VIDEO DISPLAY CORP
Form 10-Q
July 15, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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 May 31, 2014.

or

¨ **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 0-13394

VIDEO DISPLAY CORPORATION

(Exact name of registrant as specified on its charter)

GEORGIA	**58-1217564**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1868 TUCKER INDUSTRIAL ROAD, TUCKER, GEORGIA 30084

(Address of principal executive offices)

770-938-2080

(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 x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	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 ¨ No x

As of May 31, 2014, the registrant had 6,495,919 shares of Common Stock outstanding.

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ITEM 1 FINANCIAL STATEMENTS

Video Display Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands)

	May 31, 2014 (unaudited)	February 28, 2014
Assets		
Current assets		
Cash and cash equivalents	**$ 1,393**	$ 2,299
Restricted cash	**1,200**	1,200
Trading investments, at fair value	**3,580**	4,914
Accounts receivable, less allowance for doubtful accounts of $37 and $40	**2,195**	1,876
Notes receivable	**1,662**	1,000
Inventories, net	**9,260**	9,915
Deferred income taxes	**241**	242
Income taxes refundable	**1,139**	1,120
Prepaid expenses and other	**162**	182
Total current assets	**20,832**	22,748
Property, plant, and equipment		
Land	**154**	154
Buildings	**2,589**	2,589
Machinery and equipment	**7,229**	7,249
	9,972	9,992
Accumulated depreciation and amortization	**(8,471)**	(8,431)
Net property, plant, and equipment	**1,501**	1,561
Notes receivable	**1,720**	1,698
Intangible assets, net	**652**	684
Deferred income taxes	**732**	760
Other assets	**29**	29
Total assets	**$ 25,466**	$ 27,480

The accompanying notes are an integral part of these condensed consolidated statements.

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Video Display Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (continued)

(in thousands)

	May 31, 2014 (unaudited)	February 28, 2014
Liabilities and Shareholders Equity		
Current liabilities		
Accounts payable	**$ 1,269**	$ 946
Accrued liabilities	**436**	925
Current maturities of long-term debt	**49**	48
Total current liabilities	**1,754**	1,919
Long-term debt, less current maturities	**220**	233
Deferred rent	**510**	540
Unrecognized gain on sale of assets	**554**	554
Total liabilities	**3,038**	3,246
Shareholders Equity		
Preferred stock, no par value 10,000 shares authorized; none issued and outstanding		
Common stock, no par value 50,000 shares authorized; 9,732 issued and 6,495 outstanding at May 31, 2014 and 9,732 issued and 7,020 outstanding at February 28, 2014	**7,293**	7,293
Additional paid-in capital	**162**	160
Retained earnings	**29,531**	29,392
Treasury stock, shares at cost; 3,237 at May 31, 2014 and 2,712 at February 28, 2014	**(14,558)**	(12,611)
Total shareholders equity	**22,428**	24,234
Total liabilities and shareholders equity	**$ 25,466**	$ 27,480

The accompanying notes are an integral part of these condensed consolidated statements.

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Video Display Corporation and Subsidiaries

Condensed Consolidated Income Statements

(in thousands, except per share data)

	Three Months Ended May 31, 2014	Three Months Ended May 31, 2013
Net sales	**$ 3,695**	$ 4,201
Cost of goods sold	**2,718**	4,023
Gross profit	**977**	178
Operating expenses		
Selling and delivery	**276**	474
General and administrative	**810**	538
	1,086	1,012
Operating loss	**(109)**	(834)
Other income (expense)		
Interest income (expense)	**14**	(359)
Other, net	**258**	469
	272	110
Income (loss) from continuing operations before income taxes	**163**	(724)
Income tax (benefit) expense	**24**	(273)
Net income (loss) from continuing operations	**139**	(451)
Income from discontinued operations, net of income tax expense		215
Net income (loss)	**$ 139**	$ (236)
Net income (loss) per share:		
From continuing operations-basic	**0.02**	(0.06)
From continuing operations-diluted	**0.02**	(0.06)
From discontinued operations-basic	**$ 0.00**	$ 0.03
From discontinued operations-diluted	**$ 0.00**	$ 0.03

Basic weighted average shares outstanding	**6,850**	7,584
Diluted weighted average shares outstanding	**6,875**	7,624

The accompanying notes are an integral part of these condensed consolidated statements.

