ADDVANTAGE TECHNOLOGIES GROUP INC
Form 10-Q
February 10, 2015

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED December 31, 2014

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM________________ TO ______________

Commission File number 1-10799

ADDvantage Technologies Group, Inc.
(Exact name of registrant as specified in its charter)

OKLAHOMA	73-1351610
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1221 E. Houston
Broken Arrow, Oklahoma 74012
(Address of principal executive office)
(918) 251-9121
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filero

Non-accelerated filer o (do not check if a smaller reporting company) Smaller reporting company x

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

Shares outstanding of the issuer's $.01 par value common stock as of January 31, 2015 were 10,041,206.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
Form 10-Q
For the Period Ended December 31, 2014

		Page
	PART I. FINANCIAL INFORMATION	
Item 1.	Financial Statements.	
	Consolidated Condensed Balance Sheets (unaudited) December 31, 2014 and September 30, 2014	2
	Consolidated Condensed Statements of Income (unaudited) Three Months Ended December 31, 2014 and 2013	4
	Consolidated Condensed Statements of Cash Flows (unaudited) Three Months Ended December 31, 2014 and 2013	5
	Notes to Unaudited Consolidated Condensed Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.	12
Item 4.	Controls and Procedures.	17
	PART II - OTHER INFORMATION	
Item 6.	Exhibits.	18
	SIGNATURES	

1

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

	December 31, 2014	September 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	$6,529,181	$5,286,097
Accounts receivable, net of allowance for doubtful accounts of $200,000	5,079,630	6,393,580
Income tax refund receivable	–	220,104
Inventories, net of allowance for excess and obsolete inventory of $2,306,628 and $2,156,628, respectively	23,119,992	22,780,523
Prepaid expenses	127,464	174,873
Deferred income taxes	1,390,000	1,416,000
Total current assets	36,246,267	36,271,177
Property and equipment, at cost:		
Land and buildings	7,212,779	7,208,679
Machinery and equipment	3,374,795	3,244,153
Leasehold improvements	135,252	206,393
Total property and equipment, at cost	10,722,826	10,659,225
Less accumulated depreciation	(4,290,324)	(4,191,516)
Net property and equipment	6,432,502	6,467,709
Intangibles, net of accumulated amortization	6,418,826	6,625,278
Goodwill	3,910,089	3,910,089
Other assets	131,428	131,428
Total assets	$53,139,112	$53,405,681

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

	December 31, 2014	September 30, 2014
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$2,543,924	$2,880,761
Accrued expenses	1,576,162	1,809,878
Accrued income taxes	104,663	–
Notes payable – current portion	852,643	845,845
Other current liabilities	993,308	983,269
Total current liabilities	6,070,700	6,519,753
Notes payable, less current portion	5,024,230	5,240,066
Deferred income taxes	178,000	267,000
Other liabilities	1,978,869	1,942,889
Shareholders' equity:		
Common stock, $.01 par value; 30,000,000 shares authorized;10,541,864 shares issued; and 10,041,206 shares outstanding	105,419	105,419
Paid in capital	(5,277,464)	(5,312,881)
Retained earnings	46,059,372	45,643,449
Total shareholders' equity before treasury stock	40,887,327	40,435,987
Less: Treasury stock, 500,658 shares, at cost	(1,000,014)	(1,000,014)
Total shareholders' equity	39,887,313	39,435,973
Total liabilities and shareholders' equity	$53,139,112	$53,405,681

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(UNAUDITED)

	Three Months Ended December 31,	
	2014	2013
Sales	$ 10,837,158	$ 6,119,733
Cost of sales	7,005,355	4,256,506
Gross profit	3,831,803	1,863,227
Operating, selling, general and administrative expenses	3,075,459	1,629,875
Income from operations	756,344	233,352
Interest expense	85,421	5,983
Income before provision for income taxes	670,923	227,369
Provision for income taxes	255,000	88,000
Income from continuing operations	415,923	139,369
Discontinued operations, net of tax	–	26,368
Net income	$ 415,923	$ 165,737
Earnings per share:		
Basic		
Continuing operations	$ 0.04	$ 0.01
Discontinued operations	–	–
Net income	$ 0.04	$ 0.02
Diluted		
Continuing operations	$ 0.04	$ 0.01
Discontinued operations	–	–
Net income	$ 0.04	$ 0.02
Shares used in per share calculation:		
Basic	10,041,206	9,998,480
Diluted	10,044,619	10,009,689

