

BUTLER NATIONAL CORP  
Form 10-Q  
March 16, 2007

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

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**FORM 10-Q**  
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Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Fee Required)

Mark One

For the quarter ended **January 31, 2007**

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (No Fee Required)

For the quarter ended **January 31, 2007**

Commission File Number **0-1678**

**BUTLER NATIONAL CORPORATION**

(Exact name of Registrant as specified in its charter)

**Kansas**

**41-0834293**

(State of Incorporation)

(I.R.S. Employer Identification No.)

**19920 West 161st Street, Olathe, Kansas 66062**

(Address of Principal Executive Office)(Zip Code)

Registrant's telephone number, including area code: **(913) 780-9595**

Former name, former address and former fiscal year if changed since last report:  
Not Applicable

**Common Stock \$.01 Par Value**

(Title of Class)

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 twelve months and (2) has been subject to such filing requirements for the past ninety days: Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act): Yes No

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

The number of shares outstanding of the Registrant's Common Stock, \$0.01 par value, as of March 9, 2007 was **53,051,837** shares.

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES

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BUTLER NATIONAL CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS

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| ASSETS   | <u>01/31/07</u> | <u>4/30/06</u> | LIABILITIES AND<br>SHAREHOLDERS' EQUITY                            | <u>01/31/07</u> | <u>4/30/06</u> |
|--|-----------------|----------------|--|-----------------|----------------|
|  | unaudited       | audited        |  | unaudited       | audited        |
| <b>CURRENT ASSETS:</b>   |                 |                | <b>CURRENT LIABILITIES:</b>  |                 |                |
| Cash   | \$ 1,611,252    | \$925,577      | Bank overdraft payable   | \$ 127,443      | \$ 343,532     |
| Accounts receivable, net of allowance for doubtful accounts of \$135,421 at January 31, 2007 and \$149,577 at April 30, 2006 | 622,465         | 679,086        | Promissory notes payable   | 2,745,230       | 2,393,607      |
| Contracts in process   | 1,036,979       | -              | Current maturities of long-term debt and capital lease obligations | 2,962,002       | 2,375,848      |
| Inventories -  |                 |                | Accounts payable   | 493,496         | 549,482        |
| Raw materials  | 4,554,030       | 5,454,438      | Customer deposits  | 533,000         | 20,000         |
| Work in process  | 650,822         | 599,658        | Accrued liabilities  |                 |                |
| Finished goods   | 91,549          | 94,631         | Compensation and compensated absences                              | 496,048         | 516,248        |
| Aircraft   | 4,937,214       | 4,849,830      | Other  | 344,249         | 265,992        |
|  | -----           | -----          | Total current liabilities  | 7,701,468       | 6,464,709      |
|  | 10,233,615      | 10,998,557     | <b>LONG-TERM DEBT AND CAPITAL LEASE, NET</b>                       |                 |                |
|  |                 |                | <b>OF CURRENT MATURITIES</b>                                       | 1,646,146       | 1,844,312      |
| Prepaid expenses and other current assets  | 56,175          | 67,563         |  |                 |                |
|  | -----           | -----          | Total liabilities  | 9,347,614       | 8,309,021      |
| Total current assets   | 13,560,486      | 12,670,783     |  |                 |                |
|  |                 |                | <b>COMMITMENTS AND CONTINGENCIES</b>                               |                 |                |
| <b>PROPERTY, PLANT AND EQUIPMENT:</b>  |                 |                | <b>SHAREHOLDERS' EQUITY:</b>                                       |                 |                |
| Land and building  | 2,283,227       | 2,283,227      | Preferred stock, par value \$5                                     |                 |                |
| Machinery and equipment  | 1,563,268       | 1,546,215      | Authorized 50,000,000 shares, all classes                          |                 |                |
| Office furniture and fixtures  | 688,823         | 688,823        | Designated Classes A and B, 200,000                                |                 |                |