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Condensed Consolidated Statement of Shareholders Equity

Three Months Ended May 31, 2014 (unaudited)

(in thousands)

	Common Shares	Share Amount	Additional Paid-in Capital	Retained Earnings	Treasury Stock
Balance, February 28, 2014	7,020	$ 7,293	$ 160	$ 29,392	$ (12,611)
Net income				139	
Repurchase of treasury stock	(525)				(1,947)
Share based compensation			2		
Balance, May 31, 2014	6,495	$ 7,293	$ 162	$ 29,531	$ (14,558)

The accompanying notes are an integral part of these condensed consolidated statements.

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Video Display Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three Months Ended May 31, 2014	2013
Operating Activities		
Net income (loss)	**139**	(236)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Income from discontinued operations, net of tax		(215)
Depreciation and amortization	**97**	99
Provision for doubtful accounts	**1**	16
Provision for inventory reserve	**82**	163
Non-cash charge for share based compensation	**2**	2
Deferred income taxes	**30**	103
Loss on disposal of assets		(400)
Realized/Unrealized gain on investments	**(166)**	
Other		3
Changes in working capital items:		
Accounts receivable	**(319)**	1,577
Other receivables	**(767)**	
Inventories	**574**	145
Prepaid expenses and other assets	**2**	35
Accounts payable and accrued liabilities	**(196)**	(1,712)
Cost, estimated earnings and billings on uncompleted contracts		(167)
Income taxes refundable/payable	**(19)**	(297)
Net cash used in operating activities	**(540)**	(884)
Investing Activities		
Capital expenditures	**(6)**	(17)
Proceeds from sale of property, plant & equipment		499
Proceeds from the sale of Lexel Imaging	**100**	
Purchases of investments	**(22,867)**	
Sales of investments	**23,443**	
Net cash provided by investing activities	**670**	482
Financing Activities		
Proceeds from long-term debt, lines of credit		6,898
Repayments of long-term debt, lines of credit	**(12)**	(6,783)
Purchase of treasury stock	**(1,947)**	
Re-issue of treasury stock		166

Proceeds from marginal float	**923**	
Repayments of notes payable to officers and directors		(50)
Net cash provided by (used in) financing activities	**(1,036)**	231
Discontinued Operations		
Operating activities		278
Investing activities		(16)
Net cash provided by discontinued operations		262
Net change in cash and cash equivalents	**(906)**	91
Cash and cash equivalents, beginning of year	**3,499**	316
Cash and cash equivalents, end of period	**2,593**	407
Cash and cash equivalents, discontinued operations		5
Cash and cash equivalents, continuing operations	**2,593**	402

The accompanying notes are an integral part of these condensed consolidated statements.

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Note 1. Summary of Significant Accounting Policies

The condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries after elimination of all significant intercompany accounts and transactions.

As contemplated by the Securities and Exchange Commission (the SEC or Commission) instructions to Form 10-Q, the following footnotes have been condensed and, therefore, do not contain all disclosures required in connection with annual consolidated financial statements. Reference should be made to the Company s year-end consolidated financial statements and notes thereto, including a description of the accounting policies followed by the Company, contained in its Annual Report on Form 10-K for the fiscal year ended February 28, 2014, as filed with the Commission. There are no material changes in accounting policy during the three months ended May 31, 2014.

The financial information included in this report has been prepared by the Company, without audit. In the opinion of management, the condensed consolidated financial information included in this report contains all adjustments (all of which are normal and recurring) necessary for a fair presentation of the results for the interim periods. Nevertheless, the results shown for interim periods are not necessarily indicative of results to be expected for the full year. The February 28, 2014 consolidated balance sheet data was derived from the audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (U.S. GAAP).

Note 2. Banking & Liquidity

In fiscal 2014, with the sale of the Company s Aydin Displays, Inc and Z-Axis, Inc. subsidiaries, the Company repaid all remaining bank debt, which included a line of credit and two term loans. At May 31, 2013 the outstanding balance of the line of credit was $10.8 million; the outstanding balances of the term loans were $1.8 million and $2.0 million. Currently, the only remaining debt of the Company is $0.3 million it owes on a building owned by its subsidiary, Teltron Technologies, Inc. in Birdsboro, PA.

The Company is currently operating using cash from operations and investing activities. The Company has a $19.0 million working capital balance at May 31, 2014, including $8.4 million in liquid assets.

The Company believes it can continue to operate the Company with existing cash flows for the current level of business. The Company is in negotiations for a new banking partner that can work with the Company on its current needs and as opportunities present themselves.

