

VIDEO DISPLAY CORP  
Form 10-Q  
January 12, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 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 November 30, 2006.**

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  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

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

As of January 5, 2006, the registrant had 9,631,000 shares of Common Stock outstanding.

**Video Display Corporation and Subsidiaries  
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**Table of Contents****ITEM 1. FINANCIAL STATEMENTS**

**Video Display Corporation and Subsidiaries**  
**Consolidated Balance Sheets**  
(in thousands)

	<b>November 30, 2006 (unaudited)</b>	February 28, 2006
<b>Assets</b>		
Current Assets		
Cash	\$ 1,778	\$ 1,577
Accounts receivable, less allowance for possible losses of \$560 and \$381	9,892	9,483
Inventories, net	31,982	34,645
Cost and estimated earnings in excess of billings on uncompleted contracts	2,609	968
Deferred income taxes	3,104	3,279
Prepaid expenses and other	685	1,720
Total current assets	50,050	51,672
Property, plant and equipment:		
Land	585	605
Buildings	8,218	8,454
Machinery and equipment	20,163	19,970
	28,966	29,029
Accumulated depreciation and amortization	(21,003)	(20,270)
Net property, plant, and equipment	7,963	8,759
Goodwill		
Intangible assets, net	1,343	1,318
Other assets	3,796	3,591
	78	98
Total assets	\$ 63,230	\$ 65,438

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

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**Video Display Corporation and Subsidiaries**  
**Consolidated Balance Sheets (continued)**  
(in thousands)

	<b>November 30, 2006 (unaudited)</b>	February 28, 2006
<b>Liabilities and Shareholders Equity</b>		
Current liabilities		
Accounts payable	\$ 5,630	\$ 6,889
Accrued liabilities	3,491	2,833
Billings in excess of cost and estimated earnings on uncompleted contracts	149	965
Lines of credit		17,567
Notes payable to officers and directors	382	6,948
Convertible notes payable, net of discount of \$19	231	
Current maturities of long-term debt and financing lease obligations	755	140
 Total current liabilities	 <b>10,638</b>	 35,342
 Lines of credit	 <b>13,655</b>	
Long-term debt, less current maturities	3,308	808
Financing lease obligations, less current maturities	292	363
Notes payable to officers and directors, less current maturities	5,801	
Convertible notes payable, net of discount of \$38		212
Deferred income taxes	55	560
 Total liabilities	 <b>33,749</b>	 37,285
 <b>Minority Interests</b>	 <b>123</b>	 123
<b>Commitments and Contingencies</b>		
 <b>Shareholders Equity</b>		
Preferred stock, no par value 10,000 shares authorized; none issued and outstanding		
Common stock, no par value 50,000 shares authorized; 9,637 and 9,628 issued and outstanding	7,275	7,198
Additional paid-in capital	143	92
Retained earnings	22,919	21,771
Accumulated other comprehensive income (loss)	95	(172)
Treasury stock, 125 and 86 shares at cost	(1,074)	(859)
 Total shareholders equity	 <b>29,358</b>	 28,030
 Total liabilities and shareholders equity	 <b>\$ 63,230</b>	 \$ 65,438

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



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**Video Display Corporation and Subsidiaries**  
**Consolidated Statements of Operations (unaudited)**  
(in thousands, except per share data)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 30,</b>		<b>November 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
Net sales	<b>\$ 22,298</b>	\$ 19,676	<b>\$ 60,728</b>	\$ 63,450
Cost of goods sold	<b>14,313</b>	13,231	<b>40,369</b>	42,865
Gross profit	<b>7,985</b>	6,445	<b>20,359</b>	20,585
Operating expenses				
Selling and delivery	<b>2,033</b>	1,929	<b>5,853</b>	5,526
General and administrative	<b>3,744</b>	3,733	<b>10,924</b>	10,905
	<b>5,777</b>	5,662	<b>16,777</b>	16,431
Operating profit	<b>2,208</b>	782	<b>3,582</b>	4,154
Other income (expense)				
Interest expense	<b>(527)</b>	(353)	<b>(1,650)</b>	(1,028)
Other, net	<b>(35)</b>	6	<b>14</b>	86
	<b>(562)</b>	(347)	<b>(1,636)</b>	(942)
Income before income taxes	<b>1,646</b>	436	<b>1,946</b>	3,212
Income tax expense	<b>630</b>	181	<b>780</b>	1,235
Net income	<b>\$ 1,016</b>	\$ 255	<b>\$ 1,166</b>	\$ 1,977
Basic earnings per share of common stock	<b>\$ .11</b>	\$ .03	<b>\$ .12</b>	\$ .20
Diluted earnings per share of common stock	<b>\$ .10</b>	\$ .03	<b>\$ .12</b>	\$ .20
Basic weighted average shares outstanding	<b>9,675</b>	9,687	<b>9,659</b>	9,699

Diluted weighted average shares outstanding	<b>9,848</b>	9,923	<b>9,858</b>	9,977
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The accompanying notes are an integral part of these condensed consolidated financial statements.



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**Video Display Corporation and Subsidiaries**  
**Consolidated Statements of Shareholders Equity and Comprehensive Income**  
**For the Nine Months Ended November 30, 2006 (unaudited)**  
(in thousands)

	<b>Common</b>	<b>Share</b>	<b>Additional</b>	<b>Retained</b>	<b>Accumulated</b>	<b>Treasury</b>	<b>Compre-</b>
	<b>Shares</b>	<b>Amount</b>	<b>Paid-in</b>	<b>Earnings</b>	<b>Other</b>	<b>Stock</b>	<b>hensive</b>
			<b>Capital</b>		<b>Comprehensive</b>		<b>Income</b>
					<b>Income</b>		
					<b>(Loss)</b>		
Balance, February 28, 2006	9,628	\$ 7,198	\$ 92	\$ 21,771	\$ (172)	\$ (859)	
Net income				1,166			\$ 1,166
Foreign currency translation adjustment					267		267
Total comprehensive income							\$ 1,433
Issuance of common stock under stock option plan	48	77					
Issuance of common stock from treasury	27			(18)		268	
Repurchase of treasury stock	(66)					(483)	
Share based compensation			51				
Balance, November 30, 2006	9,637	\$ 7,275	\$ 143	\$ 22,919	\$ 95	\$ (1,074)	

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

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**Video Display Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (unaudited)**  
(in thousands)

	<b>Nine Months Ended</b>	
	<b>November 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Operating Activities</b>		
Net income	\$ 1,166	\$ 1,977
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	1,647	1,304
Provision for bad debts	200	(16)
Provision for inventory reserve	1,165	720
Non-cash charge for share based compensation	51	
Deferred income taxes	(330)	(260)
Interest on convertible note	19	
<b>Changes in working capital, net of effects from acquisitions:</b>		
Accounts receivable	(489)	1,537
Inventories	1,939	(3,769)
Cost, estimated earnings and billings, net, on uncompleted contracts	(2,457)	960
Prepaid expenses and other assets	934	(714)
Accounts payable and accrued liabilities	(611)	169
Net cash provided by operating activities	<b>3,234</b>	1,908
<b>Investing Activities</b>		
Capital expenditures	(193)	(1,427)
Cash paid for acquisition	(550)	(1,377)
Proceeds from the sale of property, plant and equipment	159	
Net cash used in investing activities	<b>(584)</b>	(2,804)
<b>Financing Activities</b>		
Proceeds from long-term debt, lines of credit and financing lease obligations	44,664	23,999
Payments on long-term debt, lines of credit and financing lease obligations	(46,208)	(22,447)
Proceeds from loans from related parties	3,220	1,000
Repayments of loans from related parties	(3,985)	(1,028)
Purchase of common stock		(317)
Purchase of treasury stock	(484)	
Proceeds from exercise of stock options	77	22
Net cash provided by (used in) financing activities	<b>(2,716)</b>	1,229
Effect of exchange rate changes on cash	267	15
Net increase in cash	<b>201</b>	348

Cash, beginning of period	<b>1,577</b>	1,471
Cash, end of period	<b>\$ 1,778</b>	\$ 1,819

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

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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

Note 1. Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of the Company and its majority owned subsidiaries ( the Company ) after elimination of all significant intercompany accounts and transactions. Certain prior period balances have been reclassified to conform to the current period presentation.

