

BUTLER NATIONAL CORP  
Form 10-Q  
December 13, 2012

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

FORM 10-Q

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

For the quarterly period ended October 31, 2012

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 0-1678

BUTLER NATIONAL CORPORATION  
(Exact name of registrant as specified in its charter)

Kansas  
(State or other jurisdiction of incorporation or organization)

41-0834293  
(I.R.S. Employer Identification No.)

19920 West 161st Street, Olathe, Kansas 66062  
(Address of principal executive offices)(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

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 (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days: Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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  No

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting

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company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer  Accelerated filer  Non-accelerated filer  T Smaller reporting company

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

The number of shares outstanding of the Registrant's Common Stock, \$0.01 par value, as of December 3, 2012 was 58,142,914 shares.

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
As of October 31, 2012 and April 30, 2012  
(in thousands except per share data)  
(unaudited)

|   | October 31,<br>2012 | April 30,<br>2012 |
|---|---------------------|-------------------|
| <b>ASSETS</b>   |                     |                   |
| <b>CURRENT ASSETS:</b>  |                     |                   |
| Cash  | \$ 7,031            | \$ 7,431          |
| Accounts receivable   | 2,847               | 3,589             |
| Inventories   |                     |                   |
| Raw materials   | 6,211               | 6,305             |
| Work in process   | 1,085               | 982               |
| Finished goods  | 292                 | 424               |
| Total inventory   | 7,588               | 7,711             |
| Prepaid expenses and other current assets   | 2,050               | 1,493             |
| Total current assets  | 19,516              | 20,224            |
| <b>PROPERTY, PLANT AND EQUIPMENT:</b>   |                     |                   |
| Land and building   | 3,946               | 3,946             |
| Aircraft  | 6,673               | 6,288             |
| Machinery and equipment   | 3,714               | 3,714             |
| Office furniture and fixtures   | 3,068               | 3,217             |
| Construction in progress  | 6,711               | -                 |
|   | 24,112              | 17,165            |
| Accumulated depreciation  | (7,880)             | (6,688)           |
| Total property, plant and equipment   | 16,232              | 10,477            |
| <b>SUPPLEMENTAL TYPE CERTIFICATES (net of amortization of \$2,562 at</b>                                |                     |                   |
| October 31, 2012 and \$2,500 at April 30, 2012)   | 1,621               | 1,677             |
| <b>OTHER ASSETS:</b>  |                     |                   |
| Deferred tax asset  | 1,167               | 1,167             |
| Other assets (net of accumulated amortization of \$803 at October 31, 2012 and \$538 at April 30, 2012) | 6,752               | 7,017             |
| Total other assets  | 7,919               | 8,184             |
| Total Assets  | \$ 45,288           | \$ 40,562         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                     |                   |
| <b>CURRENT LIABILITIES:</b>   |                     |                   |
| Line of credit  | \$ 902              | \$ 462            |
| Current maturities of long-term debt and capital lease obligations                                      | 4,958               | 3,757             |
| Accounts payable  | 1,760               | 1,169             |
| Customer deposits   | 444                 | 1,015             |
| Gaming facility mandated payment  | 1,463               | 1,281             |
| Compensation and compensated absences   | 963                 | 1,342             |
| Accrued income tax  | -                   | 47                |