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|   |               |               |  |              |              |
|---|---------------|---------------|--|--------------|--------------|
|   |               |               | shares   |              |              |
| Leasehold improvements                  | 4,249         | 4,249         | \$1,000 Class A, 9.8%, cumulative if earned          |              |              |
|   | -----         |               | liquidation and redemption value \$100,              |              |              |
|   | 4,539,567     | 4,522,514     | no shares issued and outstanding                     | -            | -            |
| Accumulated depreciation                | (2,282,643)   | (2,166,554)   | \$1,000 Class B, 6%, convertible cumulative,         |              |              |
|   | -----         |               | liquidation and redemption value \$1,000             |              |              |
|   | 2,256,924     | 2,355,960     | no shares issued and outstanding                     | -            | -            |
| SUPPLEMENTAL TYPE CERTIFICATES          | 1,659,773     | 1,221,435     | Common stock, par value \$.01:                       |              |              |
|   |               |               | Authorized 100,000,000 shares issued and outstanding |              |              |
|   |               |               | 53,080,764 shares at                                 |              |              |
|   |               |               | at January 31 and 49,381,003 at April 30, 2006       | 530,808      | 493,810      |
| ADVANCES FOR INDIAN GAMING DEVELOPMENTS |               |               | Common stock, owed but not issued, 571,073 shares    | 5,710        | 42,708       |
| (net of reserves of \$2,912,440)        | 1,806,551     | 1,806,551     | at January 31 and 4,270,834 at April 30, 2006        |              |              |
|   |               |               | Capital contributed in excess of par                 | 10,612,420   | 10,612,420   |
|   |               |               | Treasury stock at cost (600,000 shares)              | (732,000)    | (732,000)    |
|   |               |               | Retained earnings                                    | (397,418)    | (587,830)    |
| OTHER ASSETS                            | 83,400        | 83,400        |  | -----        | -----        |
|   |               |               | Total shareholders' equity                           | 10,019,520   | 9,829,108    |
|   | -----         |               |  | -----        | -----        |
| Total assets                            | \$ 19,367,134 | \$ 18,138,129 | Total liabilities and shareholders' equity           | \$ 9,367,134 | \$ 8,138,129 |
|   | =====         |               |  | =====        | =====        |

The accompanying notes are an integral part of these financial statements

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED INCOME STATEMENT

|                                    | THREE MONTHS ENDED |              |
|------------------------------------|--------------------|--------------|
|                                    | January 31,        |              |
|                                    | <u>2007</u>        | <u>2006</u>  |
|                                    | (unaudited)        | (unaudited)  |
| REVENUES                           |                    |              |
| Aircraft / Modifications           | \$ 1,510,523       | \$ 1,705,395 |
| Avionics / Defense                 | 620,857            | 558,529      |
| Management / Professional Services | 1,212,250          | 807,377      |
|                                    | -----              | -----        |
| Net Revenues                       | 3,343,630          | 3,071,301    |
| COST OF SALES                      |                    |              |
| Aircraft / Modifications           | 1,289,732          | 1,537,451    |
| Avionics / Defense                 | 577,630            | 258,968      |
| Management / Professional Services | 593,202            | 247,589      |
|                                    | -----              | -----        |
| Total Cost of Sales                | 2,460,564          | 2,044,008    |
|                                    | -----              | -----        |
| GROSS PROFIT                       | 883,066            | 1,027,293    |
|                                    | 855,135            | 826,120      |

SELLING, GENERAL AND ADMINISTRATIVE  
EXPENSES

|   |    |            |            |
|---|----|------------|------------|
|   |    | -----      | -----      |
| OPERATING INCOME                                |    | 27,931     | 201,173    |
| OTHER INCOME (EXPENSE)                          |    |            |            |
| Interest expense                                |    | (139,597)  | (129,190)  |
| Other   |    | -          | 4,769      |
|   |    | -----      | -----      |
| Other expense                                   |    | (139,597)  | (124,421)  |
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES |    | (111,666)  | 76,752     |
| PROVISION FOR INCOME TAXES                      |    | (7,856)    | (39,257)   |
|   |    | -----      | -----      |
| NET INCOME                                      | \$ | (119,522)  | \$ 37,495  |
|   |    | =====      | =====      |
|   |    |            |            |
| BASIC EARNINGS PER COMMON SHARE                 | \$ | (.01)      | \$ .00     |
|   |    | =====      | =====      |
| Shares used in per share calculation            |    | 53,051,837 | 52,576,044 |
|   |    | =====      | =====      |
| DILUTED EARNINGS PER COMMON SHARE               | \$ | (.01)      | \$ .00     |
|   |    | =====      | =====      |
| Shares used in per share calculation            |    | 53,146,665 | 52,722,056 |