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended December 31,	
	2014	2013
Operating Activities		
Net income	$415,923	$165,737
Net income from discontinued operations	–	26,368
Net income from continuing operations	415,923	139,369
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	98,808	75,650
Amortization	206,452	–
Provision for excess and obsolete inventories	150,000	160,000
Deferred income tax benefit	(63,000)	(53,000)
Share based compensation expense	62,028	31,341
Changes in assets and liabilities:		
Accounts receivable	1,313,950	76,342
Income tax refund receivable	220,104	169,983
Inventories	(489,469)	(2,405,783)
Prepaid expenses	20,798	(12,693)
Accounts payable	(336,837)	1,560,197
Accrued expenses	(83,034)	(331,093)
Net cash provided by (used in) operating activities – continuing operations	1,515,723	(589,687)
Net cash used in operating activities – discontinued operations	–	(105,239)
Net cash provided by (used in) operating activities	1,515,723	(694,926)
Investing Activities		
Additions to machinery and equipment	(63,601)	(1,374)
Net cash used in investing activities	(63,601)	(1,374)
Financing Activities		
Payments on notes payable	(209,038)	(46,002)
Net cash used in financing activities	(209,038)	(46,002)
Net increase (decrease) in cash and cash equivalents	1,243,084	(742,302)
Cash and cash equivalents at beginning of period	5,286,097	8,476,725
Cash and cash equivalents at end of period	$6,529,181	$7,734,423
Supplemental cash flow information:		
Cash paid for interest	$53,957	$5,953
Cash paid for income taxes	$–	$–

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation and Accounting Policies

Basis of presentation

The condensed consolidated financial statements include the accounts of ADDvantage Technologies Group, Inc. and its subsidiaries, all of which are wholly owned (collectively, the "Company"). Intercompany balances and transactions have been eliminated in consolidation. The Company's reportable segments are Cable Television ("Cable TV") and Telecommunications ("Telco").

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. However, the information furnished reflects all adjustments, consisting only of normal recurring items which are, in the opinion of management, necessary in order to make the consolidated condensed financial statements not misleading. It is suggested that these consolidated condensed financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09: "Revenue from Contracts with Customers (Topic 606)". This guidance was issued to clarify the principles for recognizing revenue and develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards ("IFRS"). The guidance is effective for the fiscal years and interim periods within those years beginning after December 15, 2016. Management is evaluating the impact that ASU No. 2014-09 will have on the Company's consolidated financial statements.

Note 2 – Inventories

Inventories at December 31, 2014 and September 30, 2014 are as follows:

	December 31, 2014	September 30, 2014
New:		
Cable TV	$16,691,894	$16,949,713
Refurbished:		
Cable TV	3,778,007	3,982,140
Telco	4,956,719	4,005,298
Allowance for excess and obsolete inventory	(2,306,628)	(2,156,628)
	$23,119,992	$22,780,523

New inventory includes products purchased from the manufacturers plus "surplus-new", which are unused products purchased from other distributors or multiple system operators. Refurbished inventory includes factory refurbished, Company refurbished and used products. Generally, the Company does not refurbish its used inventory until there is a sale of that product or to keep a certain quantity on hand.

The Company regularly reviews the Cable Television segment inventory quantities on hand, and an adjustment to cost is recognized when the loss of usefulness of an item or other factors, such as obsolete and excess inventories, indicate that cost will not be recovered when an item is sold. The Company recorded charges in the Cable Television segment to allow for obsolete inventory, which increased the cost of sales during the three months ended December 31, 2014, and 2013, by approximately $0.2 million. For the Telco segment, any obsolete and excess telecommunications inventory is processed through its recycling program when it is identified.

