

VICON INDUSTRIES INC /NY/
Form 10-Q
May 15, 2017

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, 2017

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 11-2160665
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

135 Fell Court, Hauppauge, New York 11788
(Address of principal executive offices) (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, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company) Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At May 9, 2017, the registrant had outstanding 9,348,388 shares of Common Stock, \$.01 par value.

VICON INDUSTRIES, INC.
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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VICON INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended		Six Months Ended	
	3/31/2017	3/31/2016	3/31/2017	3/31/2016
Net sales	\$6,003,382	\$7,998,124	\$12,608,360	\$18,878,680
Cost of sales	3,757,137	5,359,153	7,789,956	11,968,535
Gross profit	2,246,245	2,638,971	4,818,404	6,910,145
Operating expenses:				
Selling, general and administrative expense	2,801,538	3,726,200	5,482,395	7,656,350
Engineering and development expense	1,289,475	1,339,658	2,429,451	2,658,054
Goodwill writedown	—	6,016,469	—	6,016,469
	4,091,013	11,082,327	7,911,846	16,330,873
Operating loss	(1,844,768)	(8,443,356)	(3,093,442)	(9,420,728)
Other income (expense):				
Gain on sale of building	—	784,896	—	784,896
Interest income	170	160	403	324
Interest expense	(58,503)	—	(112,071)	—
Loss before income taxes	(1,903,101)	(7,658,300)	(3,205,110)	(8,635,508)
Income tax expense	—	—	—	—
Net loss	\$(1,903,101)	\$(7,658,300)	\$(3,205,110)	\$(8,635,508)
Loss per share:				
Basic	\$(.20)	\$(.82)	\$(.34)	\$(.92)
Diluted	\$(.20)	\$(.82)	\$(.34)	\$(.92)
Weighted average shares outstanding:				
Basic	9,348,388	9,341,038	9,348,388	9,335,880
Diluted	9,348,388	9,341,038	9,348,388	9,335,880

See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
 (UNAUDITED)

	Three Months Ended		Six Months Ended	
	3/31/2017	3/31/2016	3/31/2017	3/31/2016
Net loss	\$(1,903,101)	\$(7,658,300)	\$(3,205,110)	\$(8,635,508)
Other comprehensive income (loss):				
Unrealized gain (loss) on securities	(38)	159	(449)	74
Foreign currency translation adjustment	140,932	(184,391)	276,170	(27,082)
Other comprehensive income (loss)	140,894	(184,232)	275,721	(27,008)
Comprehensive loss	\$(1,762,207)	\$(7,842,532)	\$(2,929,389)	\$(8,662,516)

See Accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	3/31/2017	9/30/2016
	(Unaudited)	
CURRENT ASSETS		
Cash and cash equivalents	\$2,072,588	\$1,954,422
Marketable securities	13,343	13,545
Accounts receivable, net	4,486,792	6,158,504
Inventories:		
Parts, components, and materials	1,042,123	1,432,135
Work-in-process	1,418,521	812,455
Finished products	4,882,182	4,745,660
	7,342,826	6,990,250
Prepaid expenses and other current assets	551,616	572,440
TOTAL CURRENT ASSETS	14,467,165	15,689,161
Property, plant and equipment	5,928,340	5,865,969
Less accumulated depreciation and amortization	(5,442,739)	(5,345,786)
	485,601	520,183
Intangible assets, net	972,500	1,106,500
Other assets	769,457	761,865
TOTAL ASSETS	\$16,694,723	\$18,077,709
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$3,239,518	\$2,551,080
Accrued compensation and employee benefits	1,767,365	1,701,103
Accrued expenses	1,303,826	1,472,272
Unearned revenue	355,592	476,565
TOTAL CURRENT LIABILITIES	6,666,301	6,201,020
Revolving credit borrowings	2,750,000	1,750,000
Unearned revenue - non current	95,728	76,950
Other long-term liabilities	1,560,637	1,522,825
TOTAL LIABILITIES	11,072,666	9,550,795
Commitments and contingencies		
SHAREHOLDERS' EQUITY		
Common stock, par value \$.01 per share		
authorized - 25,000,000 shares	100,448	100,448
issued - 10,044,827 shares		
Capital in excess of par value	40,542,451	40,517,919
Accumulated deficit	(31,330,069)	(28,124,959)
Treasury stock at cost, 696,439 shares	(3,437,643)	(3,437,643)
Accumulated other comprehensive loss	(253,130)	(528,851)
TOTAL SHAREHOLDERS' EQUITY	5,622,057	8,526,914