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

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED INCOME STATEMENT

NINE MONTHS ENDED

January 31,

2007

2006

(unaudited)

(unaudited)

REVENUES

|                                    |    |            |    |            |
|------------------------------------|----|------------|----|------------|
| Aircraft / Modifications           | \$ | 5,655,338  | \$ | 6,318,358  |
| Avionics / Defense                 |    | 1,996,512  |    | 2,042,556  |
| Management / Professional Services |    | 3,122,950  |    | 3,875,852  |
|                                    |    | -----      |    | -----      |
| Net Revenues                       |    | 10,774,800 |    | 12,236,766 |

COST OF SALES

|                                    |  |           |  |           |
|------------------------------------|--|-----------|--|-----------|
| Aircraft / Modifications           |  | 4,527,137 |  | 5,544,392 |
| Avionics / Defense                 |  | 1,558,890 |  | 1,044,890 |
| Management / Professional Services |  | 1,340,943 |  | 2,319,560 |
|                                    |  | -----     |  | -----     |
| Total Cost of Sales                |  | 7,426,970 |  | 8,908,842 |

GROSS PROFIT

|  |  |           |  |           |
|--|--|-----------|--|-----------|
|  |  | 3,347,830 |  | 3,327,924 |
|--|--|-----------|--|-----------|

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|  |            |            |
|--|------------|------------|
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 2,723,420  | 2,577,684  |
|  | -----      | -----      |
| OPERATING INCOME                             | 624,410    | 750,240    |
| OTHER INCOME (EXPENSE)                       |            |            |
| Interest expense                             | (401,101)  | (345,586)  |
| Other  | 34,783     | 4,769      |
|  | -----      | -----      |
| Other expense                                | (366,318)  | (340,817)  |
| INCOME BEFORE PROVISION FOR INCOME TAXES     | 258,092    | 409,423    |
| PROVISION FOR INCOME TAXES                   | (67,680)   | (59,257)   |
|  | -----      | -----      |
| NET INCOME                                   | \$ 190,412 | \$ 350,166 |
|  | =====      | =====      |
| BASIC EARNINGS PER COMMON SHARE              | \$ .01     | \$ .01     |
|  | =====      | =====      |
| Shares used in per share calculation         | 53,051,837 | 52,576,044 |
|  | =====      | =====      |
| DILUTED EARNINGS PER COMMON SHARE            | \$ .01     | \$ .01     |
|  | =====      | =====      |



|                                      |            |            |
|--------------------------------------|------------|------------|
| Shares used in per share calculation | 53,146,665 | 52,722,056 |
|                                      | =====      | =====      |

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

**BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | NINE MONTHS ENDED |             |
|---|-------------------|-------------|
|   | January 31,       |             |
|   | <u>2007</u>       | <u>2006</u> |
|   | (unaudited)       | (unaudited) |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                   |             |
| Net income (loss)   | \$ 190,412        | \$ 350,166  |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operations - |                   |             |
| Depreciation  | 116,089           | 99,821      |
| Changes in assets and liabilities:  |                   |             |
| Accounts receivable   | 56,621            | 577,310     |
| Contracts in process  | (765,965)         | (338,540)   |
| Inventories   | 493,927           | (1,187,627) |
| Prepaid expenses and other current assets   | 11,388            | (26,140)    |
| Accounts payable  | (272,075)         | (342,479)   |
| Customer deposits   | 513,000           | (10,000)    |
| Accrued liabilities   | 58,058            | (57,227)    |
|   | -----             | -----       |
| Cash provided by (used in) operating activities   | 401,455           | (934,716)   |
|   | -----             | -----       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                   |             |
| Capital expenditures  | (455,390)         | (28,600)    |
|   | -----             | -----       |
| Cash provided by (used in) investing activities   | (455,391)         | (28,600)    |