As contemplated by the Securities and Exchange Commission (the Commission ) instructions to Form 10-Q, the following footnotes have been condensed and, therefore, do not contain all disclosures required in connection with annual financial statements. Reference should be made to the Company's year-end 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, 2006, as filed with the Commission. Other than the adoption of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment* as described in Note 10, there have been no material changes in accounting policy during Fiscal 2007.

The financial information included in this report has been prepared by the Company, without audit. In the opinion of management, the 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, 2006 consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The Company has a subsidiary in the United Kingdom ( U.K. ), which uses the British pound as its functional currency. Assets and liabilities of this foreign subsidiary are translated using the exchange rate in effect at the end of the period. Revenues and expenses are translated using the average of the exchange rates in effect during the period. Translation adjustments and transaction gains and losses related to long-term intercompany transactions are accumulated as a separate component of shareholders' equity.

Note 2. New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. Interpretation No. 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. The cumulative effect of initially adopting Interpretation No. 48 is to record an adjustment to opening retained earnings in the year of adoption and should be presented separately. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized upon adoption of Interpretation No. 48. Management is in the process of evaluating the provisions of the interpretation, but does not anticipate that the adoption of this interpretation will have a material impact on the Company's consolidated financial statements.

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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

In September 2006, the FASB issued Statement of Financial Accounting Standards ( Statement No. ) 157, *Fair Value Measurements*. Statement No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The statement does not require new fair value measurements, but is applied to the extent that other accounting pronouncements require or permit fair value measurements. The statement emphasizes that fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. Companies will be required to disclose the extent to which fair value is used to measure assets and liabilities, the inputs used to develop the measurements, and the effect of certain of the measurements on earnings (or changes in net assets) for the period. Statement No. 157 is effective for fiscal years beginning after November 15, 2007. Management does not anticipate that the adoption of this statement will have a material impact on the Company s consolidated financial statements.

In September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, which requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. Statement No. 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. This statement is effective for fiscal years ending after December 15, 2006. The Company does not currently provide defined benefit pension or other postretirement plans, therefore management has determined that the adoption of this interpretation will not have an impact on the Company s consolidated financial statements.

In September 2006, the staff of the Securities and Exchange Commission issued Staff Accounting Bulletin 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 requires that public companies utilize a dual balance-sheet and income-statement approach to assessing the quantitative effects of financial misstatements. SAB 108 also addresses the mechanics of correcting misstatements that include the effects from prior years, and provides for error correction through a one-time cumulative effect adjustment to beginning-of-year retained earnings upon initial adoption. The guidance in SAB 108 must be applied to annual financial statements for fiscal years ending after November 15, 2006. Management is in the process of assessing the impact of adopting SAB 108 but does not expect that it will have a material impact on the Company s consolidated financial statements.

**Note 3. Business Acquisitions**

In August 2006, the Company acquired certain assets of Hobson Bros. Inc. of Chicago for the production of various molded plastic and rubber parts, wire assemblies and stamped metal parts used primarily in the display industry. The fair value of these assets, including inventories of \$30,000, equipment of \$168,000 and product development designs and drawings of \$50,000, were acquired in exchange for 26,830 shares of the Company s common stock held as treasury shares. The market value of shares issued was \$9.32 at the date of close for a total acquisition cost of \$250,000. The product development designs and drawings are being amortized over a five year period. These assets will be integrated into the Company s Tucker Georgia facilities.

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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

On June 22, 2006, the Company acquired the business and assets of EDL Displays, Inc. ( EDL ) located in Dayton Ohio. EDL is noted for its specialized, large-size, ruggedized, high-resolution displays with application in air traffic control, shipboard navigation, simulation, homeland security, and command and control. The assets acquired in this transaction have been recorded based on their fair value at the date of acquisition and include accounts receivable of \$120,000, inventories of \$400,000, equipment of \$50,000 and certain intellectual property and customer lists of \$658,000. Total consideration for the assets acquired included a cash payment of \$550,000 and the assumption of a \$678,000 bank loan. The purchase agreement provides for an adjustment to the purchase price based on final collection of accounts receivable and evaluation of the market value of purchased inventories. The intellectual property, including product development designs and drawings are being amortized over a five year period, while the customer list is being amortized over a three year period, which the Company estimates to be the useful life of these assets. The EDL business was relocated and merged into the Company's Pennsylvania based Aydin Displays operation effective December 31, 2006.

In May 2005, the Company acquired the IDS division of Three Five Systems, Inc. Three Five Systems specializes in flat panel, touch screen and rack mount systems with custom military, industrial and commercial requirements. As part of this transaction, the Company acquired fixed assets of \$74,000, inventories of \$773,000, and various other assets of \$530,000 in exchange for cash of \$1,377,000. The other assets include product development designs and drawings and a customer list, as well as a non-compete agreement. The product development designs and drawings are being amortized over a five year period, while the customer list is being amortized over a three year period, which the Company estimates to be the useful life of these assets. The IDS division is a part of the Company's Aydin operations. The IDS operations of Three Five Systems, Inc. are not significant to the Company.

The aggregate purchase price has been allocated based on fair values as of the date of the completion of the acquisition as follows (in thousands):

Inventories	\$ 773
Machinery & equipment	74
Product designs, customer lists and other assets	530
	\$ 1,377

**Note 4. Inventories**

Inventories are stated at the lower of cost (first in, first out) or market and consisted of the following (in thousands):

	<b>November 30, 2006</b>	February 28, 2006
Raw materials	\$ 17,221	\$ 18,618
Work-in-process	4,164	3,772
Finished goods	15,851	16,688
	<b>37,236</b>	39,078
Reserves for obsolescence	<b>(5,254)</b>	(4,433)
	<b>\$ 31,982</b>	\$ 34,645



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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

## Note 5. Costs and Estimated Earnings Related to Billings on Uncompleted Contracts

Information relative to contracts in progress consisted of the following (in thousands):

	<b>November 30, 2006</b>	February 28, 2006
Costs incurred to date on uncompleted contracts	\$ <b>3,950</b>	\$ 4,528
Estimated earnings recognized to date on these contracts	<b>1,290</b>	2,585
	<b>5,240</b>	7,113
Billings to date	<b>(2,780)</b>	(7,110)
Costs and estimated earnings in excess of billings, net	\$ <b>2,460</b>	\$ 3
Costs and estimated earnings in excess of billings	\$ <b>2,609</b>	\$ 968
Billings in excess of costs and estimated earnings	<b>(149)</b>	(965)
	<b>\$ 2,460</b>	\$ 3

Costs and estimated earnings in excess of billings are the results of contracts in progress (jobs) in completing orders to customers' specifications on contracts accounted for under SOP 81-1 Accounting for Performance of Construction-Type and Certain Production-Type Contracts. Costs included are material, labor and overhead. These jobs require design and engineering effort for a specific customer purchasing a unique product. The Company records revenue on these fixed-price and cost-plus contracts on the percentage of completion basis using the ratio of costs incurred to estimated total costs at completion as the measurement basis for progress toward completion and revenue recognition. Any losses identified on contracts are recognized immediately. Contract accounting requires significant judgment relative to assessing risks, estimating contract costs and making related assumptions for schedule and technical issues. With respect to contract change orders, claims or similar items, judgment must be used in estimating related amounts and assessing the potential for realization. These amounts are only included in contract value when they can be reliably estimated and realization is probable. Billings are generated based on specific contract terms, which might be a progress payment schedule, specific shipments, etc. None of the above contracts in progress contain post-shipment obligations.