Note 3 – Intangible Assets

Intangible assets that have finite useful lives are amortized on a straight-line basis over their estimated useful lives ranging from 3 years to 10 years. The intangible assets with their associated accumulated amortization amounts at December 31, 2014 and September 30, 2014 are as follows:

	December 31, 2014		
	Gross	Accumulated Amortization	Net
Intangible assets:			
Customer relationships – 10 years	$ 4,257,000	$ (354,750)	$ 3,902,250
Technology – 7 years	1,303,000	(155,119)	1,147,881
Trade name – 10 years	1,293,000	(107,750)	1,185,250
Non-compete agreements – 3 years	254,000	(70,555)	183,445
Total intangible assets	$ 7,107,000	$ (688,174)	$ 6,418,826

	September 30, 2014		
	Gross	Accumulated Amortization	Net
Intangible assets:			
Customer relationships – 10 years	$4,257,000	$ (248,325)	$4,008,675
Technology – 7 years	1,303,000	(108,583)	1,194,417
Trade name – 10 years	1,293,000	(75,425)	1,217,575
Non-compete agreements – 3 years	254,000	(49,389)	204,611
Total intangible assets	$7,107,000	$ (481,722)	$6,625,278

Note 4 – Notes Payable and Line of Credit

Notes Payable

The Company has an Amended and Restated Revolving Credit and Term Loan Agreement (“Credit and Term Loan Agreement”). At December 31, 2014, the Company has two term loans outstanding under the Credit and Term Loan Agreement. One outstanding term loan has an outstanding balance of $1.3 million at December 31, 2014 and is due on November 20, 2021, with monthly principal payments of $15,334 plus accrued interest. The interest rate is the prevailing 30-day LIBOR rate plus 1.4% (1.56% at December 31, 2014) and is reset monthly. This term loan is collateralized by inventory, accounts receivable, equipment and fixtures and general intangibles.

The second outstanding term loan has an outstanding balance of $4.5 million at December 31, 2014 and is due March 4, 2019, with monthly principal and interest payments of $68,505, with the balance due at maturity. It is a five year term loan with a seven year amortization payment schedule with a fixed interest rate of 4.07%. This term loan is collateralized by inventory, accounts receivable, equipment and fixtures and general intangibles.

Capital Lease Obligations

The Company has two capital lease obligations related to machinery and equipment totaling $59 thousand at December 31, 2014 with monthly principal and interest payments of $2,069. The capital lease obligations are due on June 20, 2017 and September 20, 2017.

7

Line of Credit

The Company has a $7.0 million Revolving Line of Credit ("Line of Credit") under the Credit and Term Loan Agreement. At December 31, 2014, the Company had no balance outstanding under the Line of Credit. The Line of Credit requires quarterly interest payments based on the prevailing 30-day LIBOR rate plus 2.75% (2.91% at December 31, 2014), and the interest rate is reset monthly. Any future borrowings under the Line of Credit are due on November 27, 2015. Future borrowings under the Line of Credit are limited to the lesser of $7.0 million or the net balance of 80% of qualified accounts receivable plus 50% of qualified inventory. Under these limitations, the Company's total available Line of Credit borrowing base was $7.0 million at December 31, 2014. Among other financial covenants, the Line of Credit agreement provides that the Company maintain a fixed charge ratio of coverage (EBITDA to total fixed charges) of not less than 1.25 to 1.0, determined quarterly. The Line of Credit is collateralized by inventory, accounts receivable, equipment and fixtures and general intangibles.

Fair Value of Debt

FASB ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a consistent framework for measuring fair value and establishes a fair value hierarchy based on the observability of inputs used to measure fair value. The three levels of the fair value hierarchy are as follows:

- Level 1 – Quoted prices for identical assets in active markets or liabilities that we have the ability to access. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Inputs are other than quoted prices in active markets included in Level 1 that are either directly or indirectly observable. These inputs are either directly observable in the marketplace or indirectly observable through corroboration with market data for substantially the full contractual term of the asset or liability being measured.
- Level 3 – Inputs that are not observable for which there is little, if any, market activity for the asset or liability being measured. These inputs reflect management's best estimate of the assumptions market participants would use in determining fair value.

The Company has determined the carrying value of its variable-rate term loan approximates its fair value since the interest rate fluctuates periodically based on a floating interest rate.