CASH FLOWS FROM FINANCING  
ACTIVITIES

|  |             |            |
|--|-------------|------------|
| Borrowings under promissory notes, net               | 351,622     | 1,045,234  |
| Repayments of long-term debt, net                    | 387,989     | (332,948)  |
|  | -----       | -----      |
| Cash provided by (used in) financing activities      | 739,611     | 712,286    |
|  | -----       | -----      |
| NET INCREASE (DECREASE) IN CASH                      | 685,675     | (251,030)  |
|  |             |            |
| CASH, beginning of period                            | 925,577     | 1,066,955  |
|  | -----       | -----      |
| CASH, end of period                                  | \$1,611,252 | \$ 815,925 |
|  | =====       | =====      |
| SUPPLEMENTAL DISCLOSURES OF<br>CASH FLOW INFORMATION |             |            |
| Interest paid  | \$ 401,102  | \$ 345,585 |
| Income taxes paid                                    | 47,180      | 69,257     |

The accompanying notes are an integral part of these statements.

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q of Regulation S-X and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with the annual report on Form 10-K dated April 30, 2006. In our opinion, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the nine months ended January 31, 2007 are not indicative of the results of operations that may be expected for the year ending April 30, 2007.

Certain reclassifications within the condensed financial statement captions have been made to maintain consistency in presentation between years.

2. Advances for Indian Gaming Development: We are advancing funds for the establishment of Indian gaming. These funds have been capitalized in accordance with Statements of Financial Accounting Standards (SFAS) 67 "Accounting for Costs and Initial Rental Operations of Real Estate Projects." Such standard requires costs associated with the acquisition, development, and construction of real estate and real estate related projects to be capitalized as part of that project.

Our advances to the tribes for gaming developments are capitalized. These advances represent costs to be

reimbursed upon approval of Indian gaming in several locations. We have agreements in place which require payments of advances to be made to us upon opening of Indian gaming facilities. Once gaming facilities have gained proper approvals, we plan to enter into a note receivable arrangement with the Tribe to secure reimbursement of advanced funds for that particular project. Reserves have been recorded for advances for the Indian gaming development costs when we are unable to determine whether reimbursement from the tribes will occur.

We have advanced and invested a total of \$4,718,991 in Indian gaming developments. We have reserves of \$2,912,440, at January 31, 2007 and April 30, 2006. We believe that our advances for Indian gaming developments will be totally reimbursed as casinos are opened. Due to the fact that all of the proposed casinos are involved in legal and governmental actions whose outcome is not certain nor is there any time frame for resolution we believe it is necessary to establish reserves against the advances. The reserve amount is an estimate of the value we would receive if a Tribal casino was not opened and we were forced to liquidate the assets that we have acquired with our advances. The assets are intended to be used for Tribal casino development and consist of purchased land and improvements. The land purchases are located adjacent to residential developments. We believe that these tracts could be developed and sold for residential and commercial use to recover advances if the gaming enterprises do not open.

3. Earnings Per Share: Earnings per common share is based on the weighted average number of common shares outstanding during the year. Stock options have been considered in the dilutive earnings per share calculation.

4. Research and Development: We charge to operations research and development costs. The amount charged in the nine months ended January 31, 2007 and 2006 were approximately \$1,506,362 and \$342,449 respectively.

5. Borrowings: A line of credit in the amount of \$1,224,285 was entered into on July 7, 2006. An additional line of credit in the amount of \$1,508,000 was entered into on October 25, 2006. Both lines of credit are to be used for the BCS Design, Inc. construction projects in Junction City, Kansas. As of January 31, 2007 we have borrowed \$733,249 and \$219,591 respectively. On January 16, 2007 the operating line of credit was increased by \$500,000.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RISK FACTORS

The information set forth below includes "forward-looking" information and is subject to Risk Factors as outlined in the Private Securities Litigation Reform Act of 1995. The Risk Factors listed under Item 1A of our Form 10-K and the Cautionary Statements, filed by us as Exhibit 99 to our Form 10-K, are incorporated herein by reference and you are specifically referred to such Risk Factors and Cautionary Statements for a discussion of factors which could affect our operations and forward-looking statements contained herein.