Changes in job performance, manufacturing efficiency, final contract settlements and other factors affecting estimated profitability may result in revisions to costs and income and are recognized in the period in which the revisions are determined. The effect of changes in the estimated profitability of contracts for the three and nine month period ended November 30, 2006, was to increase net earnings by approximately \$0.8 million and \$1.1 million, respectively, above the amounts which would have been reported had the preceding year contract profitability estimates been used. This increase in profitability was primarily the result of cost savings on raw materials and manufacturing efficiencies gained through acceleration of the delivery schedule for units produced under a major contract for flat panel display products.

As of November 30, 2006 and February 28, 2006, there were no production costs which exceeded the aggregate estimated cost of all in process and delivered units relating to long-term contracts. Additionally, there were no claims outstanding that would affect the ultimate realization of full contract values. As of November 30, 2006 and February 28, 2006, there were no progress payments that had been netted against inventory.





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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

## Note 6. 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 \$587,000 and \$448,000 for the nine months ended November 30, 2006 and 2005, respectively.

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

	<b>November 30, 2006</b>		February 28, 2006	
	<b>Cost</b>	<b>Accumulated Amortization</b>	Cost	Accumulated Amortization
Customer lists	\$ 3,386	\$ 959	\$ 2,968	\$ 658
Non-compete agreements	1,245	489	1,230	301
Patents	665	125	335	78
Other intangibles	148	75	119	24
	<b>\$ 5,444</b>	<b>\$ 1,648</b>	<b>\$ 4,652</b>	<b>\$ 1,061</b>

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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

## Note 7. Long-term Debt and Financing Lease Obligations

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

	<b>November 30, 2006</b>	February 28, 2006
Note payable to bank syndicate (RBC Centura and Regions Bank); interest rate at LIBOR plus applicable margin as defined per the loan agreement, (7.42% combined rate as of November 30, 2006); monthly principal payments of \$50 plus accrued interest, payable through July 2011; collateralized by all assets of the Company.	\$ 2,800	\$
Note payable to bank; interest at the Prime Rate plus 0.50%, (8.75% as of November 30, 2006); monthly principal and interest payments of \$11, payable through February 2013 at current interest rates; collateralized by all assets acquired from EDL Displays, Inc.	632	
Mortgage payable to bank; interest rate at Federal Home Loan Bank Board Index rate plus 1.95% (7.35% as of November 30, 2006); monthly principal and interest payments of \$5 payable through October 2021; collateralized by land and building of Teltron Technologies, Inc.	525	540
Mortgage payable to Pennsylvania Industrial Development Authority; interest rate at 4.25%; monthly principal and interest payments of \$2.8 payable through October 2017; collateralized by a second priority lien on land and building of Teltron Technologies, Inc.		308
Other	19	14
	<b>3,976</b>	862
Financing lease obligations	<b>379</b>	449
	<b>4,355</b>	1,311
Less current maturities	<b>(755)</b>	(140)
	<b>\$ 3,600</b>	\$ 1,171

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**Video Display Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements (unaudited)**  
**November 30, 2006**

Note 8. Lines of Credit

On June 29, 2006, Video Display Corporation and Subsidiaries executed a Loan and Security Agreement with a syndicate including RBC Centura Bank and Regions Bank to provide a \$17 million line of credit to the Company and a \$3.5 million line of credit to the Company's subsidiary Fox International, Inc. As of November 30, 2006, the outstanding balances of these lines of credit were \$11.0 million and \$2.7 million, respectively. The available amounts for borrowing were \$6.0 million and \$0.8 million, respectively. These loans are secured by all assets and personal property of the Company. The agreement contains covenants, including requirements related to tangible cash flow, ratio of debt to cash flow and assets coverage. The agreement also includes restrictions on the incurrence of additional debt or liens, investments (including Company stock), divestitures and certain other changes in the business. The agreement expires in June 2008, and accordingly is classified under long term liabilities on the Company's balance sheet. The interest rate on these loans is a floating LIBOR rate based on a fixed charge coverage ratio, as defined in the loan documents. These new lines of credit replaced two lines of credit outstanding with Bank of America, which were terminated in conjunction with this agreement. At the date of termination, the Company was not in compliance with the consolidated Fixed Charge Coverage Ratio and the consolidated Senior Funded Debt to EBITDA ratio covenants as defined by the Bank of America credit line agreements. In conjunction with Loan and Security Agreement, the syndicate also executed a \$3.0 million term note with the Company, and the CEO of the Company provided a \$6.0 million subordinated term note to the Company. See related information in Notes 7 and 13.

Prior to its replacement discussed above, the Company maintained a \$27.5 million credit facility, executed in November 2004, with a bank, collateralized by equipment, inventories and accounts receivable of the Company. The interest rate on this line was a floating LIBOR rate based on a ratio of debt to EBITDA, as defined in the loan documents. The line of credit agreement contained covenants, including requirements related to tangible cash flow, ratio of debt to cash flow and asset coverage. Additionally, the bank required that any contemplated acquisitions be accretive.

The new \$3.5 million line of credit to Fox International, Inc. discussed above, replaced a line of credit in the same amount with another bank which had been outstanding since April 2005. At that time, the Company repaid a \$2.8 million short term line of credit (collateralized by assets of Fox International, Inc.) with a bank plus the balance of a mortgage secured by the land and building of Fox International, Inc. The interest rate on this line was a floating LIBOR rate based on a ratio of debt to EBITDA, as defined in the loan documents. The line of credit agreement contained covenants, including requirements related to tangible cash flow, ratio of debt to cash flow and asset coverage. Additionally, the bank required that any contemplated acquisitions be accretive.