The Company has determined the fair value of its fixed-rate term loan utilizing the Level 2 hierarchy as the fair value can be estimated from broker quotes corroborated by other market data. These broker quotes are based on observable market interest rates at which loans with similar terms and maturities could currently be executed. The Company then estimated the fair value of the fixed-rate term loan using cash flows discounted at the current market interest rate obtained. The fair value of the Company's fixed rate loan was $4.5 million as of December 31, 2014.

Note 5 – Earnings Per Share

Basic earnings per share are based on the sum of the average number of common shares outstanding and issuable restricted and deferred shares. Diluted earnings per share include any dilutive effect of stock options and restricted stock. In computing the diluted weighted average shares, the average stock price for the period is used in determining the number of shares assumed to be reacquired under the treasury stock method from the exercise of options.

Basic and diluted earnings per share for the three months ended December 31, 2014 and 2013 are:

	Three Months Ended December 31,	
	2014	2013
Income from continuing operations	$415,923	$139,369
Discontinued operations, net of tax	–	26,368
Net income attributable to common shareholders	$415,923	$165,737
Basic weighted average shares	10,041,206	9,998,480
Effect of dilutive securities:		
Stock options	3,413	11,209
Diluted weighted average shares	10,044,619	10,009,689
Earnings per common share:		
Basic		
Continuing operations	$0.04	$0.01
Discontinued operations	–	–
Net income	$0.04	$0.02
Diluted		
Continuing operations	$0.04	$0.01
Discontinued operations	–	–
Net income	$0.04	$0.02

Note 6 – Stock Option Plan

Plan Information

The 1998 Incentive Stock Plan (the “Plan”) provides for awards of stock options and restricted stock to officers, directors, key employees and consultants. The Plan provides that upon any issuance of additional shares of common stock by the Company, other than pursuant to the Plan, the number of shares covered by the Plan will increase to an amount equal to 10% of the then outstanding shares of common stock. Under the Plan, option prices will be set by the Board of Directors and may be greater than, equal to, or less than fair market value on the grant date.

At December 31, 2014, 1,024,656 shares of common stock were reserved for the exercise of, or lapse of restrictions on, stock awards under the Plan. Of these reserved shares, 40,415 shares were available for future grants.

Stock Options

All share-based payments to employees, including grants of employee stock options, are recognized in the financial statements based on their grant date fair value over the requisite service period. Compensation expense for share-based awards is included in the operating, selling, general and administrative expense section of the Company’s consolidated condensed statements of income.

Stock options are valued at the date of the award, which does not precede the approval date, and compensation cost is recognized on a straight-line basis over the vesting period. Stock options granted to employees generally become exercisable over a three, four or five-year period from the date of grant and generally expire ten years after the date of grant. Stock options granted to the Board of Directors generally become exercisable on the date of grant and generally expire ten years after the grant.

A summary of the status of the Company's stock options at December 31, 2014 and changes during the three months then ended is presented below:

	Shares	Wtd. Avg. Ex. Price
Outstanding at September 30, 2014	560,000	$2.96
Granted	–	–
Exercised	–	–
Expired	–	–
Forfeited	–	–
Outstanding at December 31, 2014	560,000	$2.96
Exercisable at December 31, 2014	210,000	$3.09

No nonqualified stock options were granted for the three months ended December 31, 2014. The Company estimates the fair value of the options granted using the Black-Scholes option valuation model. The Company estimates the expected term of options granted based on the historical grants and exercises of the Company's options. The Company estimates the volatility of its common stock at the date of the grant based on both the historical volatility as well as the implied volatility on its common stock. The Company bases the risk-free rate that is used in the Black-Scholes option valuation model on the implied yield in effect at the time of the option grant on U.S. Treasury zero-coupon issues with equivalent expected term. The Company has never paid cash dividends on its common stock and does not anticipate paying cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model. The Company amortizes the resulting fair value of the options ratably over the vesting period of the awards. The Company uses historical data to estimate the pre-vesting option forfeitures and records share-based expense only for those awards that are expected to vest.

Compensation expense related to unvested stock options recorded for the three months ended December 31, 2014 is as follows:

	Three Months Ended December 31, 2014
Fiscal year 2012 grant	$8,261
Fiscal year 2014 grant	$27,156

The Company records compensation expense over the vesting term of the related options. At December 31, 2014, compensation costs related to these unvested stock options not yet recognized in the consolidated condensed statements of income was $190,125.