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|   |           |           |
|---|-----------|-----------|
| Other   | 291       | 207       |
| Total current liabilities   | 10,781    | 9,280     |
| <b>LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, NET OF CURRENT MATURITIES:</b>   |           |           |
|   | 10,624    | 8,678     |
| Total liabilities   | 21,405    | 17,958    |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |           |           |
| <b>STOCKHOLDERS' EQUITY:</b>  |           |           |
| Preferred stock, par value \$5:   |           |           |
| Authorized 50,000,000 shares, all classes   |           |           |
| Designated Classes A and B 200,000 shares   |           |           |
| \$1,000 Class A, 9.8%, cumulative if earned liquidation and redemption value \$100, no shares issued and outstanding  | -         | -         |
| \$1,000 Class B, 6%, convertible cumulative, liquidation and redemption value \$1,000, no shares issued and outstanding   | -         | -         |
| Common stock, par value \$.01: Authorized 100,000,000 shares issued and outstanding 58,142,914 shares at October 31, 2012 and 57,907,564 shares at April 30, 2012 | 581       | 579       |
| Common stock, owed but not issued 278,573 shares at October 31, 2012 and at April 30, 2012  | 3         | 3         |
| Capital contributed in excess of par  | 12,736    | 12,568    |
| Treasury stock at cost, 600,000 shares  | (732)     | (732)     |
| Retained Earnings   | 8,553     | 8,170     |
| Total stockholders' equity Butler National Corporation  | 21,141    | 20,588    |
| Noncontrolling Interest in BHCMC, LLC   | 2,742     | 2,016     |
| Total stockholders' equity  | 23,883    | 22,604    |
| Total Liabilities and Stockholders' Equity  | \$ 45,288 | \$ 40,562 |

The accompanying notes are an integral part of these financial statements

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED OCTOBER 31, 2012 AND 2011  
(in thousands, except per share data)  
(unaudited)

|  | THREE MONTHS<br>ENDED<br>October 31, |                   |
|--|--------------------------------------|-------------------|
|  | 2012                                 | 2011              |
| <b>REVENUES:</b>   |                                      |                   |
| Professional services  | \$ 9,170                             | \$ 9,139          |
| Aerospace products   | 4,367                                | 5,002             |
| Total revenues   | 13,537                               | 14,141            |
| <b>COSTS AND EXPENSES:</b>                                       |                                      |                   |
| Cost of professional services                                    | 5,370                                | 5,015             |
| Cost of aerospace products                                       | 3,177                                | 2,577             |
| Marketing and advertising  | 997                                  | 2,192             |
| Employee benefits  | 522                                  | 751               |
| Depreciation and amortization                                    | 745                                  | 473               |
| General, administrative and other                                | 2,027                                | 1,754             |
| Total costs and expenses   | 12,838                               | 12,762            |
| <b>OPERATING INCOME</b>  | <b>699</b>                           | <b>1,379</b>      |
| <b>OTHER INCOME (EXPENSE):</b>                                   |                                      |                   |
| Interest expense   | (332)                                | (93)              |
| Other income (expense), net                                      | 1                                    | -                 |
| Total other income (expense)                                     | (331)                                | (93)              |
| <b>INCOME BEFORE INCOME TAXES</b>                                | <b>368</b>                           | <b>1,286</b>      |
| <b>PROVISION FOR INCOME TAXES</b>                                | <b>68</b>                            | <b>306</b>        |
| <b>NET INCOME</b>  | <b>300</b>                           | <b>980</b>        |
| Net income attributable to noncontrolling interest in BHCMC, LLC | (186)                                | (522)             |
| <b>NET INCOME ATTRIBUTABLE TO BUTLER NATIONAL CORPORATION</b>    | <b>\$ 114</b>                        | <b>\$ 458</b>     |
| <b>BASIC EARNINGS PER COMMON SHARE</b>                           | <b>\$ .00</b>                        | <b>\$ .01</b>     |
| <b>WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION</b>     | <b>57,546,314</b>                    | <b>56,594,262</b> |
| <b>DILUTED EARNINGS PER COMMON SHARE</b>                         | <b>\$ .00</b>                        | <b>\$ .01</b>     |
| <b>WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION</b>     | <b>57,546,314</b>                    | <b>56,594,262</b> |