Note 3. Recent Accounting Pronouncements

In May, 2014, the FASB issued ASU 2014-09 *Revenue with Contracts from Customers* . ASU 2014-09 clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. GAAP and IFRS. The new guidance (i) removes inconsistencies, and weaknesses in revenue requirements, (ii) provides a more robust framework for addressing revenue issues, (iii) improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, (iv) provides more useful information to users of financial statements through improved disclosure requirements, and (v) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer.

The guidance is effective for annual reporting periods beginning after December 15, 2016 including interim periods within that reporting period. The Company does not expect the adoption of this update to have a significant effect on the Company s consolidated financial position or results of operations.

In April 2014, the FASB issued ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* . ASU 2014-08 changes the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Under the new guidance, a discontinued operation is defined as: (i) a disposal of a component or group of components that is disposed of or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity s operations and financial results or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. The standard states that a strategic shift could include a disposal of (i) a major geographical area of operations, (ii) a major line of business, (iii) a major equity method investment, or (iv) other major parts of an entity. Under current U.S. GAAP, an entity is prohibited from reporting a discontinued operation if it has certain continuing cash flows or involvement component after the disposal. The new guidance eliminates these criteria.

The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation, an entity s continuing involvement with a discontinued operation following the disposal date and retained equity method investments in a

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discontinued operation. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within that year. The Company does not expect the adoption of this update to have a significant effect on the Company s consolidated financial position or results of operations.

Note 4. - Inventories

Inventories are stated at the lower of cost (first in, first out) or market.

Inventories consisted of the following (in thousands):

	May 31, 2014	February 28, 2014
Raw materials	**$ 7,168**	$ 7,906
Work-in-process	**350**	242
Finished goods	**1,935**	1,878
	9,453	10,026
Reserves for obsolescence	**(193)**	(111)
	$ 9,260	$ 9,915

Note 5. Intangible Assets

Intangible assets consist primarily of the unamortized value of purchased patents, customer lists, non-compete agreements and other intangible assets. Intangible assets are amortized over the period of their expected lives, generally ranging from 5 to 15 years. Amortization expense related to intangible assets was approximately $31 thousand for the three months ended May 31, 2014 and 2013, respectively.

The cost and accumulated amortization of intangible assets was as follows (in thousands).

	May 31, 2014		February 28, 2014	
	Cost	**Accumulated Amortization**	Cost	Accumulated Amortization
Customer lists	**$ 2,863**	**$ 2,217**	$ 2,863	$ 2,187
Non-compete agreements	**1,000**	**1,000**	1,000	1,000
Patents	**233**	**227**	233	225
Other intangibles	**6**	**6**	6	6

	$ 4,102	**$ 3,450**	$ 4,102	$ 3,418

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Note 6. Long-Term Debt and Financing Lease Obligations

Long-term debt and financing lease obligations consisted of the following (in thousands):

	May 31, 2014	February 28, 2014
Mortgage payable to bank; interest rate at Community Banks Base rate plus 0.5% (3.75% as of May 31, 2014); monthly principal and interest payments of $5 thousand payable through October 2021; collateralized by land and building of Teltron Technologies, Inc.	**269**	281
	269	281
Less current maturities	**(49)**	(48)
	$ 220	$ 233

Note 7. Supplemental Cash Flow Information

Supplemental cash flow information is as follows (in thousands):

	Three Months Ended May 31,	
	2014	2013
Cash paid for:		
Interest	$ 9	$ 326
Income taxes, net of refunds	$ 13	$ 33

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Note 8. Shareholder s Equity

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding during each period. Shares issued during the period are weighted for the portion of the period that they were outstanding. Diluted earnings (loss) per share is calculated in a manner consistent with that of basic earnings (loss) per share while giving effect to all potentially dilutive common shares that were outstanding during the period.

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three-month periods ended May 31, 2014 and 2013 (in thousands, except per share data):

	Net Income (Loss)	Weighted Average Common Shares Outstanding	Earnings (Loss) Per Share
Three months ended May 31, 2014			
Basic	$ 139	6,850	$ 0.02
Effect of dilution:			
Options		25	
Diluted	$ 139	6,875	$ 0.02
Three months ended May 31, 2013			
Basic-continuing operations	$ (451)	7,584	$ (0.06)
Basic-discontinued operations	215		0.03
Effect of dilution:			
Diluted-continuing operations			
Diluted-discontinued operations		40	
Diluted	$ (236)	7,624	$ (0.03)

Stock-Based Compensation Plans

For the three-month period ended May 31, 2014 and 2013, the Company recognized general and administrative expenses of $2.2 thousand and $1.8 thousand, respectively, related to share-based compensation. The liability for the share-based compensation recognized is presented in the consolidated balance sheet as part of additional paid in capital. As of May 31, 2014, total unrecognized compensation costs related to stock options granted was $6.4 thousand. The unrecognized stock option compensation cost is expected to be recognized over a period of approximately 1 year.