Restricted Stock

The Company granted restricted stock in March 2014 to its Board of Directors totaling 19,050 shares, which were valued at market value on the date of grant. The shares are being held by the Company for 12 months and will be delivered to the directors at the end of the 12 month holding period. The fair value of these shares upon issuance totaled $60,000 and is being amortized over the 12 month holding period as compensation expense. The Company granted restricted stock in April of 2014 to certain employees totaling 23,676 shares, which were valued at market value on the date of grant. The shares have a holding restriction, which will expire in equal annual installments of 7,892 shares over three years starting in April 2015. The fair value of these shares upon issuance totaled $76,000 and is being amortized over the respective one, two and three year holding periods as compensation expense. The unamortized portion of the restricted stock is included in prepaid expenses on the Company's consolidated condensed balance sheets.

Note 7 – Segment Reporting

The Company is reporting its financial performance based on its external reporting segments: Cable Television and Telecommunications. These reportable segments are described below.

Cable Television ("Cable TV")

The Company's Cable TV segment sells new, surplus and re-manufactured cable television equipment throughout North America, Central America, South America and, to a substantially lesser extent, other international regions that utilize the same technology. In addition, this segment also repairs cable television equipment for various cable companies.

Telecommunications ("Telco")

The Company's Telco segment sells certified used telecommunications networking equipment from a broad range of manufacturers to customers primarily in North America as well as other international regions. In addition, this segment also offers its customers decommissioning services for surplus and obsolete equipment, which it in turn processes through its recycling services.

The Company evaluates performance and allocates its resources based on operating income. The accounting policies of its reportable segments are the same as those described in the summary of significant accounting policies.

Segment assets consist primarily of cash and cash equivalents, accounts receivable, inventory, property, plant and equipment, goodwill and intangible assets.

	Three Months Ended	
	December 31, 2014	December 31, 2013
Sales		
Cable TV	$6,833,020	$6,119,733
Telco	4,036,293	–
Intersegment	(32,155)	–
Total sales	$10,837,158	$6,119,733
Gross profit		
Cable TV	$2,034,845	$1,863,227
Telco	1,796,958	–
Total gross profit	$3,831,803	$1,863,227
Operating income		
Cable TV	$618,811	$233,352
Telco	137,533	–
Total operating income	$756,344	$233,352

	December 31, 2014	September 30, 2014
Segment assets		
Cable TV	$27,705,307	$29,241,335
Telco	17,372,214	17,781,114
Non-allocated	8,061,591	6,383,232
Total assets	$53,139,112	$53,405,681

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Special Note on Forward-Looking Statements

Certain statements in Management's Discussion and Analysis ("MD&A"), other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements generally are identified by the words "estimates," "projects," "believes," "plans," "intends," "will likely result," and sin expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. These statements are subject to a number of risks, uncertainties and developments beyond our control or foresight, including changes in the trends of the cable television industry, changes in the trends of the telecommunications industry, changes in our supplier agreements, technological developments, changes in the economic environment generally, the growth or formation of competitors, changes in governmental regulation or taxation, changes in our personnel and other such factors. Our actual results, performance or achievements may differ significantly from the results, performance or achievement expressed or implied in the forward-looking statements. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

Overview

The following MD&A is intended to help the reader understand the results of operations, financial condition, and cash flows of the Company. MD&A is provided as a supplement to, and should be read in conjunction with the information presented elsewhere in this quarterly report on Form 10-Q and with the information presented in our annual report on Form 10-K for the year ended September 30, 2014, which includes our audited consolidated financial statements and the accompanying notes to the consolidated financial statements.

The Company is reporting its financial performance based on its external reporting segments: Cable Television and Telecommunications. These reportable segments are described below.

Cable Television ("Cable TV")

The Company's Cable TV segment sells new, surplus and re-manufactured cable television equipment throughout North America, Central America and South America. In addition, this segment also repairs cable television equipment for various cable companies.

Telecommunications ("Telco")

The Company's Telco segment sells certified used telecommunications networking equipment from a broad range of manufacturers primarily in North America. In addition, this segment offers its customers decommissioning services for surplus and obsolete equipment, which it then processes through its recycling services.