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## Note 9. Segment Information

Condensed segment information is as follows (in thousands):

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended November 30,</b>		<b>Ended November 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net Sales				
Display Segment	<b>\$ 15,801</b>	\$ 15,010	<b>\$ 43,620</b>	\$ 49,110
Wholesale Distribution Segment	<b>6,497</b>	4,666	<b>17,108</b>	14,340
	<b>\$ 22,298</b>	\$ 19,676	<b>\$ 60,728</b>	\$ 63,450
Operating profit				
Display Segment	<b>\$ 2,167</b>	\$ 586	<b>\$ 3,483</b>	\$ 3,448
Wholesale Distribution Segment	<b>41</b>	196	<b>99</b>	706
Income from Operations	<b>2,208</b>	782	<b>3,582</b>	4,154
Interest expense	<b>(527)</b>	(353)	<b>(1,650)</b>	(1,028)
Other income, net	<b>(35)</b>	6	<b>14</b>	86
Income before income taxes	<b>\$ 1,646</b>	\$ 436	<b>\$ 1,946</b>	\$ 3,212

## Note 10. Supplemental Cash Flow Information

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

	<b>Nine Months</b>	
	<b>Ended November 30,</b>	
	<b>2006</b>	<b>2005</b>
Cash Paid for:		
Interest	<b>\$ 1,589</b>	\$ 978
Income taxes, net of refunds	<b>\$ 109</b>	\$ 3,250
Non-cash Transactions:		
Assets acquired in exchange for assumption of debt	<b>\$ 678</b>	\$
Assets acquired in exchange for common stock	<b>\$ 250</b>	\$
Leased capital equipment	<b>\$</b>	\$ 433
Conversion of note payable to common stock	<b>\$</b>	\$ 125



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Note 11. Shareholder's Equity

**Earnings Per Share**

Basic earnings per share is computed by dividing income 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 per share is calculated in a manner consistent with that of basic earnings per share while giving effect to all potentially dilutive common shares outstanding during the period.

The following table sets forth the computation of basic and diluted earnings per share for the three and nine month periods ended November 30, 2006 and 2005 (in thousands, except per share data):

	Net Income	Weighted Average Common Shares Outstanding	Earnings Per Share
<b>Three months ended November 30, 2006</b>			
<b>Basic</b>	\$ 1,016	9,675	\$ 0.11
<b>Effect of dilution:</b>			
<b>Options</b>		173	
<b>Diluted</b>	\$ 1,016	9,848	\$ 0.10
 Three months ended November 30, 2005			
Basic	\$ 255	9,687	\$ 0.03
Effect of dilution:			
Options		236	
Diluted	\$ 255	9,923	\$ 0.03
 <b>Nine months ended November 30, 2006</b>			
<b>Basic</b>	\$ 1,166	9,659	\$ 0.12
<b>Effect of dilution:</b>			
<b>Options</b>		199	
<b>Diluted</b>	\$ 1,166	9,858	\$ 0.12
 Nine months ended November 30, 2005			
Basic	\$ 1,977	9,699	\$ 0.20
Effect of dilution:			
Options		278	
Diluted	\$ 1,977	9,977	\$ 0.20





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**Stock-Based Compensation Plans**

On March 1, 2006, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123 (Revised 2004), *Share-Based Payment* ( Statement No. 123(R) ), which requires employee share-based compensation to be accounted for under the fair value method and requires the use of an option pricing model for estimating the fair value of stock options at the date of grant. Previously, the Company accounted for stock options under the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and provided the required pro forma disclosures prescribed by SFAS No. 123, *Accounting for Stock-Based Compensation*, ( Statement No. 123 ), as amended. Since the exercise price of options equaled the market price of the stock on the date of grant, the stock options had no intrinsic value and, therefore, no expense was recognized for stock options by the Company prior to the beginning of Fiscal 2007.

The Company elected to adopt Statement No. 123(R) using the modified prospective method, which requires compensation expense to be recorded for all unvested share-based awards beginning in the first quarter of adoption. Accordingly, prior period information presented in this Report on Form 10-Q has not been restated to reflect the fair value method of expensing stock options.

For the three and nine month periods ended November 30, 2006, the Company recognized general and administrative expense of \$26,000 and \$51,000, related to share-based compensation. After the adoption of SFAS No. 123(R), the liability for the share-based compensation recognized is presented in the consolidated balance sheet as part of additional paid in capital. As of November 30, 2006, total unrecognized compensation costs related to stock options and shares of restricted stock granted was \$275,000. The unrecognized share based compensation cost is expected to be recognized over a period of approximately 5 years.

Upon recommendation of the Board of Directors of the Company, on August 25, 2006, the Shareholders of the Company approved the Video Display Corporation 2006 Stock Incentive Plan ( Plan ), whereby options to purchase up to 500,000 shares of the Company's common stock may be granted and up to 100,000 restricted common stock shares may be awarded. Options may not be granted at a price less than the fair market value, determined on the day the options are granted. Options granted to a participant who is the owner of ten percent or more of the common stock of the Company may not be granted at a price less than 110% of the fair market value, determined on the day the options are granted. The exercise price of each option granted is fixed and may not be re-priced. The life of each option granted is determined by the plan administrator, but may not exceed the lesser of five years from the date the participant has the vested right to exercise the option, or seven years from the date of the grant. The life of an option granted to a participant who is the owner of ten percent or more of the common stock of the Company may not exceed five years from the date of grant. All full-time or part-time employees, and Directors of the Company, are eligible for participation in the Plan. In addition, any consultant or advisor who renders bona fide services to the Company, other than in connection with the offer or sale of securities in a capital-raising transaction, is eligible for participation in the plan. The plan administrator is appointed by the Board of Directors of the Company, and must include two or more outside, independent Directors of the Company. The plan may be terminated by action of the Board of Directors, but in any event will terminate on the tenth anniversary of its effective date.

Prior to expiration on May 1, 2006 the Company maintained an incentive stock option plan whereby options to purchase up to 1.2 million shares could be granted to directors and key employees at a price not less than fair market value at the time the options were granted. Upon vesting, options granted are exercisable for a period not to exceed ten years. No further options may be granted pursuant to the plan after the expiration date; provided however, those options outstanding at that date will remain exercisable in accordance with their respective terms.

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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 be outstanding based on historical information. Estimates of expected future stock price volatility are based on the historic volatility of the Company's common stock. The Company calculates the historic volatility as the standard deviation of the differences in the natural logarithms of the weekly stock closing price, adjusted for dividends and stock splits.

On September 1, 2006, the Company granted 10,000 restricted common stock shares to certain management employees at fair value on the date of grant, \$8.12 per share. Total compensation cost associated with the grant, \$81,000 will be recognized over the twenty-one month vesting period, at which time the restrictions on the shares will terminate. No forfeitures are expected in relation to this grant due to the limited term of vesting. No stock options were granted during the nine month period ended November 30, 2006.

Had compensation cost been determined based upon the fair value at the grant date for awards under the stock option plan consistent with the methodology prescribed under Statement No. 123, the effect on the Company's pro forma net income and net income per share would have been as follows (in thousands, except per share data):

	<b>Three Months Ended November 30, 2005</b>	<b>Nine Months Ended November 30, 2005</b>
Net income, as reported	\$ 255	\$ 1,977
Stock-based employee compensation expense determined under fair value basis, net of tax	(24)	(39)
Pro forma net income	\$ 231	\$ 1,938
Net earnings per share:		
Basic as reported	\$ 0.03	\$ 0.20
Basic pro forma	\$ 0.02	\$ 0.20
Diluted as reported	\$ 0.03	\$ 0.20
Diluted pro forma	\$ 0.02	\$ 0.19

**Stock Repurchase Program**

The Company has a stock repurchase program, pursuant to which it was originally authorized to repurchase up to 462,500 shares of the Company's common stock in the open market. On January 11, 2006, the Board of Directors of the Company approved a continuation of the stock repurchase program, and authorized the Company to repurchase up to 600,000 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. During the fiscal quarter ended November 30, 2006, the Company repurchased 65,608 shares at an average price of \$7.37 per share, which have been added to treasury shares on the consolidated balance sheet. Under this program, an additional 593,010 shares remain authorized to be repurchased by the Company at November 30, 2006. As discussed in Note 8, the Loan and Security Agreement executed by Company on June, 29, 2006 included restrictions on investments which restricted further repurchases of stock under this program. In October 2006, the participating banks granted a limited exception to these restrictions, allowing the Company to purchase up to 120,000 shares at a total cost not to exceed \$900,000.