### RESULTS OF OPERATIONS

YEAR TO DATE JANUARY 31, 2007 COMPARED TO YEAR TO DATE JANUARY 31, 2006

Our sales for the nine months ended January 31, 2007 were \$10,774,800, a decrease of 11.9% from the nine months ended January 31, 2006 with sales of \$12,236,766. Our operating profit for the nine months ended January 31, 2007 was \$624,410, compared to \$750,240 for the nine months ended January 31, 2006

Discussion of the specific changes by operation at each business segment follows:

**Aircraft Modifications:** Sales from Aircraft Modifications including modified aircraft decreased \$663,019 (10.5%) from \$6,318,358 in the first nine months of fiscal year 2006 to \$5,655,338 in the current nine months of fiscal 2007.

Sales for the months of December 2006 and January 2007 were 34% less than the same months in fiscal 2006.

Revenues from non RVSM modification services increased \$143,563 or 3.5% in the first nine months of fiscal 2007. RVSM revenues decreased by 35% in the first nine months of fiscal 2007, compared to the first nine months of fiscal 2006.

We believe we will sell and install approximately an additional 50 to 100 Lear 20 & 30 series RVSM kits during the next few years. In addition to the RVSM sales, we expect to experience some increase in our base modification sales. As the economy grows aircraft owners may elect to update, modify, and purchase business aircraft. A shift to business aircraft ownership positively impacts our aircraft modification revenues. Although we cannot anticipate the future we must always consider the negative impact of items such as the 9-11 event, increases in fuel prices and general economic downturns.

Considerable time was spent on additions to the RVSM STC and certification of special mission STC's for our modification customers. These events reallocated used capacity and reduced RVSM completions. The modifications segment had an operating profit of \$665,813 for the nine months ended January 31, 2007 compared to operating profit of \$393,066 for the nine months ended January 31, 2006.

**Aircraft Acquisitions and Sales:** There was no activity for the nine months ended January 31, 2007 compared to the acquisition of four aircraft during the nine months ended January 31, 2006. FAA required modifications to the business aircraft fleet may increase customer demand for company owned aircraft.

**Avionics:** Sales were \$1,996,512 for the nine months ended January 31, 2007 compared to \$2,042,556 in the comparable period of the preceding year, a decrease of 2.3%. Operating loss for the nine months ended January 31, 2007 was \$54,550 compared to an operating profit of \$739,786 for the nine months ended January 31, 2006, a change of \$794,336. The decrease in operating profit is related to additional material cost, material spoilage, additional labor requirements and rework labor costs on a major build-to-print contract. Further operating losses from this contract may be experienced in fiscal 2008.

We expect this business segment to grow in future years as more defense classic aviation products are upgraded with modern gun control equipment. In addition we expect new fuel system protection devices like the TSD and GFI to be required as the focus on aviation becomes more intense.

**Services - SCADA Systems and Monitoring Services:** Revenue increased from \$1,050,582 for the nine months ended January 31, 2006 to \$1,777,651 for the nine months ended January 31, 2007, an increase of 69%. During the nine months ended January 31, 2007 we maintained a relatively level volume of long-term contracts with municipalities. Revenue fluctuates due to the introduction of new products and services and the related installations of these products. Our contract with one of our largest customers has been renewed

through fiscal 2008. We had an operating profit of \$443,561 in Monitoring Services for the nine months ended January 31, 2007, compared to \$238,880 for the nine months ended January 31, 2006.

**Gaming:** Revenues from management services related to gaming increased for the nine months ended January 31, 2007. This increase is related to the approval of Class III casino gaming in Oklahoma.

