March 31, 2012:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs
01/01/12-01/31/12	9,936	\$3.39	\$976,627
02/01/12-02/29/12	1,100	3.59	\$972,679
03/01/12-03/31/12	—	—	\$972,679
Total	11,036	\$3.41	

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ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable

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
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*

* In accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed to be “furnished” and not “filed.”

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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 14, 2012

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

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