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY \$ 16,694,723 \$ 18,077,709

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended	
	3/31/2017	3/31/2016
Cash flows from operating activities:		
Net loss	\$(3,205,110)	\$(8,635,508)
Adjustments to reconcile net loss to net cash used in operating activities:		
Goodwill impairment	—	6,016,469
Gain on sale of building	—	(784,896)
Depreciation and amortization	258,773	425,565
Amortization of deferred compensation	738	742
Stock compensation expense	23,794	298,778
Change in assets and liabilities:		
Accounts receivable, net	1,592,307	4,407,978
Inventories, net	(401,213)	(623,947)
Prepaid expenses and other current assets	14,886	(271,183)
Other assets	(7,593)	(23,840)
Accounts payable	707,076	(1,073,879)
Accrued compensation and employee benefits	70,627	(796,443)
Accrued expenses	(163,235)	(233,268)
Unearned revenue	(102,195)	(507,389)
Other liabilities	40,327	11,443
Net cash used in operating activities	(1,170,818)	(1,789,378)
Cash flows from investing activities:		
Proceeds from sale of building, net	—	1,512,320
Net increase in marketable securities	(247)	(173)
Capital expenditures	(94,371)	(112,619)
Net cash provided by (used in) investing activities	(94,618)	1,399,528
Cash flows from financing activities:		
Revolving credit borrowings	1,000,000	—
Proceeds from exercise of stock options	—	5,184
Net cash provided by financing activities	1,000,000	5,184
Effect of exchange rate changes on cash	383,602	165,767
Net increase (decrease) in cash	118,166	(218,899)
Cash and cash equivalents at beginning of year	1,954,422	2,390,409
Cash and cash equivalents at end of period	\$2,072,588	\$2,171,510

See Accompanying Notes to Condensed Consolidated Financial Statements.

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VICON INDUSTRIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2017

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, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2017. 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, 2016.

Note 2: Marketable Securities

Marketable securities consist of mutual fund investments principally in federal, state and local government debt securities of \$13,343 as of March 31, 2017. 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, with unrealized gains and losses reported in accumulated other comprehensive loss as a component of shareholders' equity. The cost of such securities at March 31, 2017 was \$13,927, with \$584 of cumulative unrealized losses reported at March 31, 2017.

Note 3: Accounts Receivable

Accounts receivable is stated net of an allowance for uncollectible accounts of \$1,025,000 and \$1,069,000 as of March 31, 2017 and September 30, 2016, 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 and six month periods ended March 31, 2017 and 2016:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2017	2016	2017	2016
Basic EPS Computation				
Net loss	\$(1,903,101)	\$(7,658,300)	\$(3,205,110)	\$(8,635,508)
Weighted average shares outstanding	9,348,388	9,341,038	9,348,388	9,335,880
Basic loss per share	\$(.20) \$(.82) \$(.34) \$(.92

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	Three Months Ended		Six Months Ended	
	March 31, 2017	2016	March 31, 2017	2016
Diluted EPS Computation				
Net loss	\$(1,903,101)	\$(7,658,300)	\$(3,205,110)	\$(8,635,508)
Weighted average shares outstanding	9,348,388	9,341,038	9,348,388	9,335,880
Stock options	—	—	—	—
Stock compensation arrangements	—	—	—	—
Diluted shares outstanding	9,348,388	9,341,038	9,348,388	9,335,880
Diluted loss per share	\$(.20)	\$(.82)	\$(.34)	\$(.92)

For the for the three and six month periods ended March 31, 2017 and 2016, all outstanding stock options and shares issuable under stock compensation arrangements totaling 623,587 and 670,300 shares, respectively, have been omitted from the calculation of diluted EPS as their effect would have been antidilutive. The actual effect of these stock options and shares, if any, on the diluted earnings per share calculation will vary significantly depending on fluctuations in the market price of the Company's stock.