The Company estimates the fair value of stock options granted using the Black-Scholes option-pricing model, which requires the Company to estimate the expected term of the stock option grants and expected future stock price volatility over the term. The term represents the expected period of time the Company believes the options will remain outstanding based on historical information. Estimates of expected future stock price volatility are based on the historic volatility of the Company s common stock, which represents the standard deviation of the differences in the weekly stock closing price, adjusted for dividends and stock splits.

No options were granted during the three month periods ended May 31, 2014 and 2013.

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Stock Repurchase Program

The Company has a stock repurchase program, pursuant to which it was originally authorized to repurchase up to 1,632,500 shares of the Company s common stock in the open market. On January 20, 2014, the Board of Directors of the Company approved a one time continuation of the stock repurchase program, and authorized the Company to repurchase up to 1,500,000 additional shares of the Company s common stock, depending on the market price of the shares. There is no minimum number of shares required to be repurchased under the program. The Company did purchase 524,694 shares in the quarter ended May 31, 2014. For the quarter ended May 31, 2013, the Company did not purchase any shares. Under the Company s stock repurchase program, an additional 1,107,815 shares remain authorized to be repurchased by the Company at May 31, 2014.

Note 9. Income Taxes

The effective tax rate for the three months ended May 31, 2013 and 2014 was 37.7% (benefit) and 14.7%, respectively. These rates differ from the Federal statutory rate primarily due to the effect of state taxes, the permanent non-deductibility of certain expenses for tax purposes, and research and experimentation credits. The disparity of the effective rate from May 31, 2013 compared to 2014 is due largely to the Company not qualifying for the Domestic Production Activities deduction, a reduction in state income taxes due to having a loss in earnings and the use of the net operating loss carryforward.

Note 10. Discontinued Operations

On August 30, 2013, Video Display Corporation (the Company) completed the sale of the assets and the transfer of specified liabilities of the Company s wholly-owned subsidiary, Aydin Displays Inc. (Aydin). Aydin s assets were sold to a newly formed acquisition affiliate of Sparton Corp. for a combination of cash totaling $15 million, plus an additional earn-out potential that could be in excess of $6 million dollars based upon the achievement of reaching certain projected levels of EBITDA generated by the new Aydin in the subsequent 12-month period to the August 30, 2013 closing. The sale provisions included a holdback of $1.2 million on the proceeds which was put into an escrow account until August 30, 2014. The Company recognized a gain on the sale of the Aydin assets of $2.9 million pre-tax. The potential earn-out is not included in the gain recognized. Along with the sale, the Company signed a lease agreement with the buyer, whereby the Company rented a building owned by another subsidiary of the Company to the buyer with no rent for a five year period. The Company deferred $0.6 million of the gain, and will recognize it as rental income over the five-year period. Aydin had net sales of $8.3 million and pre-tax net income of $0.5 million for the six months ending August 30, 2013 before the sale.

On January 16, 2014, the Company sold their wholly-owned subsidiary, Z-Axis, Inc. The sale includes Z-Axis as well as its BEAR Power Supplies and Boundless Technologies business units. Z-Axis, Inc. was sold to one of the subsidiary s original founders for approximately $9 million in cash and a $1 million dollar note. The Company recognized a gain on the sale of $5.4 million pre-tax. Z-Axis, Inc. had $7.8 million in net sales and pre-tax net profit of $0.6 million for the ten and a half months of fiscal 2014 before the sale.

On March 26, 2014 with an effective date of February 28, 2014, the Company completed the sale of the Company s wholly-owned subsidiary, Lexel Imaging, Inc. to Citadal Partners, LLC for approximately $3.9 million, consisting of $1.0 million cash payable over 180 days and included in current assets as a note and a guarantee to purchase $2.9 million in inventory over a five year period. The inventory was adjusted to its net realizable value as part of the sale. The Company recognized a loss on the sale of $4.4 million pre-tax. Lexel Imaging, Inc. had net sales of $ 7.6 million and a pre-tax net loss of $0.8 million for the twelve months ending February 28, 2014.