Results of Operations

Comparison of Results of Operations for the Three Months Ended December 31, 2014 and December 31, 2013

Consolidated

Consolidated sales increased $4.7 million, or 77%, to $10.8 million for the three months ended December 31, 2014 from $6.1 million for the three months ended December 31, 2013. The increase in sales was primarily in the Telco segment resulting from the Nave Communications Company ("Nave Communications") acquisition on February 28, 2014, while sales from the Cable TV segment increased $0.7 million compared to the same period last year. Consolidated gross profit increased $1.9 million, or 106%, to $3.8 million for the three months ended December 31, 2014 from $1.9 million for the same period last year. The increase in gross profit was due primarily to gross profit from the Telco segment as a result of the Nave Communications acquisition, while gross profit from the Cable TV segment increased $0.1 million, or 9%, compared to the same period last year.

Consolidated operating, selling, general and administrative expenses include all personnel costs, which include fringe benefits, insurance and business taxes, as well as occupancy, communication and professional services, among other less significant cost categories. Operating, selling, general and administrative expenses increased $1.5 million, or 89%, to $3.1 million for the three months ended December 31, 2014 from $1.6 million for the same period last year. This increase in expenses was primarily due to the Telco segment of $1.7 million as a result of the Nave Communications acquisition, partially offset by a decrease in the Cable TV segment of $0.2 million.

Interest expense increased $0.1 million to $0.1 million for the three months ended December 31, 2014 from $6 thousand for the same period last year. The increase was due primarily to interest expense incurred on the second outstanding term loan entered into in connection with the Nave Communications acquisition.

The provision for income taxes was $0.3 million for the three months ended December 31, 2014, or an effective rate of 38%, from a provision for income taxes of $0.1 million for the three months ended December 31, 2013, or an effective rate of 39%.

Segment Results

Cable TV

Sales for the Cable TV segment increased $0.7 million to $6.8 million for the three months ended December 31, 2014 from $6.1 million for the same period last year. The increase in sales was due primarily to an increase in new equipment sales of $0.9 million, partially offset by a decrease in repairs revenue of $0.2 million. Gross margin was 30% for the three months ended December 31, 2014 and 2013.

Operating, selling, general and administrative expenses decreased $0.2 million to $1.4 million for the three months ended December 31, 2014 from $1.6 million for the same period last year. The decrease was due primarily to decreased personnel costs.

Telco

Sales for the Telco segment were $4.0 million for the three months ended December 31, 2014 and zero for the same period last year as a result of the acquisition of Nave Communications. Sales for the Telco segment consisted of $3.7 million of used equipment sales and $0.3 million of recycling revenue. Gross margin was 45% for the three months ended December 31, 2014.

Operating, selling, general and administrative expenses were $1.7 million for the three months ended December 31, 2014. These expenses included an additional accrual of $0.2 million related to the first earn-out payment related to the Nave Communications acquisition. We will make future earn-out payments over the next three years equal to 70% of Nave Communications' annual EBITDA in excess of $2.0 million per year ("Nave Earn-out"), which we estimate will be between $0.7 million and $1.0 million annually.

Discontinued Operations

Discontinued operations, net of tax, was zero for the three months ended December 31, 2014 compared to $26 thousand for the same period last year. This activity included the operations of Adams Global Communications prior to the sale on January 31, 2014.

Non-GAAP Financial Measure

EBITDA is a supplemental, non-GAAP financial measure. EBITDA is defined as earnings before interest expense, income taxes, depreciation and amortization. EBITDA is presented below because this metric is used by the financial community as a method of measuring our financial performance and of evaluating the market value of companies considered to be in similar businesses. Since EBITDA is not a measure of performance calculated in accordance with GAAP, it should not be considered in isolation of, or as a substitute for, net earnings as an indicator of operating performance. EBITDA, as calculated below, may not be comparable to similarly titled measures employed by other companies. In addition, EBITDA is not necessarily a measure of our ability to fund our cash needs.