Note 5: Accumulated Other Comprehensive Loss

The Company's accumulated other comprehensive loss balances at March 31, 2017 and September 30, 2016 consisted of the following:

	March 31, 2017	September 30, 2016
Foreign currency translation adjustment	\$(252,546)	\$(528,716)
Unrealized loss on marketable securities	(584)	(135)
Accumulated other comprehensive loss	\$(253,130)	\$(528,851)

Note 6: Intangible Assets

The components and estimated useful lives of intangible assets as of March 31, 2017 and September 30, 2016 are stated below. Amortization is provided on a straight line method, or in the case of customer relationships, on an accelerated method, over the following estimated useful lives:

	March 31, 2017		September 30, 2016		Estimated Useful Life
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization	
Definite-lived intangibles:					
Customer relationships	\$910,000	\$483,833	\$910,000	\$371,833	7 years
Tradenames	660,000	113,667	660,000	91,667	15 years
	\$1,570,000	\$597,500	\$1,570,000	\$463,500	

Amortization expense was \$67,000 and \$129,250 for the three month periods ended March 31, 2017 and 2016, respectively, and \$134,000 and \$258,500 for the six month periods ended March 31, 2017 and 2016, respectively.

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Future amortization expense for intangible assets over the next five years ending September 30 and thereafter is summarized as follows:

Fiscal Year	Amount
Remainder of 2017	\$ 134,000
2018	177,000
2019	123,000
2020	91,000
2021	72,000
Thereafter	\$ 375,500

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 (“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, 2017 and 2016, the Company recorded non-cash compensation expense of \$11,395 and \$145,580, respectively (\$.00 and \$.02 per basic and diluted share, respectively), relating to stock compensation. For the six month periods ended March 31, 2017 and 2016, the Company recorded non-cash compensation expense of \$23,794 and \$298,778, respectively (\$.00 and \$.03 per basic and diluted share, respectively), relating to stock compensation.

Note 8: Recent Accounting Pronouncements

In May 2014, the FASB issued guidance on revenue from contracts with customers. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of time value of money in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved, in certain circumstances. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. This guidance permits the use of either the retrospective or cumulative effect transition method and is effective for the Company beginning in 2019; early adoption is not permitted prior to 2018. The Company is currently in the initial stages of evaluating the effect of implementing this guidance.

In February 2016, the FASB issued guidance on lease accounting requiring lessees to recognize a right-of-use asset and a lease liability for long-term leases. The liability will be equal to the present value of lease payments. This guidance must be applied using a modified retrospective transition approach to all annual and interim periods presented and is effective for the Company beginning in fiscal 2019. The Company is currently in the initial stages of evaluating the effect of implementing this guidance.

In March 2016, the FASB issued guidance on simplifying several aspects of accounting for share-based payment award transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This guidance requires a mix of prospective, modified retrospective, and

retrospective transition to all annual and interim periods presented and is effective for the Company beginning in fiscal 2018. The Company is currently in the initial stages of evaluating the effect of implementing this guidance.

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Note 9: 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. The Company has a valuation allowance against its deferred tax assets due to the uncertainty of future realization. The full valuation allowance is determined to be appropriate due to 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. At September 30, 2016, the Company had \$13.4 million of unrecognized net deferred tax assets available, which includes approximately \$8.8 million of tax effected U.S. and foreign net operating loss carryforwards. On August 29, 2014, the Company merged with IQinVision, Inc. In connection with this merger, the Company's ability to utilize pre-merger net operating losses and tax credit carryforwards in the future is subject to certain limitations pursuant to Section 382 of the Internal Revenue Code. The annual limitation on utilization of the Company's U.S. net operating loss carryforwards is presently estimated at \$500,000.

