VICON INDUSTRIES INC /NY/
Form 10-Q
May 12, 2011

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

FORM 10-Q

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

For the quarterly period ended March 31, 2011

[ ] 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.

[x] 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 [ ] (Do not check if a smaller reporting company)	Smaller reporting company [x]

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 11, 2011, the registrant had outstanding 4,486,836 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	
	3/31/11	3/31/10
Net sales	$12,077,325	$11,374,704
Cost of sales	7,374,592	6,701,311
Gross profit	4,702,733	4,673,393
Operating expenses:		
Selling, general and administrative expense	4,301,069	4,314,036
Engineering & development expense	1,472,144	1,385,660
	5,773,213	5,699,696
Operating loss	(1,070,480)	(1,026,303)
Interest income	(48,140)	(52,149)
Other income	(1,188)	(3,146)
Loss before income taxes	(1,021,152)	(971,008)
Income tax benefit	(308,000)	(281,000)
Net loss	$(713,152)	$(690,008)
Loss per share:		
Basic and diluted	$(.16)	$(.15)
Weighted average shares outstanding:		
Basic and diluted	4,480,836	4,532,981

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	
	3/31/11	3/31/10
Net sales	$23,804,850	$22,473,995
Cost of sales	14,293,184	13,163,157
Gross profit	9,511,666	9,310,838
Operating expenses:		
Selling, general and administrative expense	8,394,596	8,699,029
Engineering & development expense	2,913,584	2,741,713
	11,308,180	11,440,742
Operating loss	(1,796,514)	(2,129,904)
Interest income	(132,448)	(104,701)
Other expense (income)	(11,790)	2,912
Loss before income taxes	(1,652,276)	(2,028,115)
Income tax benefit	(485,000)	(641,000)
Net loss	$(1,167,276)	$(1,387,115)
Loss per share:		
Basic and diluted	$(.26)	$(.30)
Weighted average shares outstanding:		
Basic and diluted	4,481,018	4,561,452

See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	3/31/11 (Unaudited)	9/30/10
CURRENT ASSETS		
Cash and cash equivalents	$8,637,997	$8,789,967
Marketable securities	5,346,794	5,358,537
Accounts receivable, net	7,865,620	10,021,342
Inventories:		
Parts, components, and materials	4,505,003	3,706,372
Work-in-process	1,854,783	2,416,690
Finished products	5,231,652	4,957,865
	11,591,438	11,080,927
Recoverable income taxes	171,690	146,161
Deferred income taxes	795,376	760,313
Prepaid expenses and other current assets	623,051	508,937
TOTAL CURRENT ASSETS	35,031,966	36,666,184
Property, plant and equipment	12,929,122	12,656,955
Less accumulated depreciation and amortization	(8,384,575)	(8,033,178)
	4,544,547	4,623,777
Deferred income taxes	1,846,243	1,382,686
Other assets	1,366,329	1,253,784
TOTAL ASSETS	$42,789,085	$43,926,431
LIABILITIES AND SHAREHOLDERS’ EQUITY		
CURRENT LIABILITIES		
Accounts payable	$3,459,156	$3,437,460
Accrued compensation and employee benefits	2,221,615	2,286,103
Accrued expenses	1,201,469	1,254,482
Unearned revenue	591,771	705,484
Income taxes payable	32,589	32,589
TOTAL CURRENT LIABILITIES	7,506,600	7,716,118
Unearned revenue	281,710	308,063
Other long-term liabilities	2,420,028	2,358,306
TOTAL LIABILITIES	10,208,338	10,382,487
SHAREHOLDERS’ EQUITY		
Common stock, par value $.01	52,930	52,861
Capital in excess of par value	24,758,784	24,583,239
Retained earnings	11,934,390	13,101,666
Less treasury stock, at cost	(4,062,414)	(3,987,869)

Accumulated other comprehensive loss	(102,943)	(205,953)
TOTAL SHAREHOLDERS' EQUITY	32,580,747	33,543,944
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$42,789,085	$43,926,431