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Note 12. Comprehensive Income

Statement of Financial Accounting Standards No. 130 Reporting Comprehensive Income establishes standards for reporting and presentation of non-owner changes in shareholders' equity. For the Company, total non-owner changes in shareholders' equity include net income and the change in the cumulative foreign exchange translation adjustment component of shareholders' equity. During the nine months ended November 30, 2006 and 2005, total comprehensive income was \$1.4 million and \$2.0 million, respectively.

Note 13. Related Party Transactions

In conjunction with an agreement involving re-financing of the Company's lines of credit, on June 29, 2006 the Company's Chief Executive Officer provided a \$6.0 million subordinated term note to the Company with an amortization of 15 years, and a maturity of 60 months. The interest rate on this note is equal to the prime rate plus one percent. The note is secured by a general lien on all assets of the Company, subordinate to the lien held by the syndicate of RBC Centura and Regions Bank. The balance outstanding under this loan agreement was approximately \$5.9 million at November 30, 2006.

On February 27, 2006 the Company's Chief Executive Officer loaned the Company \$6.8 million under a note agreement which provided for interest at nine percent or the prime rate plus  $\frac{1}{4}$  of one percent, whichever was higher, paid monthly. Principal payments were due in a series of monthly payments, with a final payment of \$1.0 million due October 1, 2006. The balance outstanding under this loan agreement was \$3.0 million at June 29, 2006 when the balance was re-paid in conjunction with the note agreement discussed above.

The Company has a demand note outstanding from another officer, bearing interest at 8%. During the nine months ended November 30, 2006, an additional \$220,000 was advanced on this demand note and \$53,000 was repaid, resulting in a balance outstanding of \$315,000 at November 30, 2006.

Note 14. Disposal of Assets

Effective May 31, 2006, the Company sold the net assets of the Wintron Technology division, primarily accounts receivable, inventory and property, plant and equipment, through a leveraged buyout to a group, including managers and shareholders of the Company. Total proceeds from the sale at book value were approximately \$354,000, resulting in no gain or loss. Net sales from the Wintron facility for the three months ended May 31, 2006 were \$126,000, producing a loss before income taxes of \$101,000. Fiscal 2006 net sales and loss before income taxes were \$500,000 and \$649,000, respectively.

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Note 15. Subsequent Event

Effective December 31, 2006, the Company acquired the Cathode Ray Tube Manufacturing and Distribution Business and certain assets of Clinton Electronics Corp. located in Loves Park, Illinois. The Cathode Ray Tube Manufacturing and Distribution Business has been an industry leader in the supply of monochrome CRTs used in video display products since 1964. The assets acquired in this transaction have been recorded based on their fair value at the date of acquisition and include inventories of \$2,125,000, equipment of \$100,000 and certain intellectual property and customer lists of \$325,000. Consideration for the assets acquired include a \$1.0 million face value Convertible Note Payable, convertible into 120,000 shares of the Company's common stock, delivered on the closing date, January 9, 2007, an agreement to deliver, on the first anniversary of the closing date, a certificate for \$1,125,000 in market value of the Company's common stock as of that date, and on the second anniversary of the closing date, a certificate for \$500,000 in market value of the Company's common stock as of that date. The Company will record the convertible notes payable net of an implied discount of \$75,000. The purchase agreement provides for an adjustment to this base purchase price on the second anniversary of the closing date, to be paid in shares of the Company's common stock, based on the remaining fair value of the initial inventories on hand as of that date. The purchase agreement also included a \$300,000 cash payment on the closing date for a 12 month lease of facilities located in Loves Park. The product development designs and drawings are being amortized over a five year period, while the customer list is being amortized over a three year period, which the Company estimates to be the useful life of these assets.

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**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 consolidated financial statements and with the Company's 2006 Annual Report to Shareholders, which included audited financial statements and notes thereto for the fiscal year ended February 28, 2006, as well as Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Overview**

The Company is a worldwide leader in the manufacture and distribution of a wide range of display devices, encompassing, among others, entertainment, military, medical and simulation display solutions. The Company is comprised of two segments (1) the manufacture and distribution of monitors, projection systems and CRT displays and (2) the wholesale distribution of consumer electronic parts. The display segment is organized into four interrelated operations aggregated into one operating segment pursuant to the aggregation criteria of SFAS 131:

**Monitors** offers a complete range of CRT, flat panel and projection display systems for use in training and simulation, military, medical and industrial applications.

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

**Home Entertainment** offers a wide range of CRTs and projection tubes for television and home theater equipment.

**Components** provides replacement electron guns and other components for CRTs primarily for servicing the Company's internal needs.

During Fiscal 2007, management of the Company is focusing key resources on strategic efforts to dispose of unprofitable operations while seeking acquisition opportunities that enhance the profitability and sales growth of the Company's more profitable product lines. In addition, the Company plans to seek new products through acquisitions and internal development that complement existing profitable product lines. Challenges facing the Company during these efforts include:

**Inventory management** the Company continually monitors historical sales trends as well as projected future needs to ensure adequate on hand supplies of inventory and to ensure against overstocking of slower moving, obsolete items.

Certain of the Company's divisions maintain significant inventories of CRTs and component parts in an effort to ensure its customers a reliable source of supply. The Company's inventory turnover averages over 175 days, although in many cases the Company would anticipate holding 90 to 100 days of inventory in the normal course of operations. This level of inventory is higher than some of the Company's competitors due to the fact that it sells a number of products representing older, or trailing edge, technology that may not be available from other sources. The market for these trailing edge technology products is declining and, as manufacturers for these products discontinue production or exit the business, the Company may make last time buys. In the monitor operations of the Company's business, the market for its products is characterized by fairly rapid change as a result of the development of new technologies, particularly in the flat panel display area. If the Company fails to anticipate the changing needs of its customers and accurately forecast their requirements, it may accumulate inventories of products which its customers no longer need and which the Company will be unable to sell or return to its vendors. Because of this, the Company's management monitors the adequacy of its inventory reserves regularly, and at November 30, 2006, believes its reserves to be adequate.

**Interest rate exposure** The Company had outstanding debt in excess of \$23.0 million as of November 30, 2006, all of which is subject to interest rate fluctuations by the Company's lenders. Higher rates applied by the Federal

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Reserve Board over the past year have negatively affected the Company's earnings and potential future rate hikes may continue to negatively impact the Company's earnings. It is the intent of the Company to continually monitor interest rates and consider converting portions of the Company's debt from floating rates to fixed rates should conditions be favorable for such interest rate swaps or hedges.