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 2013 in the U.S. and 2010 in the U.K., Germany and Israel.

Note 10: 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, other receivables, accounts payable and revolving credit borrowings approximate fair value due to either the short-term maturity of these instruments or the fact that the interest rate of the revolving credit borrowings is based upon current market rates.

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.

Note 11: Product Warranties

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.

Changes in the Company's warranty liability (included in accrued expenses) for the three and six month periods ended March 31, 2017 and 2016 were as follows:

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2017	2016	2017	2016
Balance at beginning of period	\$650,000	\$650,000	\$650,000	\$650,000
Provision for warranties	102,000	110,000	216,000	218,000
Expenses incurred	(102,000)	(110,000)	(216,000)	(218,000)
Balance at end of period	\$650,000	\$650,000	\$650,000	\$650,000

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Note 12: Credit Agreement

On March 4, 2016, the Company entered into a Credit Agreement (the “Agreement”) with NIL Funding Corporation to provide a \$3 million revolving line of credit for working capital purposes which was subsequently amended and restated on two occasions as described below. The Agreement provides for a borrowing formula based upon eligible accounts receivable and is secured by a first priority security interest in substantially all of the Company’s assets. Borrowings under the Agreement bore interest at a rate of 6.75% per annum. The Agreement also provides for an unused commitment fee equal to .5% per annum. The Agreement includes provisions that are customarily found in similar financing agreements. NIL Funding Corporation is an affiliate of The InterTech Group, whose Executive Vice President and Chief Operating Officer, Julian A. Tiedemann, serves as the Chairman of the Company’s Board of Directors.

On August 18, 2016, the Company entered into an Amended and Restated Credit Agreement (the “Amended Agreement”) with NIL Funding Corporation which increased the \$3 million revolving line of credit to \$6 million. Under the Amended Agreement, the facility was to mature on October 2, 2018 and consisted of two credit lines of \$4 million and \$2 million which bore interest at rates of 6.95% per annum and 8.25% per annum, respectively. The \$4 million line of credit was subject to a borrowing formula based upon eligible accounts receivable. The Amended Agreement also provided for an initial commitment fee of \$60,000, which was paid at closing, as well as an unused commitment fee equal to .5% per annum. The Amended Agreement includes a financial covenant that requires the Company to maintain a specified minimum tangible net worth, as defined, and is otherwise substantially similar to the original Agreement with NIL Funding Corporation. At March 31, 2017, the Company was not in compliance with this covenant. As of March 31, 2017, outstanding borrowings under the Amended Agreement were \$2,750,000.

On April 20, 2017, the Company entered into a Second Amended and Restated Credit Agreement (the “Second Amended Agreement”) with NIL Funding Corporation, under which only \$2 million of the \$6 million facility is subject to a borrowing formula, effectively providing the Company with \$2 million of additional borrowing availability. The Second Amended Agreement also extends the maturity date of the credit facility to April 2, 2019, and reduces the Company’s minimum tangible net worth requirement, but is otherwise substantially similar to the Amended Agreement.

In connection with the Second Amended Agreement, NIL Funding was issued a three-year warrant to purchase 1.5 million shares of the Company's common stock at a price of \$.40 per share.

NOTE 13. Going Concern and Liquidity

The accompanying financial statements have been prepared on a going concern basis which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future and, thus, do not include any adjustments relating to the recoverability and classification of assets and liabilities that may be necessary if the Company is unable to continue as a going concern. However, the Company's ability to continue as a going concern is dependent upon generating profitable operations in the future and obtaining the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due.