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	
	3/31/11	3/31/10
Cash flows from operating activities:		
Net loss	$(1,167,276)	$(1,387,115)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	333,105	363,246
Amortization of deferred compensation	2,378	2,378
Stock compensation expense	151,287	154,224
Deferred income taxes	(461,202)	(370,000)
Change in assets and liabilities:		
Accounts receivable, net	2,193,365	2,157,811
Inventories	(484,182)	673,595
Recoverable income taxes	(23,318)	(332,286)
Prepaid expenses and other current assets	(110,272)	(236,485)
Other assets	(112,545)	(32,931)
Accounts payable	1,355	(467,611)
Accrued compensation and employee benefits	(67,391)	(752,836)
Accrued expenses	(25,643)	(108,949)
Unearned revenue	(140,066)	124,494
Income taxes payable	-	(123,267)
Other liabilities	59,942	(85,997)
Net cash provided by (used in) operating activities	149,537	(421,729)
Cash flows from investing activities:		
Net increase in marketable securities	(112,896)	(5,022,120)
Capital expenditures	(239,371)	(250,354)
Net cash used in investing activities	(352,267)	(5,272,474)
Cash flows from financing activities:		
Repurchases of common stock	(74,545)	(695,071)
Proceeds from exercise of stock options	21,949	49,511
Net cash used in financing activities	(52,596)	(645,560)
Effect of exchange rate changes on cash	103,356	(205,349)
Net decrease in cash	(151,970)	(6,545,112)
Cash at beginning of year	8,789,967	16,650,191
Cash at end of period	$8,637,997	$10,105,079

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, 2011

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, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2011. 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, 2010. 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 $5,305,576 and holdings in an equity security of $41,218. 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 as a component of shareholders’ equity. The cost of such securities at March 31, 2011 was $5,365,403, with $18,609 of cumulative unrealized losses reported at March 31, 2011.

Note 3: Accounts Receivable

Accounts receivable is stated net of an allowance for uncollectible accounts of $1,025,000 and $982,000 as of March 31, 2011 and September 30, 2010, 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.

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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, 2011 and 2010:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Basic EPS Computation				
Net loss	$(713,152)	$(690,008)	$(1,167,276)	$(1,387,115)
Weighted average shares outstanding	4,480,836	4,532,981	4,481,018	4,561,452
Basic loss per share	$(.16)	$(.15)	$(.26)	$(.30)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Diluted EPS Computation				
Net loss	$(713,152)	$(690,008)	$(1,167,276)	$(1,387,115)
Weighted average shares outstanding	4,480,836	4,532,981	4,481,018	4,561,452
Stock options	-	-	-	-
Stock compensation arrangements	-	-	-	-
Diluted shares outstanding	4,480,836	4,532,981	4,481,018	4,561,452
Diluted loss per share	$(.16)	$(.15)	$(.26)	$(.30)

For the three months ended March 31, 2011 and 2010, 58,794 and 86,309 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, 2011 and 2010, 52,103 and 95,864 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 month and six month periods ended March 31, 2011 and 2010 was as follows:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Net loss	$(713,152)	$(690,008)	$(1,167,276)	$(1,387,115)
Other comprehensive income (loss):				
Unrealized loss on	(8,089)	(9,135)	(78,522)	(10,556)

securities, net of tax				
Unrealized gain (loss) on derivatives, net of tax	(43,565)	44,724	18,820	97,026
Foreign currency translation adjustment	311,615	(411,863)	162,712	(384,131)
Comprehensive loss	$(453,191)	$(1,066,282)	$(1,064,266)	$(1,684,776)

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The accumulated other comprehensive loss balances at March 31, 2011 and September 30, 2010 consisted of the following:

	March 31, 2011	September 30, 2010
Foreign currency translation adjustment	$(34,545)	$(197,257)
Unrealized loss on derivatives, net of tax	(49,789)	(68,609)
Unrealized gain (loss) on securities, net of tax	(18,609)	59,913
Accumulated other comprehensive loss	$(102,943)	$(205,953)

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, 2011, the Company had forward exchange contracts outstanding with notional amounts aggregating $3.4 million, whose aggregate fair value was a liability of approximately $79,031. 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 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.

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, 2011 and 2010, the Company recorded non-cash compensation expense of $73,319 and $77,561 respectively, ($.02 and $.02 per basic and diluted share, respectively) relating to stock compensation. For the six-month periods ended March 31, 2011 and 2010, the Company recorded non-cash compensation expense of $151,287 and $154,224, respectively, ($.03 and $.03 per basic and diluted share, respectively) relating to stock compensation.