All of these companies net sales, expenses and net profits are being shown as discontinued operations per ASC 205-20-45 *Reporting Discontinued Operations* . The operating income and cash flows from these businesses are reflected as discontinued operations in the consolidated financial statements for all periods presented. The Company has reclassified results that were previously included in continuing operations as discontinued operations for these businesses.

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The summarized financial information for discontinued operations for the three months ended May 31, 2013, is as follows:

	Three months ending May, 2013
Net sales	8,399
Cost of goods sold	6,227
Gross profit	2,172
Operating expenses	
Selling and delivery	783
General and administrative	1,139
Total operating expenses	1,922
Operating profit from discontinued operations	250
Other income (expense)	80
Interest expense	(4)
Other, net	76
Income from discontinued operations before income taxes	326
Income tax expense	111
Income from discontinued operations	215

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Video Display Corporation and Subsidiaries

May 31, 2014

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

The following discussion should be read in conjunction with the attached interim condensed consolidated financial statements and with the Company s 2014 Annual Report to Shareholders, which included audited condensed consolidated financial statements and notes thereto for the fiscal year ended February 28, 2014, as well as Management s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The Company is a worldwide leader in the manufacturing and distribution of a wide range of display devices, encompassing, among others, industrial, military, medical, and simulation display solutions. The Company is comprised of one segment the manufacturing and distribution of displays and display components. The Company is organized into four interrelated operations aggregated into one reportable segment pursuant to the aggregation criteria of FASB ASC Topic 280 *Segment Reporting* :

- **Simulation and Training Products** offers a complete range of projection display systems for use in training and simulation, military, medical, entertainment and industrial applications.

- **Data Display CRTs** offers a wide range of CRTs for use in data display screens, including computer terminal monitors and medical monitoring equipment.

- **Broadcast and Control Center Products** offers high-end visual display products for use in video walls and command and control centers.

- **Cyber Secure Products** offers advanced TEMPEST technology, also known as Emanation Security EMSEC, products and custom engineering solutions to include extreme environmental performance and survivability technologies.

During fiscal 2015, management of the Company is focusing key resources on strategic efforts to grow its business through internal sales or through niche acquisitions that enhance the profitability and sales of the Company s more profitable product lines. Challenges facing the Company during these efforts include:

Liquidity As of May 31, 2014, the Company is operating using cash from operations and investing activities. The Company believes it can operate the Company with existing cash flows for the current level of business. Should business increase dramatically or an acquisition candidate be found, the Company may need to find more permanent sources of capital to fund the growth.

Inventory management The Company s business units utilize different inventory components than the divisions had in the past. The Company has a monthly reserve at each of its divisions to offset any obsolescence although most purchases are for current orders, which should reduce the amount of obsolescence in the future. The Company still has CRT inventory in stock and, although it believes the inventory will be sold in the future, will continue to reserve for any additional obsolescence. Management believes the adequacy of its inventory reserves at May 31, 2014 and February 28, 2014 to be adequate.

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Results of Operations

The following table sets forth, for the three months ended May 31, 2014 and 2013, the percentages that selected items in the Statements of Operations bear to total sales:

	Three Months Ended May 31, 2014	2013
Sales		
Simulation and Training	**55.0%**	42.6%
Data Display CRT	**16.9**	15.3
Broadcast and Control Centers	**10.9**	27.9
Cyber Secure Products	**17.2**	14.2
Total Company	**100.0%**	100.0%
Costs and expenses		
Cost of goods sold	**73.6%**	95.8%
Selling and delivery	**7.5**	11.3
General and administrative	**21.9**	12.8
	103.0%	119.9%
Operating loss	**(3.0)%**	(19.9)%
Interest income/expense	**0.4%**	(8.5)%
Other income, net	**7.0**	11.2
Income/ loss before income taxes	**4.4%**	(17.2)%
Income tax expense/ benefit	**0.4**	6.5
Net income/ loss from continuing operations	**4.0**	(10.7)
Income from discontinued operations, net of income tax		5.1
Net income/ loss	**4.0%**	(5.6)%

Net sales

Consolidated net sales were down 12.0% for the three months ended May 31, 2014 compared to the three months ended May 31, 2013. The Company s AYON Visual Solutions division was off 65.6% for the quarter from last year s quarter. Their business is project driven and last year in the first quarter they completed a large job for a cable news network, which they did not have this year. The industry they operate in just completed their major trade show for the year and new quoting opportunities are now coming in for projects later this year. We expect this division to improve over last year s results by the end of the fiscal year. The CRT division was off by 2.4% for the quarter or $15 thousand, which equates to approximately 1-2 average orders. This division s primary business is in flight simulation. The Display Systems division showed an increase of 3.3% due to increases throughout their customer base. This division is expected to do well throughout the remainder of the year due to new contracts received in the fourth quarter of the last fiscal year and the first quarter of this fiscal year. AYON CyberSecurity s sales increased by 6.1% due to a large order to a government agency that shipped in late May. This division is expected to exceed last year s results due to the increases in the customer base due to its improved quality.