The Company continues to incur operating losses due to decreased revenue levels and ongoing strategic investments. Since 2012, the Company has made a significant investment in the development of a completely new, and strategically critical, video management system (VMS). The first release of this product offering was launched in January 2017 and is ultimately expected to significantly enhance the Company’s market competitiveness. The funding of this major development effort has contributed to the ongoing operating losses and depletion of cash reserves. The Company has also encountered issues with certain of its camera offerings that have negatively impacted its revenues during the last twelve months. Although these issues have been substantially resolved, their market impact has lingered into fiscal

2017. In response, the Company phased in material operating expense reductions over the course of the past several years and will consider further cost cutting measures throughout the remainder of the fiscal year. However, the Company intends to continue funding the development of its new VMS platform and rebuilding its market channels. At March 31, 2017, the Company had \$2.1 million of cash reserves and a maximum of \$3.25 million of borrowings available under the Credit Agreement described above, which is subject in part to a borrowing-base formula. Cash losses over the past several years have been financed in part by the sale of the Company's two principal operating facilities and ongoing management of working capital levels. The Company expects to continue to draw on its credit facility to finance its near term working capital needs. In addition, the Company is currently seeking additional funding sources to finance its aggressive product development roadmap and growth initiatives over the upcoming twelve month period. Since there are no guarantees that such plans will be successful and that the Company will have sufficient available cash to sustain its operations through the next twelve month period, there is substantial doubt about the Company's ability to continue as a going concern.

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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 and intangible 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 DVR's, NVR's, video encoders, decoders, servers and related video management software, data storage units, analog, digital and HD megapixel fixed and robotic cameras, virtual and analog matrix video switchers and controls, and system peripherals.

The Company sells video surveillance system components in a highly competitive worldwide marketplace principally to authorized security distributors, dealers and system integrators. Such dealers and integrators typically resell and install 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.

The Company competes in a market of rapid technology shifts which enhance the performance capability of security systems. As a result, the Company spends a significant amount on new product development. In fiscal 2016 and 2015, the Company incurred \$5.2 million and \$5.1 million of engineering and development expense or 15% and 11% of net sales, respectively. The Company's expenditures for product development are substantially less than its major competitors. The ongoing market shift to intelligent software solutions will continue to burden the Company's development resources and increase ongoing annual expense for product development. Further, the Company's sales effort requires a high level of customer service and technical support for its products. The Company routinely considers various strategic options that may augment or supplement its present product offerings and technology platforms.

The Company has a foreign sales and distribution subsidiary in Europe that conducts certain of its business in British pounds and Euros that represented approximately 23% of the Company's consolidated sales for fiscal 2016. It also has an Israel based engineering and development subsidiary that incurs a majority of its operating expenses in Shekels that represented approximately 14% of the Company's operating expenses for fiscal 2016. Changes in these local foreign currency exchange rates could have a direct impact on the Company's reported financial position and results.

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Results of Operations

Three Months Ended March 31, 2017 Compared with March 31, 2016

Net sales for the quarter ended March 31, 2017 decreased by \$2.0 million (25%) to \$6.0 million compared with \$8.0 million in the year ago period. Sales in the Americas decreased \$1.6 million (26%) to \$4.6 million compared with \$6.2 million in the year ago period, while Europe, Middle East and Africa (EMEA) sales decreased \$380,000 (22%) to \$1.4 million compared with \$1.8 million in the year ago period. Order intake for the quarter ended March 31, 2017 decreased by \$518,000 (7%) to \$6.8 million compared with \$7.3 million in the year ago period. Americas order intake decreased by \$232,000 (4%) to \$5.6 million compared with \$5.8 million in the year ago period, while EMEA order intake decreased \$286,000 (18%) to \$1.3 million compared with \$1.6 million in the year ago period. The backlog of unfilled orders was \$1.7 million at March 31, 2017 compared with \$1.7 million at September 30, 2016. The Company's market share continued to be impacted by its reliance upon a legacy product offering as well as past camera line production issues that have since been resolved. Scheduled new core product launches during the remainder of fiscal 2017 are expected to significantly improve the Company's market competitiveness.