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 dome camera and system controller product lines, among other products that collectively represent significant sales to the Company. Among other things, the suit seeks past damages, enhanced damages and attorney's fees. The Company and its outside patent counsel believe that the complaint against the Company is without merit and is vigorously defending itself in a joint defense with certain other named defendants. 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. Such damages claim was based upon $233 million of alleged infringing product sales for the period at a royalty rate of 5%.

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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 and in May 2007, the plaintiff appealed the examiner's decision to the USPTO Board of Patent Appeals and Interferences (BPAI). On August 16, 2010, the BPAI issued its decision to affirm the USPTO examiner's finding of invalidity of two of the asserted claims and reversed the examiner's finding of invalidity of the other four claims. In August 2010, Federal District Court granted the plaintiff's motion to reopen the case, which has been scheduled for trial in early 2012. The Company believes that it has substantial non-infringement and invalidity defenses to the plaintiff's remaining claims and in November 2010, filed a petition with the USPTO to reexamine such claims based upon newly discovered prior art. In January 2011, the Company's request for reexamination was granted by the USPTO and is pending an appeal by the plaintiff.

The Company believes that the plaintiff's damages claims through 2005 are without merit and has not yet received their subsequent damages claims through the expiration of their patent in May 2009. Due to the inherent uncertainty of a jury trial and technical nature of this matter, the Company has been unable to reasonably estimate a range of possible loss, if any, at this time. The Company has held settlement discussions with the plaintiff in the past with no result and may continue to do so in the future. However, there is no assurance that any settlement can be reached.

Notwithstanding any of the foregoing, the matter could ultimately result in a liability that is material to the Company's results of operations and financial position. The Company has been informed by its legal counsel that the estimated future cost of this litigation could approximate $1.5 million through trial, including legal and expert witness representation.

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 October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, "Revenue Recognition (Topic 605) — Multiple-Deliverable Revenue Arrangements" (ASU 2009-13) and ASU 2009-14, "Software (Topic 985) — Certain Revenue Arrangements That Include Software Elements" (ASU 2009-14). ASU 2009-13 modifies the requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. ASU 2009-14 modifies the software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product's essential functionality. These new updates became effective in the Company's December 31, 2010 quarter and had no material impact upon its consolidated financial position, results of operations or cash flows.

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Note 10: Income Taxes

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 2003 in the U.S. and 2005 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 $79,031 less favorable than the market rates for similar term contracts at March 31, 2011.

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, manufactures, assembles and markets a wide range of video systems and system components used for security, surveillance, safety and communication purposes 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 physical security information management software, analog, megapixel and IP fixed and robotic cameras, virtual and analogue matrix video switchers and controls, and system peripherals.

The Company sells high-end 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 does not maintain a sizable backlog as its customer orders are typically deliverable within three months or often upon receipt of order. The Company’s operating cost structure is principally fixed and therefore profitability is largely dependent upon sales levels. Since fiscal year 2009, the Company’s sales levels have been impacted by the worldwide economic downturn as capital expenditures for construction and renovation projects have weakened. Such sales declines have had an adverse impact on the Company’s financial results for these periods.

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 2010 and 2009, the Company incurred $5.5 million and $5.4 million of engineering and development expense or 11% and 9% 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 2010 despite a reduction in sales and such expenditure levels are expected to continue in fiscal 2011. The Company has considered various strategic initiatives that may augment or supplement its present product offerings and technology platforms, among other benefits.

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The Company has a foreign sales and distribution subsidiary in Europe that conducts business in British pounds and Euros that represented approximately 31% of the Company's consolidated sales for fiscal 2010. It also has an Israel based engineering and development subsidiary that incurs a majority of its operating expenses in Shekels that represented approximately 18% of the Company's operating expenses for fiscal 2010. 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 companies. Subsequent to fiscal 2009, such world currency exchange rate changes have moderated, which significantly lessened the Company's currency impacts compared with 2009. The Company has also historically secured selected forward currency exchange contracts to help stabilize the impact of changing exchange rates and will continue to do so in fiscal 2011.