Gross margins

Consolidated gross margins increased to 26.4% for the three months ended May 31, 2014 from 4.2% for the three months ended May 31, 2013.

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Every division showed an improvement in their gross margin percentage. The Company s two new divisions, AYON Visual Systems and AYON CyberSecurity, had lower gross margins than the other more established divisions. AYON Visual Solutions is a distributor of specialized displays, so it will consistently have lower margins than the other manufacturers in the group as distributors typically operate on smaller margins. AYON CyberSecurity improved its gross margins by 46.2%, but still came in with a negative 21.4%. The division is still working to improve its efficiencies and cut costs in the manufacturing area of its business. As its revenues increase, they hope to improve on their efficiencies of scale and generate more gross profit dollars. The Data Display division gross margins increased from 11.1% for the three months ended May 31, 2013 to 28.0% for the three months ended May 31, 2014, due to customer and product mix. They expect to have steady margins with their flight simulator customers while continuing to move slower moving items overseas at reduced margins. There were no overseas sales in the first quarter which kept the margins higher than last year. We would expect to see the margins remain above last year s levels.

Operating expenses

Operating expenses as a percentage of sales increased from 24.1% for the three months ended May 31, 2013 to 29.4% for the three months ended May 31, 2014. This was primarily due to a decrease in the revenue base to absorb the corporate overhead. The Company was able to control fixed costs, such as rent and other administrative costs, on flat sales volumes. Overall expenses increased by $73.8 thousand. The Company expects to continue to contain these costs while increasing revenues.

Interest expense

The Company s interest expense has decreased dramatically, as it no longer has a line of credit or any other debt except for a mortgage on a building it owns in Pennsylvania. The interest expense for the quarter ending May 31, 2014 was $9.3 thousand compared to $365.8 thousand for the quarter ending May 31, 2013.

Income taxes

The effective tax rate for the three months ended May 31, 2013 and 2012 was 37.7% (benefit) and 14.7%, respectively. These rates differ from the Federal statutory rate primarily due to the effect of state taxes, the permanent non-deductibility of certain expenses for tax purposes, and research and experimentation credits. The disparity of the effective rate from May 31, 2013 compared to 2014 is due largely to the Company not qualifying for the Domestic Production Activities deduction for May 31, 2013, a reduction in state income taxes due to having a loss in earnings and the use of the net operating loss carry-forward.

Liquidity and Capital Resources

In fiscal 2014, with the sale of the Company s Aydin Displays, Inc and Z-Axis, Inc. subsidiaries, the Company repaid all remaining bank debt in January, 2014, which included a line of credit and two term loans. At May 31, 2013, the outstanding balance of the line of credit was $10.8 million; the outstanding balances of the term loans were $2.0 million and $1.8 million. Currently, the only remaining debt of the Company is $0.3 million it owes on a building owned by its subsidiary, Teltron Technologies, Inc. in Birdsboro, PA.

The Company is currently operating using cash from operations and investing activities. The Company has a $19.0 million working capital balance at May 31, 2014 including $8.4 million in liquid assets.

The Company believes it can continue to operate the Company with existing cash flows for the current level of business. The Company is in negotiations for a new banking partner, which can work with the Company on its current needs and as opportunities present themselves.

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The Company continually monitors its cash and financing positions in order to find ways to lower its costs and to produce positive operating cash flow. The Company examines possibilities to grow its business through internal sales or niche acquisitions. There could be an impact on working capital requirements to fund this growth. As in the past, the intent is to finance such projects with operating cash flows; however, more permanent sources of capital may be required in certain circumstances.

Cash used by operations for the three months ended May 31, 2014 was $0.5 million. The net income from operations was $0.1 million and adjustments to reconcile net income to net cash were $0.1 million including depreciation and reserves. Changes in working capital used $0.7 million, primarily due to an increase in accounts and other receivables of $1.0 million, a decrease in inventories of $0.6 million, and a decrease in payables of $0.2 million. Cash used in operations for the three months ended May 31, 2013 was $0.9 million.