**Results of Operations**

The following table sets forth, for the three and nine months ended November 30, 2006 and 2005, the percentages which selected items in the Statements of Operations bear to total sales:

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended November 30, 2006</b>	2005	<b>Ended November 30, 2006</b>	2005
Sales				
Display Segment				
Monitors	<b>56.4%</b>	62.0%	<b>56.4%</b>	60.6%
Data Display CRTs	<b>11.0</b>	8.9	<b>11.6</b>	11.3
Entertainment CRTs	<b>3.1</b>	4.5	<b>3.3</b>	4.6
Electron Guns and Components	<b>0.4</b>	0.9	<b>0.5</b>	0.9
Total Display Segment	<b>70.9%</b>	76.3%	<b>71.8%</b>	77.4%
Wholesale Distribution Segment	<b>29.1</b>	23.7	<b>28.2</b>	22.6
	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Costs and expenses				
Cost of goods sold	<b>64.2%</b>	67.2%	<b>66.5%</b>	67.6%
Selling and delivery	<b>9.1</b>	9.8	<b>9.6</b>	8.7
General and administrative	<b>16.8</b>	19.0	<b>18.0</b>	17.2
	<b>90.1%</b>	96.0%	<b>94.1%</b>	93.5%
Income from Operations	<b>9.9%</b>	4.0%	<b>5.9%</b>	6.5%
Interest expense	<b>(2.4)%</b>	(1.8)%	<b>(2.7)%</b>	(1.6)%
Other income, net	<b>(0.1)</b>	0.0	<b>0.0</b>	0.1
Income before income taxes	<b>7.4%</b>	2.2%	<b>3.2%</b>	5.0%
Provision for income taxes	<b>2.8</b>	0.9	<b>1.3</b>	1.9
Net Income	<b>4.6%</b>	1.3%	<b>1.9%</b>	3.1%

Net sales

Consolidated net sales increased 13.2% or \$2.6 million for the three months ended November 30, 2006 and decreased 4.4% or \$2.7 million for the nine months ended November 30, 2006, as compared to the same periods ended November 30, 2005. Display segment sales increased 5.3% or \$0.8 million for the three-month comparative period and decreased 11.2% or \$5.5 million for the nine-month comparative period. Sales within the Wholesale Distribution segment increased 38.3% or \$1.8 million for the three-month comparative period and increased 19.6% or \$2.8 million for the nine-month comparative period.

The net increase in Display Segment sales for the three months ended November 30, 2006 is primarily attributed to improved Data Display CRT revenues, which increased \$0.7 million, as compared to the same period ended November 30, 2005. This increase is attributable to improved sales prices for certain high resolution color tubes and monochrome

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tubes reflecting declining availability of these products. As overall demand for these products is declining, manufacturing of these tubes is being phased out. The Monitor revenues increased \$0.4 million over the three-month period primarily due to sales of display screens under a contract with a major vendor in the military defense industry, which was partially offset by reduced demand for new flight training systems for commercial and military flight training. Continuing recent historical trends, Entertainment CRTs and Electron Gun and Components revenues declined \$0.2 million and \$0.1 million, respectively over the comparable three-month period.

The net decrease in Display Segment sales for the nine months ended November 30, 2006 is primarily attributed to declines in Monitor, Entertainment CRTs and Electron Gun and Components revenues, as compared to the same period ended November 30, 2005. The Monitor revenues declined \$4.2 million over the nine-month period primarily due to the fulfillment of a military contract for replacement CRTs early in fiscal 2006, which has not been renewed, and reduced demand for new flight training systems for commercial and military flight training. Entertainment CRT revenues declined \$0.9 million over the comparable nine-month period. A significant portion of the entertainment division's sales are to major television retailers as replacements for products sold under manufacturer and extended warranties. Due to continued lower retail sales prices for mid-size television sets (25" to 30"), fewer extended warranties were sold by retailers, a trend consistent with recent prior fiscal years. The Company remains the primary supplier of product to meet manufacturers' standard warranties. Future revenue trends in this division will be negatively impacted by the decreasing number of extended warranties sold for larger, more expensive sets. Because the Company is in the replacement market, it has the ability to track retail sales trends and, accordingly, can attempt to adjust quantities of certain size CRTs carried in stock and reduce exposure to obsolescence.

Electron Gun and Components revenues declined \$0.3 million over the comparable three-month and nine-month periods. Electron Gun and Components revenues have generally declined in recent years due to weaker demand for electron gun and stem sales. Electron gun sales have historically been dependent upon the demand by domestic and foreign television CRT remanufacturers. These sales have declined over the past few years as consumers move towards purchasing new technology as opposed to repairing existing sets.

Wholesale Distribution segment net sales growth is attributed to an expansion of the call center late in fiscal 2006, which acts as a consumer and dealer support center for in-warranty and out-of-warranty household products, appliances, parts and accessories for Black & Decker, DeLonghi, Norelco, Coby and various other manufacturers. This call center also acts as a technical support center for these same manufacturers.

**Gross margins**

Consolidated gross margins increased from 32.8% for the three months ended November 30, 2005 to 35.8% for the three months ended November 30, 2006. For the nine months ended November 30, 2006, consolidated gross margins improved from 32.4% to 33.5% for the comparable prior year period.

Display segment margins increased from 25.9% to 32.5% for the comparative three-month period and increased from 26.4% to 28.5% for the comparative nine-month period. Gross margins within the Monitor division increased to 32.4% for the three months ended November 30, 2006 compared to 26.6% for the same period a year ago and increased to 29.9% from 26.3% for the nine months ended November 30, 2006 compared to the prior year. This increase is primarily attributable to continued streamlining of operational facilities and cost reduction efforts as well as the one time impact of certain relocation and integration costs incurred in Fiscal 2005. Data display gross margins increased to 34.1% for the three months ended November 30, 2006 compared to 7.9% for the same period a year ago and increased to 23.3% from 17.4% for the nine months ended November 30, 2006 compared to the prior year. The improved margins for the three and nine months ended November 30, 2006 primarily reflect improved selling prices of certain CRT tubes with limited availability and the transition to internal manufacturing of certain high resolution projection tubes. Gross margins in home entertainment CRTs decreased from 52.6% for the three months ended November 30, 2005 to 28.0% for the three months ended November 30, 2006 and decreased from 46.2% for the nine months ended November 30, 2005 to 28.0% for the nine months ended November 30, 2006, due to the impact of the reduced sales volume. Gross margins from





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component parts sold increased from 22.5% for the three months ended November 30, 2005 to 41.8% for the three months ended November 30, 2006 and decreased from 40.8% for the nine months ended November 30, 2005 to (10.5%) for the nine months ended November 30, 2006, reflecting the disposal of the unprofitable Wintron facility in May 2006 and due to the impact of the reduced sales volume.

The Wholesale Distribution segment gross margins decreased from 54.9% to 43.9% for the comparative three-month period and declined from 53.3% to 46.5% for the comparative nine-month period, primarily due to the impact of increased sales volume of lower margin call center service sales for the three and nine months ended November 30, 2006. Expenses for the call center are classified as operating expenses.

**Operating expenses**

Operating expenses as a percentage of sales decreased from 28.8% to 25.9% for the three months ended November 30, 2006 compared to the three months ended November 30, 2005 and increased from 25.9% to 27.6% for the nine-month comparative period, primarily due to the impact of sales volume trends over the comparable periods.

Display segment operating expenses decreased \$0.3 million for the three-month period ended November 30, 2006, and decreased \$0.6 million for the nine-month period ended November 30, 2006, as compared to the comparable prior year periods. These expense reductions are primarily due to cost savings derived from managements efforts to consolidate facilities, reduce overhead personnel and disposal of unprofitable operations, and decreases in corporate legal and professional fees.

Wholesale Distribution segment operating expenses increased \$0.4 million and \$0.9 million for the three-month and nine-month periods ended November 30, 2006, compared to the comparable periods a year ago, primarily due to additional expenses associated with the call center which was expanded late in fiscal 2006. These expenses (primarily payroll) are classified in general and administrative expense in the consolidated financial statements.