A reconciliation by segment of operating income to EBITDA follows:

	Three Months Ended December 31, 2014			Three Months Ended December 31, 2013		
	Cable TV	Telco	Total	Cable TV	Telco	Total
Operating income	$618,811	$137,533	$756,344	$233,352	$–	$233,352
Depreciation	71,564	27,244	98,808	68,976	–	68,976
Amortization	–	206,452	206,452	–	–	–
EBITDA	$690,375	$371,229	$1,061,604	$302,328	$–	$302,328

Critical Accounting Policies

Note 1 to the Consolidated Financial Statements in Form 10-K for fiscal 2014 includes a summary of the significant accounting policies or methods used in the preparation of our Consolidated Condensed Financial Statements. Some of those significant accounting policies or methods require us to make estimates and assumptions that affect the amounts reported by us. We believe the following items require the most significant judgments and often involve complex estimates.

General

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We base our estimates and judgments on historical experience, current market conditions, and various other factors we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant estimates and assumptions relate to the carrying value of our inventory and, to a lesser extent, the adequacy of our allowance for doubtful accounts.

Inventory Valuation

Our position in the industry requires us to carry large inventory quantities relative to annual sales, but it also allows us to realize high overall gross profit margins on our sales. We market our products primarily to multiple system operators ("MSOs"), telecommunication providers and other users of cable television and telecommunication equipment who are seeking products for which manufacturers have discontinued production or cannot ship new equipment on a same-day basis as well as providing used products as an alternative to new products from the manufacturer. Carrying these large inventory quantities represents our largest risk.

We are required to make judgments as to future demand requirements from our customers. We regularly review the value of our inventory in detail with consideration given to rapidly changing technology which can significantly affect future customer demand. For individual inventory items, we may carry inventory quantities that are excessive relative to market potential, or we may not be able to recover our acquisition costs for sales that we do make. In order to address the risks associated with our investment in inventory, we review inventory quantities on hand and reduce the carrying value when the loss of usefulness of an item or other factors, such as obsolete and excess inventories, indicate that cost will not be recovered when an item is sold.

Our inventories consist of new and used electronic components for the cable television and telecommunications industries. Inventory is stated at the lower of cost or market, with cost determined using the weighted-average method. At December 31, 2014, we had total inventory, before the reserve for excess and obsolete inventory, of $25.4 million, consisting of $16.7 million in new products and $8.7 million in used or refurbished products.

For the Cable TV segment, our reserve at December 31, 2014 for excess and obsolete inventory was $2.3 million, which reflects an increase of approximately $0.2 million to reflect deterioration in the market demand of that inventory. If actual market conditions are less favorable than those projected by management, and our estimates prove to be inaccurate, we could be required to increase our inventory reserve and our gross margins could be materially adversely affected.

For the Telco segment, we do not maintain an inventory reserve as we recycle any surplus and obsolete equipment on hand through our recycling program when it is identified.

Inbound freight charges are included in cost of sales. Purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs and other inventory expenditures are included in operating expenses, since the amounts involved are not considered material.

Accounts Receivable Valuation

Management judgments and estimates are made in connection with establishing the allowance for doubtful accounts. Specifically, we analyze the aging of accounts receivable balances, historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms. Significant changes in customer concentration or payment terms, deterioration of customer credit-worthiness, or weakening in economic trends could have a significant impact on the collectability of receivables and our operating results. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional provision to the allowance for doubtful accounts may be required. The reserve for bad debts was $0.2 million at December 31, 2014 and September 30, 2014. At December 31, 2014, accounts receivable, net of allowance for doubtful accounts, was $5.1 million.

Goodwill

Goodwill represents the excess of purchase price of acquisitions over the acquisition date fair value of the net assets of businesses acquired. Goodwill is not amortized and is tested at least annually for impairment. We perform our annual analysis during the fourth quarter of each fiscal year and in any other period in which indicators of impairment warrant additional analysis. Goodwill is evaluated for impairment by first comparing our estimate of the fair value of each reporting unit, or operating segment, with the reporting unit's carrying value, including goodwill. Our reporting units for purposes of the goodwill impairment calculation are the Cable TV operating segment and the Telco operating segment.