**Corporate / Professional Services:** These services include the architectural services of BCS Design, Inc., arrangements for financing, and on site contract management of gaming establishments and engineering services. Flight and engineering services are also provided. Management consulting and professional fees were \$248,563 for the nine months ended January 31, 2007 and \$1,963,597 for the nine months ended January 31, 2006, a decrease of 87.3%. We completed construction projects in fiscal 2006 that accounted for approximately \$1,552,000 of this decrease.

**Selling, General and Administrative (SG&A):** Expenses were \$2,723,420 or 25% of revenues for the nine months ended January 31, 2007. Business overhead expenses were maintained at relatively the same level as last year.

**Other Income (Expense):** Other expenses increased from \$340,817 in the nine months ended January 31, 2006 to \$366,318 for the nine months ended January 31, 2007. The additional interest expenses of \$55,515 were a combination of increased interest rates and additional borrowings.

**Earnings:** Our net income for the prior nine months period ended January 31, 2006 was \$350,166. Our net income for the current nine months ended January 31, 2007 was \$190,412.

**Employees:** We employed 93 at January 31, 2007 and 80 at January 31, 2006.

#### THIRD QUARTER FISCAL 2007 COMPARED TO THIRD QUARTER FISCAL 2006

Our sales for the three months ended January 31, 2007 were \$3,343,630, an increase of 8.9% from the three months ended January 31, 2006 with sales of \$3,071,301. Our operating profit for the three months ended January 31, 2007 was \$27,931, compared to \$201,173 for the three months ended January 31, 2006.

Discussion of the specific changes by operation at each business segment follows:

**Aircraft Modifications:** Sales from Aircraft Modifications including modified aircraft decreased \$194,872 (11.4%) from \$1,705,395 in the third quarter of fiscal year 2006 to \$1,510,523 in the current quarter of fiscal 2007. Revenues from non RVSM modification services decreased \$115,789 or 9.3% in the third quarter of fiscal 2007. RVSM revenues decreased by 16.8% in the third quarter of fiscal 2007, compared to the third quarter of fiscal 2006.

We believe we will sell and install approximately an additional 50 to 100 Lear 20 & 30 series RVSM kits during the next few years. In addition to the RVSM sales, we expect to experience some increase in our base modification sales. As the economy grows aircraft owners may elect to update, modify, and purchase business aircraft. A shift to business aircraft ownership positively impacts our aircraft modification revenues. Although we cannot anticipate the future we must always consider the negative impact of items such as the 9-11 event, increases in fuel prices and general economic downturns.

Considerable time was spent on additions to the RVSM STC and certification of special mission STC's for our modification customers. These events reallocated used capacity and reduced RVSM completions. The

modifications segment had an operating profit of \$141,642 for the three months ended January 31, 2007 compared to operating profit of \$42,262 for the three months ended January 31, 2006.

**Aircraft Acquisitions and Sales:** There was no activity for the three months ended January 31, 2007. We acquired one aircraft during the three months ended January 31, 2006. FAA required modifications to the business aircraft fleet may increase customer demand for company owned aircraft.

**Avionics:** Sales were \$620,858 for the three months ended January 31, 2007 compared to \$558,529 in the comparable period of the preceding year, an increase of 11.2%. Operating loss for the three months ended January 31, 2007 was \$83,904 compared to an operating profit of \$242,779 for the three months ended January 31, 2006, a change of \$326,683. The decrease in operating profit is related to additional material cost, material spoilage, additional labor requirements and rework labor costs on a major build-to-print contract. Further operating losses from this contract may be experienced in fiscal 2008.

We expect this business segment to grow in future years as more defense classic aviation products are upgraded with modern gun control equipment. In addition we expect new fuel system protection devices like the TSD and GFI to be required as the focus on aviation becomes more intense.

**Services - SCADA Systems and Monitoring Services:** Revenue increased from \$357,082 for the three months ended January 31, 2006 to \$716,923 for the three months ended January 31, 2007, an increase of 100%. During the three months ended January 31, 2007 we maintained a relatively level volume of long-term contracts with municipalities. Revenue fluctuates due to the introduction of new products and services and the related installations of these products. Our contract with one of our largest customers has been renewed through fiscal 2008. We had an operating profit of \$151,011 in Monitoring Services for the three months ended January 31, 2007, compared to \$64,095 for the three months ended January 31, 2006.