Gross profit margins were 37.4% for the quarter ended March 31, 2017 compared with 33.0% in the year ago period. The year ago quarter margins included \$150,000 (1.9%) of additional inventory provisions relating to the rework and transitioning of the Company's IQinVision camera line to a new contract manufacturing partner.

Operating expenses for the second quarter of fiscal 2017 decreased \$7.0 million to \$4.1 million compared with \$11.1 million for the year ago period. In the year ago period, the Company charged off its entire \$6.0 million goodwill carrying value. Selling, general and administrative (SG&A) expenses for the current quarter decreased \$925,000 to \$2.8 million compared with \$3.7 million in the year ago period. Such decreases included the effects of planned staff and other cost reduction initiatives necessitated by lower revenue expectations. Engineering and development expenses decreased \$50,000 to \$1.3 million for the current quarter compared with \$1.3 million for the year ago period as the Company continued investing in its new video management system platform.

The Company incurred an operating loss of \$1.9 million for the second quarter of fiscal 2017 compared with an operating loss of \$8.4 million in the year ago period.

The Company recorded a gain on the sale of its United Kingdom based operating facility of \$785,000 in the second quarter of fiscal 2016.

The Company incurred interest expense of \$59,000 for the second quarter of fiscal 2017 relating to borrowings under its revolving credit agreement.

The Company provides for 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 both periods (see Note 9: Income Taxes).

As a result of the foregoing, the Company reported a net loss of \$1.9 million for the second quarter of fiscal 2017 compared with a net loss of \$7.7 million in the year ago period.

Results of Operations

Six Months Ended March 31, 2017 Compared with March 31, 2016

Net sales for the six months ended March 31, 2017 decreased by \$6.3 million (33%) to \$12.6 million compared with \$18.9 million in the year ago period. Sales in the Americas decreased \$4.6 million (31%) to \$10.2 million compared with \$14.8 million in the year ago period, while Europe, Middle East and Africa (EMEA) sales decreased \$1.7 million

(41%) to \$2.4 million compared with \$4.1 million in the year ago period. Order intake for the six months ended March 31, 2017 decreased by \$6.4 million (34%) to \$12.6 million compared with \$19.0 million in the year ago period. Americas order intake decreased by \$4.8 million (32%) to \$10.3 million compared with \$15.1 million in the year ago period, while EMEA order intake decreased \$1.6 million (41%) to \$2.3 million compared with \$3.9 million in the year ago period. The Company's market share continued to be impacted by its reliance upon a legacy product offering as well as past camera line production issues that have since been resolved. Scheduled new core product launches during the remainder of fiscal 2017 are expected to significantly improve the Company's market competitiveness.

Gross profit margins were 38.2% for the six months ended March 31, 2017 compared with 36.6% in the year ago period. The year ago period margins included \$150,000 (0.8%) of additional inventory provisions relating to the rework and transitioning of the Company's IQinVision camera line to a new contract manufacturing partner.

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Operating expenses for the six months ended March 31, 2017 decreased \$8.4 million to \$7.9 million compared with \$16.3 million for the year ago period. In the year ago period, the Company charged off its entire \$6.0 million goodwill carrying value. Selling, general and administrative (SG&A) expenses for the current year period decreased \$2.2 million to \$5.5 million compared with \$7.7 million in the year ago period. Such decreases included the effects of planned staff and other cost reduction initiatives necessitated by lower revenue expectations. Engineering and development expenses decreased \$229,000 to \$2.4 million for the current year period compared with \$2.7 million for the year ago period as the Company continued investing in its new video management system platform.

The Company incurred an operating loss of \$3.1 million for the six months ended March 31, 2017 compared with an operating loss of \$9.4 million in the year ago period.

The Company recorded a gain on the sale of its United Kingdom based operating facility of \$785,000 in the first six months of fiscal 2016.

The Company incurred interest expense of \$112,000 for the six months ended March 31, 2017 relating to borrowings under its revolving credit agreement.

The Company provides for 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 both periods (see Note 9: Income Taxes).