**Interest expense**

Interest expense increased \$0.2 million and \$0.6 million for the three and nine months ended November 30, 2006 as compared to the same periods a year ago. The Company maintains various debt agreements with different interest rates, most of which are based on the prime rate or LIBOR. These increases in interest expense primarily reflect higher market interest rates in effect during Fiscal 2006 compared to Fiscal 2005.

**Income taxes**

The effective tax rate for the nine months ended November 30, 2006 and November 30, 2005 was 40.1% and 38.5%, respectively. These rates differ from the Federal statutory rate primarily due to the effect of state taxes and the permanent non-deductibility of certain expenses for tax purposes.

**Foreign currency translation**

Gains or losses resulting from the transactions with the Company's UK subsidiary are reported in current operations while currency translation adjustments are recognized in a separate component of shareholders' equity. There were no significant gains or losses recognized in either period related to the UK subsidiary.

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November 30, 2006****Liquidity and Capital Resources**

As of November 30, 2006, the Company had total cash of \$1.8 million. The Company's working capital was \$39.4 million and \$16.3 million at November 30, 2006 and February 28, 2006, respectively. Based on a violation of the related debt covenants, working capital at February 28, 2006 was reduced by \$17.6 in outstanding lines of credit, due to the classification of these lines as a current liability as of that date, as discussed in Note 8 to the consolidated financial statements included in Part I, Item 1 of this form 10-Q. In recent years, the Company has financed its growth and cash needs primarily through income from operations, borrowings under revolving credit facilities, advances from the Company's Chief Executive Officer and long-term debt. Liquidity provided by operating activities of the Company is reduced by working capital requirements, largely inventories and accounts receivable, debt service, capital expenditures, product line additions and dividends. In December 2006, the Company announced the selection of an exclusive agent to represent the Company in a sale and leaseback of its real estate, the net proceeds of which would be used to reduce outstanding debt.

The Company specializes in certain products representing trailing-edge technology that may not be available from other sources, and may not be currently manufactured. In many instances, the Company's products are components of larger display systems for which immediate availability is critical for the customer. Accordingly, the Company enjoys higher gross margins on certain products, but typically has larger investments in inventories than those of its competitors.

The Company continues to monitor its cash and financing positions, seeking to find ways to lower its interest costs and to produce positive operating cash flow. The Company examines possibilities to grow its business as opportunities present themselves, such as new sales contracts 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 or existing bank lines; however, more permanent sources of capital may be required in certain circumstances.

Cash provided by operations for the nine months ended November 30, 2006 was \$3.2 million as compared to cash provided of \$1.9 million for the nine months ended November 30, 2005. The net cash provided for the nine months ended November 30, 2006 is primarily the result of an increase in accounts receivable of \$0.5 million, a decrease in inventory of \$1.9 million, an increase in cost and estimated margins in excess of billings, net, on uncompleted contracts of \$2.5 million and a decrease in accounts payable and accrued expenses of \$0.6 million. The increase in accounts receivable reflects normal variations in the timing of invoicing and account collection. The decrease in inventory is primarily due to decreasing levels of CRT's in line with the overall sales trends of these products combined with the continued assessment of inventory obsolescence and the establishment of appropriate reserves, a non-cash charge. The change in cost and estimated margins in excess of billings on uncompleted contracts reflects the progress of manufacturing versus the scheduled invoice intervals under terms of the related customer contracts. The decrease in account payable and accrued expenses is attributable to the reduced volume of inventory purchases, the impact of various cost reduction efforts and to normal fluctuations in the timing of purchases and the processing of invoices for payment.

Investing activities used cash of \$0.6 million for the nine months ended November 30, 2006 compared to cash used of \$2.8 million for the nine months ended November 30, 2005. Net cash used for the nine months ended November 30, 2006 related to the acquisition of EDL and \$0.2 million for the purchase of various equipment items, partially offset by proceeds of \$0.2 million from the sale of the Wintron division. The reduction in use of cash compared to the comparable prior year period primarily reflects cash of approximately \$1.4 million used to acquire the IDS division of Three Five Systems, Inc. in May 2005 and equipment expenditures related to the call center operations in the fall of 2005.

Financing activities used cash of \$2.7 million for the nine months ended November 30, 2006, reflecting a \$1.5 million net decrease in advances under outstanding lines of credit and a \$0.8 million net repayment of advances from the Company's Chief Executive. Financing activities provided net cash of \$1.2 million for the nine months ended November 30, 2005, primarily due to additional borrowings required for the Company's general working capital needs and higher level of investing activities in the prior year period.



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**Video Display Corporation and Subsidiaries  
November 30, 2006**

The Company's debt agreements with financial institutions contain affirmative and negative covenants, including requirements related to tangible net worth and debt service coverage and new loans. Additionally, dividend payments, capital expenditures and acquisitions have certain restrictions. Substantially all of the Company's retained earnings are restricted based upon these covenants.

The Company has a stock repurchase program, pursuant to which it was originally authorized to repurchase up to 462,500 shares of the Company's common stock in the open market. On January 11, 2006, the Board of Directors of the Company approved a continuation of the stock repurchase program, and authorized the Company to repurchase up to 600,000 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. During the fiscal quarter ended November 30, 2006, the Company repurchased 65,608 shares at an average price of \$7.37 per share, which have been added to treasury shares on the consolidated balance sheet. Under this program, an additional 593,010 shares remain authorized to be repurchased by the Company at November 30, 2006. As discussed in Note 8. Lines of Credit, the Loan and Security Agreement executed by Company on June, 29, 2006 included restrictions on investments which restricted further repurchases of stock under this program. In October 2006, the participating banks granted a limited exception to these restrictions, allowing the Company to purchase up to 120,000 shares at a total cost not to exceed \$900,000.

**Critical Accounting Policies**

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon the Company's consolidated financial statements. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require the use of estimates and assumptions that affect amounts reported and disclosed in the 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 considers the projected demand for CRTs in this estimate of net realizable value. Management is able to identify consumer buying trends, such as size and application, well in advance of supplying replacement CRTs. Thus, the Company is able to adjust inventory-stocking levels according to the projected demand. The average life of a CRT is five to seven years, at which time the Company's replacement market develops. Management reviews inventory levels on a quarterly basis. Such reviews include observations of product development trends of the OEMs, new products being marketed, and technological advances relative to the product capabilities of the Company's existing inventories. There have been no significant changes in management's estimates of the trends affecting CRT obsolescence in fiscal 2006 and 2005; however, the Company cannot guarantee the accuracy of future forecasts since these estimates are subject to change based on market conditions.

*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.

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In accordance with Emerging Issues Task Force (EITF) issue 00-10, shipping and handling fees billed to customers are classified in net sales in the consolidated statements of operations. Shipping and handling costs incurred are classified in selling and delivery in the consolidated statements of operations.

A portion of the Company's revenue is derived from contracts to manufacture products to a buyer's specification. These contracts are accounted for under the provisions of the American Institute of Certified Public Accountants Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. These contracts are fixed-price and cost-plus contracts and are recorded on the percentage of completion basis using the ratio of costs incurred to estimated total costs at completion as the measurement basis for progress toward completion and revenue recognition. Any losses identified on contracts are recognized immediately. Contract accounting requires significant judgment relative to assessing risks, estimating contract costs and making related assumptions for schedule and technical issues. With respect to contract change orders, claims or similar items, judgment must be used in estimating related amounts and assessing the potential for realization. These amounts are only included in contract value when they can be reliably estimated and realization is probable.