**Gaming:** Revenues from management services related to gaming increased for the three months ended January 31, 2007. This increase is related to the approval of Class III casino gaming in Oklahoma.

**Corporate / Professional Services:** These services include the architectural services of BCS Design, Inc., arrangements for financing, and on site contract management of gaming establishments and engineering services. Flight and engineering services are also provided. Management consulting and professional fees were \$83,054 for the three months ended January 31, 2007 and \$133,683 for the three months ended January 31, 2006, a decrease of 38%.

**Other Income (Expense):** Other expenses increased from \$124,421 in the three months ended January 31, 2006 to \$139,597 for the three months ended January 31, 2007. The additional interest expense was a result of increased interest rates and borrowings.

**Earnings:** Our net income for the prior three months period ended January 31, 2006 was \$37,495. Our net loss for the current three months ended January 31, 2007 was \$119,522.

## LIQUIDITY AND CAPITAL RESOURCES

We believe that our current banks will provide the necessary capital for our business operations. However, we continue to maintain contact with other banks that have an interest in funding our working capital needs to continue our growth in operations in fiscal 2007 and beyond.

We do not, as of January 31, 2007, have any material commitments for other capital expenditures other than the terms of the Indian gaming Management Agreements should any additional casinos materialize. We will need additional funds to complete our planned Indian gaming opportunities. We will use current cash available as well as additional funds, for the start up and construction of gaming facilities. We anticipate initially obtaining these funds from internally generated working capital and borrowings.

#### **Analysis and Discussion of Cash Flow**

The increase of \$600,000 in cash can generally be attributed to the following. We received a customer deposit of \$513,000 for work to be completed in the quarter ending April 30, 2007. Net income contributed \$190,000 while inventory use contributed an additional \$494,000. We had additional borrowings of over \$700,000 of which we used to finance construction projects in Junction City. STC certifications accounted for and additional \$438,000.

We believe all our inventory will be realized in the normal course of business. Lead-time for the components is dictated by the market place resulting in a build up of inventory to support sales and to avoid halting production because of material shortages.

#### **Revenue Recognition**

We perform aircraft modifications under fixed-price contracts. Revenues from fixed-price contracts are recognized on the percentage-of-completion method, measured by the direct labor costs incurred compared to total estimated direct labor costs. Revenue for off the shelf items and aircraft sales is recognized on the date of the sale.

Revenue from Avionics are recognized when shipped and payment for materials are due within thirty days of invoicing. Revenue for SCADA services, Gaming Management, and other Corporate/Professional Services are recognized on a monthly basis as services are rendered. Payments for these services are received within 30 days of invoicing.

In regard to warranties and returns our products are special order and are not suitable for return. Our products are unique upon installation and tested prior to their release and have been accepted by the customers. In the rare event of a warranty claim, the claim is processed through the normal course of business; this may include additional charges to the customer. In our opinion any future warranty work would not be material to the financial statements.

#### **Critical Accounting Policies**

**Bad Debts:** Bad debts are calculated on the historical write-off of bad debts of the individual subsidiaries. Invoices are considered a bad debt if no payment has been made in the past 90 days. We review these policies on quarterly basis, and based on these reviews we believe we maintain adequate reserves. We do not anticipate substantial changes to these estimates in the future.

**Use of Estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Long-lived assets:** Long-lived assets and identifiable intangibles to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be

recoverable. Impairment is measured by comparing the carrying value of the long-lived asset to the estimated undiscounted future cash flows expected to result from use of the assets and their eventual disposition. We determined that as of January 31, 2007, there had been no impairment in the carrying value of long-lived assets.

**Supplemental Type Certificates:** Supplemental Type Certificates (STCs) are authorizations granted by the Federal Aviation Administration (FAA) for specific modification of a certain aircraft. The STC authorizes us to perform modifications, installations and assemblies on applicable customer-owned aircraft. Costs incurred to obtain STCs are capitalized and subsequently amortized against revenues being generated from aircraft modifications associated with the STC. The costs are expensed as services are rendered on each aircraft through costs of sales using the units of production method. The legal life of an STC is indefinite. We believe we have enough future sales to fully amortize our STC development costs.