Management utilizes a discounted cash flow analysis to determine the estimated fair value of each reporting unit. Significant judgments and assumptions including the discount rate and anticipated revenue growth rate, gross margins and operating expenses are inherent in these fair value estimates, which are based on historical operating results. As a result, actual results may differ from the estimates utilized in our discounted cash flow analysis. The use of alternate judgments and/or assumptions could result in the recognition of different levels of impairment charges in the financial statements. If the carrying value of one of the reporting units exceeds its fair value, a computation of the implied fair value of goodwill would then be compared to its related carrying value. If the carrying value of the reporting unit's goodwill exceeds the implied fair value of goodwill, an impairment loss would be recognized in the amount of the excess. If an impairment charge is incurred, it would negatively impact our results of operations and financial position.

Although we do not anticipate a future impairment charge, certain events could occur that might adversely affect the reported value of goodwill. Such events could include, but are not limited to, economic or competitive conditions, a significant change in technology, the economic condition of the customers and industries we serve, a significant decline in the real estate markets we operate in, and a material negative change in the relationships with one or more of our significant customers or equipment suppliers. If our judgments and assumptions change as a result of the occurrence of any of these events or other events that we do not currently anticipate, our expectations as to future results and our estimate of the implied value of each reporting unit also may change.

Intangible Assets

Intangible assets that have finite useful lives are amortized on a straight-line basis over their estimated useful lives ranging from 3 years to 10 years.

Liquidity and Capital Resources

Cash Flows Provided by Operating Activities

We finance our operations primarily through operations, and we also have available to us a bank line of credit of $7.0 million. During the three months ended December 31, 2014, we generated $1.5 million of cash flow for operations. The cash flow from operations was favorably impacted by $1.3 million from a net decrease in accounts receivable. The cash flow from operations was unfavorably impacted by $0.5 million from a net increase in inventory due primarily to purchases of used telecommunications equipment.

In fiscal second quarter 2015, we will make the first of three annual installment payments to the Nave Communications owners for deferred consideration resulting from the Nave Communications acquisition. The deferred consideration, which consists of $3.0 million to be paid in equal annual installments over the three years, is recorded at its present value of $2.8 million at December 31, 2014. In addition, in the fiscal second or third quarter of 2015, we will make earn-out payments equal to 70% of Nave Communications EBITDA earnings in excess of $2.0 million over the next three years, which we estimate will be between $0.7 million and $1.0 million annually.

Cash Flows Used for Investing Activities

During the three months ended December 31, 2014, cash used in investing activities was $0.1 million related to capital expenditures.

Cash Flows Used for Financing Activities

During the three months ended December 31, 2014, we made principal payments of $0.2 million on our two term loans under our Credit and Term Loan Agreement with our primary lender. The first term loan requires monthly payments of $15,334 plus accrued interest through November 2021. Our second term loan is a five year term loan with a seven year amortization payment schedule with monthly principal and interest payments of $68,505 through March 2019.

At December 31, 2014, there was not a balance outstanding under our line of credit. The lesser of $7.0 million or the total of 80% of the qualified accounts receivable plus 50% of qualified inventory is available to us under the revolving credit facility ($7.0 million at December 31, 2014). Any future borrowings under the revolving credit facility are due at maturity.

We believe that our cash and cash equivalents of $6.5 million at December 31, 2014, cash flow from operations and our existing line of credit provide sufficient liquidity and capital resources to meet our working capital and debt payment needs.

Item 4. Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure the information we are required to disclose in the reports we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based on their evaluation as of December 31, 2014, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to accomplish their objectives and to ensure the information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

We have completed the acquisition of Nave Communications effective February 28, 2014. We are in the process of assessing and, to the extent necessary, making changes to the internal control over financial reporting of Nave Communications to conform such internal control to that used in our other operations. However, we are not yet required to evaluate, and have not yet fully evaluated, changes in Nave Communications' internal control over financial reporting. Subject to the foregoing, during the period covered by this report on Form 10-Q, there have been no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

Item 6. Exhibits.

Exhibit No.	Description
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes Oxley Act of 2002.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

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.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
(Registrant)

Date: February 10, 2015 /s/ David L. Humphrey
David L. Humphrey,
President and Chief Executive Officer
(Principal Executive Officer)

Date: February 10, 2015 /s/ Scott A. Francis
Scott A. Francis,
Chief Financial Officer
(Principal Financial Officer)

Exhibit Index

The following documents are included as exhibits to this Form 10-Q:

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