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Results of Operations
Three Months Ended March 31, 2011 Compared with March 31, 2010

Net sales for the quarter ended March 31, 2011 increased 6% to $12.1 million compared with $11.4 million in the year ago period. Domestic sales increased 14% to $7.1 million compared with $6.2 million in the year ago period while international sales decreased 3% to $5.0 million compared with $5.2 million in the year ago period. Order intake for the quarter ended March 31, 2011 increased 3% to $12.1 million compared with $11.8 million in the year ago period. The backlog of unfilled orders increased $1.6 million to $4.6 million at March 31, 2011 compared with $3.0 million at September 30, 2010.

Gross profit margins for the second quarter of fiscal 2011 decreased to 38.9% compared with 41.1% in the year ago period. The decrease in current quarter margins was the result of increased competitive pressures in the worldwide security market and less favorable product mix on certain project sales.

Total operating expenses for the second quarter of fiscal 2011 increased to $5.8 million or 48% of net sales compared with $5.7 million or 50% of net sales in the year ago quarter. Selling, general and administrative expenses were $4.3 million for the second quarter of fiscal 2011 compared with $4.3 million in the year ago quarter. In the current quarter, the Company incurred $169,000 of legal fees in defense of the patent infringement suit compared with no costs incurred in the year ago period. The Company maintained its investment level in new product development in the current quarter, incurring $1.5 million of engineering and development costs compared with $1.4 million in the year ago period. The Company has substantially maintained its selling, general and administrative cost structure in anticipation of improving market conditions.

The Company incurred an operating loss of $1.1 million in the second quarter of fiscal 2011 compared with an operating loss of $1.0 million in the year ago period.

Interest income decreased to $48,000 for the second quarter of fiscal 2011 compared with $52,000 in the year ago quarter due principally to lower investable balances in the current quarter. During fiscal 2010, the Company increased its investment in marketable securities by $5.1 million in an effort to improve its yields on invested cash balances. Such marketable securities consisted of mutual fund investments principally in federal, state and local government debt securities.

The Company recorded an income tax benefit of $308,000 for the second quarter of fiscal 2011 compared with a benefit of $281,000 in the year ago quarter as a result of pretax losses incurred in the quarters.

As a result of the foregoing, the Company reported a net loss of $713,000 for the second quarter of fiscal 2011 compared with a net loss of $690,000 in the year ago period.

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Results of Operations
Six Months Ended March 31, 2011 Compared with March 31, 2010

Net sales for the six months ended March 31, 2011 increased 6% to $23.8 million compared with $22.5 million in the year ago period. Domestic sales increased 14% to $14.4 million compared with $12.6 million in the year ago period while international sales decreased 5% to $9.4 million compared with $9.9 million in the year ago period. Order intake for the six months ended March 31, 2011 decreased slightly to $25.4 million compared with $25.5 million in the year ago period.

Gross profit margins for the first six months of fiscal 2011 decreased to 40.0% compared with 41.4% in the year ago period. The decrease in current year period margins was the result of increased competitive pressures in the worldwide security market and less favorable product mix on certain project sales.

Total operating expenses for the first six months of fiscal 2011 decreased to $11.3 million or 48% of net sales compared with $11.4 million or 51% of net sales in the year ago period. Selling, general and administrative expenses were $8.4 million for the first six months of fiscal 2011 compared with $8.7 million in the year ago period. In the current year period, the Company incurred $250,000 of legal fees in defense of the patent infringement suit compared with no costs incurred in the year ago period. The Company maintained its investment level in new product development in the current year period, incurring $2.9 million of engineering and development costs compared with $2.7 million in the year ago period. The Company has substantially maintained its selling, general and administrative cost structure in anticipation of improving market conditions.

The Company incurred an operating loss of $1.8 million for the first six months of fiscal 2011 compared with an operating loss of $2.1 million in the year ago period.

Interest income increased to $132,000 for the first six months of fiscal 2011 compared with $105,000 in the year ago quarter due principally to higher market yields on marketable security investments in the current year period. During fiscal 2010, the Company increased its investment in marketable securities by $5.1 million in an effort to improve its yields on invested cash balances. Such marketable securities consisted of mutual fund investments principally in federal, state and local government debt securities. Other expense (income) for the first six months of 2011 included $12,000 of income compared with $3,000 of losses in the year ago period principally representing changes in the market value of certain equity securities held.