Investing activities provided cash of $0.7 million, $0.6 million from the sale of investments, and proceeds of $0.1 million from the sale of a subsidiary during the three months ended May 31, 2014, compared to $0.5 million from the sale of the Company s Bossier City property during the three months ended May 31, 2013.

Financing activities used cash of $1.0 million for the three months ended May 31, 2014, due to the repurchase of treasury stock of $1.9 million and the proceeds of margin float of $0.9 million, compared to cash provided of $0.2 million for the three months ended May 31, 2013, reflecting net borrowings from the line of credit and the reissuance of treasury stock.

The Company has a stock repurchase program, pursuant to which it has been authorized to repurchase up to 2,632,500 shares of the Company s common stock in the open market. On January 20, 2014, the Board of Directors of the Company approved a one time continuation of the stock repurchase program, and authorized the Company to repurchase up to 1,500,000 additional shares of the Company s common stock, depending on the market price of the shares. There is no minimum number of shares required to be repurchased under the program. For the quarter ended May 31, 201, the Company repurchased 524,694 shares at an average price of $3.71 per share. Under the Company s stock repurchase program, an additional 1,107,815 shares remain authorized to be repurchased by the Company at May 31, 2014.

Critical Accounting Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations are based upon the Company s condensed consolidated financial statements. These condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). These principles require the use of estimates and assumptions that affect amounts reported and disclosed in the condensed consolidated financial statements and related notes. The accounting policies that may involve a higher degree of judgments, estimates, and complexity include reserves on inventories, revenue recognition, the allowance for bad debts and warranty reserves. The Company uses the following methods and assumptions in determining its estimates:

Reserves on Inventories

Reserves on inventories result in a charge to operations when the estimated net realizable value declines below cost. Management regularly reviews the Company s investment in inventories for declines in value and establishes reserves when it is apparent that the expected net realizable value of the inventory falls below its carrying amount. Management reviews inventory levels on a quarterly basis. Such reviews include observations of product development trends of the original equipment manufacturers, new products being marketed, and technological advances relative to the product capabilities of the Company s existing inventories. Management believes the adequacy of its inventory reserves at May 31, 2014 and February 28, 2014 to be adequate.

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Revenue Recognition

Revenue is recognized on the sale of products when the products are shipped, all significant contractual obligations have been satisfied, and the collection of the resulting receivable is reasonably assured. The Company s delivery term typically is F.O.B. shipping point.

In accordance with FASB ASC Topic 605-45 *Revenue Recognition: Principal Agent Considerations* , shipping and handling fees billed to customers are classified in net sales in the consolidated income statements. Shipping and handling costs incurred are classified in selling and delivery in the consolidated income statements.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is determined by reviewing all accounts receivable and applying credit loss experience to the current receivable portfolio with consideration given to the current condition of the economy, assessment of the financial position of the creditors as well as past payment history and overall trends in past due accounts compared to established thresholds. The Company monitors credit exposure and assesses the adequacy of the allowance for doubtful accounts on a regular basis. Historically, the Company s allowance has been sufficient for any customer write-offs. Although the Company cannot guarantee future results, management believes its policies and procedures relating to customer exposure are adequate.

Warranty Reserves

The warranty reserve is determined by recording a specific reserve for known warranty issues and a general reserve based on claims experience. The Company considers actual warranty claims compared to net sales, then adjusts its reserve liability accordingly. Actual claims incurred could differ from the original estimates, requiring adjustments to the reserve. Management believes that its procedures historically have been adequate and does not anticipate that its assumptions are reasonably likely to change in the future.

Other Accounting Policies

Other loss contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Disclosure is required when there is a reasonable possibility that the ultimate loss will exceed the recorded provision. Contingent liabilities are often resolved over long time periods. Estimating probable losses requires analysis of multiple factors that often depend on judgments about potential actions by third parties.

Recent Accounting Pronouncements

In May, 2014, the FASB issued ASU 2014-09 *Revenue with Contracts from Customers* . ASU 2014-09 clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. GAAP and IFRS. The new guidance (i) removes inconsistencies, and weaknesses in revenue requirements, (ii) provides a more robust framework for addressing revenue issues, (iii) improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, (iv) provides more useful information to users of financial statements through improved disclosure requirements, and (v) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer.

The guidance is effective for annual reporting periods beginning after December 15, 2016 including interim periods within that reporting period. The Company does not expect the adoption of this update to have a significant effect on the Company s consolidated financial position or results of operations.