As a result of the foregoing, the Company reported a net loss of \$3.2 million for the six months ended March 31, 2017 compared with a net loss of \$8.6 million in the year ago period.

Liquidity and Capital Resources

Net cash used in operating activities was \$1.2 million for the first six months of fiscal 2017, which included a \$2.9 million reported net loss exclusive of non-cash charges and a \$401,000 increase in inventories, offset in part by cash generated from a \$1.6 million decrease in accounts receivable and a \$614,000 increase in trade and accrued liabilities. Net cash used in investing activities was \$95,000 for the first six months of fiscal 2017 consisting principally of capital expenditures. Net cash provided by financing activities was \$1.0 million for the first six months of fiscal 2017 consisting of revolving credit borrowings. As a result of the foregoing, cash (exclusive of marketable securities) increased by \$118,000 for the first six months of fiscal 2017 after the effect of exchange rate changes on the cash position of the Company.

The Company continues to incur operating losses due to decreased revenue levels and ongoing strategic investments. Since 2012, the Company has made a significant investment in the development of a completely new, and strategically critical, video management system (VMS). The first release of this product offering was launched in January 2017 and is ultimately expected to significantly enhance the Company's market competitiveness. The funding of this major development effort has contributed to the ongoing operating losses and depletion of cash reserves. The Company has also encountered issues with certain of its camera offerings that have negatively impacted its revenues during the last twelve months. Although these issues have been substantially resolved, their market impact has lingered into fiscal 2017. In response, the Company phased in material operating expense reductions over the course of the past several years and will consider further cost cutting measures throughout the remainder of the fiscal year. However, the Company intends to continue funding the development of its new VMS platform and rebuilding its market channels. At March 31, 2017, the Company had \$2.1 million of cash reserves and a maximum of \$3.25 million of borrowings available under the Credit Agreement described below, which is subject in part to a borrowing-base formula. Cash losses over the past several years have been financed in part by the sale of the Company's two principal operating facilities and ongoing management of working capital levels. During fiscal 2016, the Company entered into a Credit

Agreement that was subsequently amended and restated in August 2016 and April 2017. This Agreement currently consists of two credit lines totaling \$6 million that mature in April 2019 (see Note 12 - Credit Agreement). The Company expects to continue to draw on its credit facility to finance its near term working capital needs. In addition, the Company is currently seeking additional funding sources to finance its aggressive product development roadmap and growth initiatives over the upcoming twelve month period. Since there are no guarantees that such plans will be successful and that the Company will have sufficient available cash to sustain its operations through the next twelve month period, there is substantial doubt about the Company's ability to continue as a going concern.

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Off-Balance Sheet Arrangements

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.

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, 2016 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, 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 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 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.

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 evaluates the establishment of technological feasibility of its software in accordance with ASC 985 ("Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed"). The Company has determined that technological feasibility for its new products is reached shortly before products are released for field testing. Costs incurred after technological feasibility has been established have not been material and are expensed as incurred.

The Company assesses the recoverability of the carrying value of its long-lived and intangible assets 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. Since the Company's merger with IQinVision, it has essentially redesigned its acquired

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camera line. Thus, the Company determined that its technology asset was fully impaired and, as a result, recorded an impairment charge of \$2.0 million at September 30, 2016.

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 provides for 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.

Accounting for restructuring activities, as compared to regular operating cost management activities, requires an evaluation of formally committed and approved plans. Restructuring activities have comparatively greater strategic significance and materiality and may involve exit activities, whereas regular cost containment activities are more tactical in nature and are rarely characterized by formal and integrated action plans or exiting a particular product, facility or service.

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 that are not strictly historical facts including, without limitation, statements included under the "Management's Discussion and Analysis" caption, are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, 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 assumes no obligation to publicly update or revise its forward-looking statements or to advise of changes in the assumptions and factors on which they are based.

ITEM 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 has 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.

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, 2017 that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None

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

None

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	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification 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 15, 2017

/s/ John M. Badke
John M. Badke
Chief Executive Officer and
Chief Financial Officer

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