The Company recorded an income tax benefit of $485,000 for the first six months of fiscal 2011 compared with a benefit of $641,000 in the year ago period as a result of pretax losses incurred in the periods.

As a result of the foregoing, the Company reported a net loss of $1.2 million for the first six months of fiscal 2011 compared with a net loss of $1.4 million in the year ago period.

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Liquidity and Capital Resources

Net cash provided by operating activities was $150,000 for the first six months of fiscal 2011. Cash generated from a $2.2 million reduction in accounts receivable was offset in part by $1.1 million of losses net of non-cash items and a $902,000 net reduction in other operating assets and liabilities. Net cash used in investing activities was $352,000 for the first six months of fiscal 2011 consisting of $113,000 of marketable securities purchases and $239,000 of general capital expenditures. The marketable security purchases consisted of mutual fund investments principally in federal, state and local government debt securities. Net cash used in financing activities was $53,000 for the first six months of fiscal 2011, which included $75,000 of common stock repurchases offset in part by $22,000 of proceeds received from the exercise of stock options. As a result of the foregoing, cash (exclusive of marketable securities) decreased by $152,000 for the first six months of fiscal 2011 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 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 dome camera and system controller product lines, among other products that collectively represent significant sales to the Company. Among other things, the suit seeks past damages, enhanced damages and attorney's fees. The Company and its outside patent counsel believe that the complaint against the Company is without merit and is vigorously defending itself in a joint defense with certain other named defendants. 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. Such damages claim was based upon $233 million of alleged infringing product sales for the period at a royalty rate of 5%.

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 and in May 2007, the plaintiff appealed the examiner's decision to the USPTO Board of Patent Appeals and Interferences (BPAI). On August 16, 2010, the BPAI issued its decision to affirm the USPTO examiner's finding of invalidity of two of the asserted claims and reversed the examiner's finding of invalidity of the other four claims. In August 2010, Federal District Court granted the plaintiff's motion to reopen the case, which has been scheduled for trial in early 2012. The Company believes that it has substantial non-infringement and invalidity defenses to the plaintiff's remaining claims and in November 2010, filed a petition with the USPTO to reexamine such claims based upon newly discovered prior art. In January 2011, the Company's request for reexamination was granted by the USPTO and is pending an appeal by the plaintiff.

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The Company believes that the plaintiff's damages claims through 2005 are without merit and has not yet received their subsequent damages claims through the expiration of their patent in May 2009. Due to the inherent uncertainty of a jury trial and technical nature of this matter, the Company has been unable to reasonably estimate a range of possible loss, if any, at this time. The Company has held settlement discussions with the plaintiff in the past with no result and may continue to do so in the future. However, there is no assurance that any settlement can be reached.

Notwithstanding any of the foregoing, the matter could ultimately result in a liability that is material to the Company's results of operations and financial position. The Company has been informed by its legal counsel that the estimated future cost of this litigation could approximate $1.5 million through trial, including legal and expert witness representation.

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, 2010 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 the adoption of 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 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.

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, 2011 and concluded that it is effective.

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Changes in Internal Controls

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation referred to above that occurred during the quarter ended March 31, 2011 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.

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 dome camera and system controller product lines, among other products that collectively represent significant sales to the Company. Among other things, the suit seeks past damages, enhanced damages and attorney’s fees. The Company and its outside patent counsel believe that the complaint against the Company is without merit and is vigorously defending itself in a joint defense with certain other named defendants. 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. Such damages claim was based upon $233 million of alleged infringing product sales for the period at a royalty rate of 5%.

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Notwithstanding any of the foregoing, the matter could ultimately result in a liability that is material to the Company's results of operations and financial position. The Company has been informed by its legal counsel that the estimated future cost of this litigation could approximate $1.5 million through trial, including legal and expert witness representation.

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, 2010.

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 Company did not repurchase any of its common stock during the three month period ended March 31, 2011. The approximate dollar value of shares that may yet be purchased under the program was $1,211,217 as of March 31, 2011.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 – (REMOVED AND RESERVED)

ITEM 5 - OTHER INFORMATION

None

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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.

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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 12, 2011

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