In April 2014, the FASB issued ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* . ASU 2014-08 changes the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Under the new guidance, a discontinued operation is defined as: (i) a disposal of a component or group of components that is disposed of or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity s operations and financial results or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. The standard states that a strategic shift could include a disposal of (i) a major geographical area of operations, (ii) a major line of business, (iii) a major equity method investment, or (iv) other major parts of an entity. Under the current U.S. GAAP, an entity is prohibited from reporting a discontinued operation if it has certain continuing cash flows or involvement component after the disposal. The new guidance eliminates these criteria.

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The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation, an entity s continuing involvement with a discontinued operation following the disposal date and retained equity method investments in a discontinued operation. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within that year. The Company does not expect the adoption of this update to have a significant effect on the Company s consolidated financial position or results of operations.

Forward-Looking Information and Risk Factors

This report contains forward-looking statements and information that is based on management s beliefs, as well as assumptions made by, and information currently available to management. When used in this document, the words anticipate, believe, estimate, intends, will, and expect and similar expressions are intended to identify forwar statements. Such statements involve a number of risks and uncertainties. These risks and uncertainties, which are included under Part I, Item 1A. Risk Factors in the Company s Annual Report on Form 10-K for the year ended February 28, 2014 could cause actual results to differ materially.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company s primary market risks include changes in technology. The Company operates in an industry which is continuously changing. Failure to adapt to the changes could have a detrimental effect on the Company.

ITEM 4. CONTROLS AND PROCEDURES

Our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) are designed to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, such as this quarterly report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Our disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Our chief executive officer and chief financial officer have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of May 31, 2014. We perform this evaluation on a quarterly basis so that the conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our annual report on Form 10-K and quarterly reports on Form 10-Q. Based on this evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of May 31, 2014.

Changes in Internal Controls

There have not been any changes in our internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II

Item 1. Legal Proceedings
None.

Item 1A. Risk Factors
Information regarding risk factors appears under the caption Forward-Looking Statements and Risk Factors in Part I, Item 2 of this Form 10-Q and in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 28, 2014. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
None.

Item 3. Defaults upon Senior Securities
None.

Item 4. Submission of Matters to a Vote of Security Holders
None.

Item 5. Other information
None.

Item 6. Exhibits

Exhibit Number	Exhibit Description

3(a)	Articles of Incorporation of the Company (incorporated by reference to Exhibit 3A to the Company s Registration Statement on Form S-18 filed January 15, 1985).
3(b)	By-Laws of the Company (incorporated by reference to Exhibit 3B to the Company s Registration Statement on Form S-18 filed January 15, 1985).
10(b)	Lease dated June 1, 2008 by and between Registrant (Lessee) and Ronald D. Ordway (Lessor) with respect to premises located at 4601 Lewis Road, Stone Mountain, Georgia. (incorporated by reference to Exhibit 10(b) to the Company s 2009 Annual Report on Form 10-K)
10(c)	Lease dated November 1, 2008 by and between Registrant (Lessee) and Ronald D. Ordway (Lessor) with respect to premises located at 1868 Tucker Industrial Road, Tucker, Georgia. (incorporated by reference to Exhibit 10(c) to the Company s 2009 Annual Report on Form 10-K)
10(d)	Purchase Agreement dated August 30, 2013 by and between the Company and Sparton, Inc. with respect to the sale of the Company s Aydin Displays, Inc. subsidiary. (incorporated by reference to Exhibit 10(d) to the Company s Current Report on Form 8-K dated September 5, 2013.)
10(e)	Purchase Agreement dated January 16, 2014 by and between the Company and Z-Axis, Inc. with respect to the sale of the Company s Z-Axis, Inc. subsidiary. (incorporated by reference to Exhibit 10(e) to the Company s Current Report on Form 8-K dated January 22, 2014.)
10(f)	Purchase Agreement dated March 26, 2014 by and between the Company and Citidal Partners, LLC, with respect to the sale of the Company s Lexel Imaging, Inc. subsidiary. (incorporated by reference to Exhibit 10(f) to the Company s Current Report on Form 8-K dated April 1, 2014.)

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10(j)	Video Display Corporation 2006 Stock Incentive Plan. (incorporated by reference to Appendix A to the Company s 2006 Proxy Statement on Schedule 14A)
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification 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

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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.

		VIDEO DISPLAY CORPORATION
July 15, 2014	By:	/s/ Ronald D. Ordway Ronald D. Ordway Chief Executive Officer
July 15, 2014	By:	/s/ Gregory L. Osborn Gregory L. Osborn Chief Financial Officer