The Wholesale Distribution segment has several distribution agreements that it accounts for using the gross revenue basis as prescribed by EITF issue 99-19. The Company uses the gross method because the Company has general inventory risk, physical loss inventory risk and credit risk. The call center service revenue is recognized based on written pricing agreements with each manufacturer, on a per call, per email or per standard mail basis.

*Allowance for bad debts*

The allowance for bad debts is determined by reviewing all accounts receivable and applying historical 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 bad debts 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 historical 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 historically its procedures 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.

**New Accounting Pronouncements**

In July 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. Interpretation No. 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. The cumulative effect of initially

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November 30, 2006**

adopting Interpretation No. 48 is to record an adjustment to opening retained earnings in the year of adoption and should be presented separately. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized upon adoption of Interpretation No. 48. Management is in the process of evaluating the provisions of the interpretation, but does not anticipate that the adoption of this interpretation will have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards (Statement No. ) 157, *Fair Value Measurements*. Statement No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The statement does not require new fair value measurements, but is applied to the extent that other accounting pronouncements require or permit fair value measurements. The statement emphasizes that fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. Companies will be required to disclose the extent to which fair value is used to measure assets and liabilities, the inputs used to develop the measurements, and the effect of certain of the measurements on earnings (or changes in net assets) for the period. Statement No. 157 is effective for fiscal years beginning after November 15, 2007. Management does not anticipate that the adoption of this statement will have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, which requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. Statement No. 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. This statement is effective for fiscal years ending after December 15, 2006. The Company does not currently provide defined benefit pension or other postretirement plans, therefore management has determined that the adoption of this interpretation will not have an impact on the Company's consolidated financial statements.

In September 2006, the staff of the Securities and Exchange Commission issued Staff Accounting Bulletin 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 requires that public companies utilize a dual balance-sheet and income-statement approach to assessing the quantitative effects of financial misstatements. SAB 108 also addresses the mechanics of correcting misstatements that include the effects from prior years, and provides for error correction through a one-time cumulative effect adjustment to beginning-of-year retained earnings upon initial adoption. The guidance in SAB 108 must be applied to annual financial statements for fiscal years ending after November 15, 2006. Management is in the process of assessing the impact of adopting SAB 108 but does not expect that it will have a material impact on the Company's consolidated financial statements.

**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 forward-looking 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 of Form 10-K for the year ended February 28, 2006 could cause actual results to differ materially.

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**Subsequent Event**

Effective December 31, 2006, the Company acquired the Cathode Ray Tube Manufacturing and Distribution Business and certain assets of Clinton Electronics Corp. located in Loves Park, Illinois. The Cathode Ray Tube Manufacturing and Distribution Business has been an industry leader in the supply of monochrome CRTs used in video display products since 1964. The assets acquired in this transaction have been recorded based on their fair value at the date of acquisition and include inventories of \$2,125,000, equipment of \$100,000 and certain intellectual property and customer lists of \$325,000. Consideration for the assets acquired include a \$1.0 million face value Convertible Note Payable, convertible into 120,000 shares of the Company's common stock, delivered on the closing date, January 9, 2007, an agreement to deliver, on the first anniversary of the closing date, a certificate for \$1,125,000 in market value of the Company's common stock as of that date, and on the second anniversary of the closing date, a certificate for \$500,000 in market value of the Company's common stock as of that date. The Company will record the convertible notes payable net of an implied discount of \$75,000. The purchase agreement provides for an adjustment to this base purchase price on the second anniversary of the closing date, to be paid in shares of the Company's common stock, based on the remaining fair value of the initial inventories on hand as of that date. The purchase agreement also included a \$300,000 cash payment on the closing date for a 12 month lease of facilities located in Loves Park. The product development designs and drawings are being amortized over a five year period, while the customer list is being amortized over a three year period, which the Company estimates to be the useful life of these assets.



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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company's primary market risks include fluctuations in interest rates and variability in interest rate spread relationships, such as prime to LIBOR spreads. Approximately \$23.8 million of outstanding debt at November 30, 2006 related to long-term indebtedness under variable rate debt. Interest on the outstanding balance of this debt will be charged based on a variable rate related to the prime rate or the LIBOR rate. Both rate bases are incremented for margins specified in their agreements. Thus, the Company's interest rate is subject to market risk in the form of fluctuations in interest rates. The effect of a hypothetical one percentage point increase across all maturities of variable rate debt would result in a decrease of approximately \$0.2 million in pre-tax net income assuming no further changes in the amount of borrowings subject to variable rate interest from amounts outstanding at November 30, 2006. The Company does not trade in derivative financial instruments.

The Company has a subsidiary in the U.K., which is not material, but uses the British pound as its functional currency. Due to its limited operations outside of the U.S., the Company's exposure to changes in foreign currency exchange rates between the U.S. dollar and foreign currencies or to weakening economic conditions in foreign markets is not expected to significantly impact the Company's financial position.

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**Video Display Corporation and Subsidiaries  
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**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 November 30, 2006. 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 November 30, 2006.

**Changes in Internal Controls**

During the nine months ended November 30, 2006, the Company initiated changes in its internal control over financial reporting to address material weaknesses discussed in the 2006 Annual Report on Form 10-K. Subsequent to the end of the fiscal year, the Company hired replacement financial reporting personnel with the requisite skills, who are being trained in the Company's reporting procedures and controls. The monthly, quarterly and annual closing processes are being documented and the participating members of the financial staff are being cross-trained on upgraded procedures. Management believes that these training procedures and the replacement of financial reporting personnel will ensure that the disclosed material weaknesses will not have a material effect on financial reporting in current and future periods.

There have not been any other 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

No new material legal proceedings or material changes in existing litigation occurred during the quarter ended November 30, 2006.

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, 2006. 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

In August 2006, the Company acquired certain assets of Hobson Bros. Inc. of Chicago in exchange for 26,830 shares of the Company's common stock held as treasury shares. The market value of shares issued was \$9.32 at the date of close for a total acquisition cost of \$250,000.

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other information

None.

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**Video Display Corporation and Subsidiaries  
November 30, 2006**

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(d) | \$27,500,000 promissory note dated November 10, 2004 between the Company and Bank of America (holder) (incorporated by reference to Exhibit 10(d) to the Company's 2005 Annual Report on Form 10-K).   |
| 10(e) | \$6,800,000 term note dated February 27, 2006 between the Company and Ronald D. Ordway (holder) (incorporated by reference to Exhibit 10(e) to the Company's 2006 Annual Report on Form 10-K).   |
| 10(h) | Loan and Security Agreement and related documents, dated June 14, 2006, among Video Display Corporation and Subsidiaries and RBC Centura Bank and Regions Bank as lenders and RBC Centura Bank as collateral agent (incorporated by reference to Exhibit 10(h) to the Company's Current Report on Form 8-K dated June 29, 2006). |
| 10(i) | \$6,000,000 Subordinated Note, dated June 29, 2006, between Video Display Corporation and Ronald D. Ordway (holder) (incorporated by reference to Exhibit 10(i) to the Company's Current Report on Form 8-K dated June 29, 2006).  |
| 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.   |
| 32.1  | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |

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**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VIDEO DISPLAY CORPORATION

January 12, 2007

By: /s/ Ronald D. Ordway  
Ronald D. Ordway  
Chief Executive Officer

January 12, 2007

By: /s/ Michael D. Boyd  
Michael D. Boyd  
Chief Financial Officer