**Advances for Indian Gaming Developments:** We are advancing funds for the establishment of Indian gaming. These funds have been capitalized in accordance with Statements of Financial Accounting Standards (SFAS) 67 "Accounting for Costs and Initial Rental Operations of Real Estate Projects." Such standard requires costs associated with the acquisition, development, and construction of real estate and real estate-related projects to be capitalized as part of that project.

Our advances represent costs to be reimbursed upon approval of Indian gaming in several locations. We have agreements in place which require payments to be made to us for the respective projects upon opening of Indian gaming facilities. Once gaming facilities have gained proper approvals, we plan to enter into a note receivable arrangement with the Tribe to secure reimbursement of advanced funds for that particular project.

We have advanced and invested a total of \$4,718,991 in Indian gaming developments. We have reserves of \$2,912,440, at January 31, 2007 and January 31, 2006. We believe that our advances for Indian gaming developments will be totally reimbursed as casinos are opened. We believe it is necessary to establish reserves against the advances due to the fact that all of the proposed casinos are involved in legal and governmental actions whose outcome is not certain nor is there any time frame for resolution. The reserve amount is an estimate of the value we would receive if a Tribal casino was not opened and we were forced to liquidate the assets that we have acquired with our advances. These assets were intended to be used with Tribal casinos and consist of the purchase of land and land improvements related to the development of Indian Gaming facilities. We believe that these tracts could be developed and sold for residential and commercial use to recover our advances if the gaming enterprises do not open.

### **Changing Prices and Inflation**

We did experience some pressure from inflation in fiscal 2007. These include increases in airplane travel and transportation costs. This additional cost may not be transferable to our customers resulting in lower income. We anticipate long-term fuel costs and interest rates to continue to rise.

### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

### **Part I Item 3:**

Quantitative and Qualitative Disclosures about Market Risk.  
None



**Part I Item 4**

**Controls and Procedures**

We maintain a set of disclosure controls and procedures designed to ensure that information required to be disclosed in our filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Our principal executive and financial officers have evaluated our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q and have determined that such disclosure controls and procedures are effective.

**PART II.  
OTHER INFORMATION**

- |          |   |
|----------|---|
| Item 1   | Legal Proceedings<br>None   |
| Item 1A. | Risk Factors<br>There are no material changes to the risk factors disclosed under Item 1A of our Form 10-K.                                     |
| Item 2   | Unregistered Shares of Equity Securities and Use of Proceeds<br>None  |
| Item 3   | Defaults Upon Senior Securities<br>None   |
| Item 4   | Submission of Matters to Vote of Security Holders<br>None   |
| Item 5   | Other Information<br>None   |
| Item 6   | Exhibits  |
|          | 3.1   |
|          | Articles of Incorporation, as amended and restated are incorporated by reference to Exhibit 3.1 of our Form DEF 14A filed on December 26, 2001. |
|          | 3.2   |
|          | Bylaws, as amended, are incorporated by reference to Exhibit 3.2 of our Form DEF 14A filed on December 15, 2003.                                |
|          | 31.1  |
|          | Certificate of Chief Executive Officer  |
|          | 31.2  |
|          | Certificate of Chief Financial Officer  |
|          | 32.1  |
|          | Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.      |
|          | 32.2  |
|          | Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.      |

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Exhibit Number 99  
Cautionary Statements for Purposes of the "Safe Harbor"  
Provisions of the Private Securities Litigation Reform Act of  
1995, are incorporated by reference to Exhibit 99 of the Form  
10-K for the fiscal year ended April 30, 2006.

SIGNATURES

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

BUTLER NATIONAL CORPORATION  
(Registrant)

March 16, 2007  
Date

/S/ Clark D. Stewart  
Clark D. Stewart  
(President and Chief Executive Officer)

March 16, 2007  
Date

/S/ Angela D. Shinabargar  
Angela D. Shinabargar  
(Chief Financial Officer)