The accompanying notes are an integral part of these financial statements



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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE SIX MONTHS ENDED OCTOBER 31, 2012 AND 2011  
(in thousands, except per share data)  
(unaudited)

|  | SIX MONTHS ENDED<br>October 31, |                   |
|--|---------------------------------|-------------------|
|  | 2012                            | 2011              |
| <b>REVENUES:</b>   |                                 |                   |
| Professional services  | \$ 18,977                       | \$ 17,737         |
| Aerospace products   | 8,028                           | 8,550             |
| Total revenues   | 27,005                          | 26,287            |
| <b>COSTS AND EXPENSES:</b>                                       |                                 |                   |
| Cost of professional services                                    | 10,507                          | 9,992             |
| Cost of aerospace products                                       | 6,101                           | 5,513             |
| Marketing and advertising  | 2,117                           | 3,137             |
| Employee benefits  | 1,004                           | 1,509             |
| Depreciation and amortization                                    | 1,456                           | 936               |
| General, administrative and other                                | 3,836                           | 3,147             |
| Total costs and expenses   | 25,021                          | 24,234            |
| <b>OPERATING INCOME</b>  | <b>1,984</b>                    | <b>2,053</b>      |
| <b>OTHER INCOME (EXPENSE):</b>                                   |                                 |                   |
| Interest expense   | (678)                           | (181)             |
| Other income (expense), net                                      | 10                              | 2                 |
| Total other income (expense),                                    | (668)                           | (179)             |
| <b>INCOME BEFORE INCOME TAXES</b>                                | <b>1,316</b>                    | <b>1,874</b>      |
| <b>PROVISION FOR INCOME TAXES</b>                                | <b>208</b>                      | <b>388</b>        |
| <b>NET INCOME</b>  | <b>1,108</b>                    | <b>1,486</b>      |
| Net income attributable to noncontrolling interest in BHCMC, LLC | (726)                           | (920)             |
| <b>NET INCOME ATTRIBUTABLE TO BUTLER NATIONAL CORPORATION</b>    | <b>\$ 382</b>                   | <b>\$ 566</b>     |
| <b>BASIC EARNINGS PER COMMON SHARE</b>                           | <b>\$ .01</b>                   | <b>\$ .01</b>     |
| <b>WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION</b>     | <b>57,546,314</b>               | <b>56,594,262</b> |
| <b>DILUTED EARNINGS PER COMMON SHARE</b>                         | <b>\$ .01</b>                   | <b>\$ .01</b>     |
| <b>WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION</b>     | <b>57,546,314</b>               | <b>56,594,262</b> |

The accompanying notes are an integral part of these financial statements





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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDING OCTOBER 31, 2012 AND 2011  
(dollars in thousands)  
(unaudited)

|  | SIX MONTHS ENDED |                |
|--|------------------|----------------|
|  | October 31,      |                |
|  | 2012             | 2011           |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                  |                  |                |
| Net income   | \$ 1,108         | \$ 1,486       |
| Adjustments to reconcile cash flows from operating activities                |                  |                |
| Depreciation and amortization  | 1,520            | 980            |
| Stock issued for services  | 91               | -              |
| Stock options issued to employees and directors                              | 74               | 251            |
| Changes in assets and liabilities  |                  |                |
| Accounts receivable  | 742              | (51)           |
| Inventories  | 123              | (319)          |
| Prepaid expenses and other current assets                                    | (557)            | (376)          |
| Accounts payable   | 591              | 259            |
| Customer deposits  | (571)            | (421)          |
| Accrued liabilities  | (426)            | (888)          |
| Gaming facility mandated payment   | 182              | (666)          |
| Other liabilities  | 88               | 42             |
| Cash flows from operating activities   | 2,965            | 297            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                  |                  |                |
| Capital expenditures   | (6,952)          | (1,211)        |
| Cash flows from investing activities   | (6,952)          | (1,211)        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                  |                  |                |
| Borrowings line of credit, net   | 440              | 115            |
| Contributed capital  | -                | 5              |
| Borrowings of promissory notes, long-term debt and capital lease obligations | 4,598            | 728            |
| Repayments of promissory notes, long-term debt and capital lease obligations | (1,451)          | (974)          |
| Cash flows from financing activities   | 3,587            | (126)          |
| <b>NET INCREASE (DECREASE) IN CASH</b>                                       | <b>(400)</b>     | <b>(1,040)</b> |
| CASH, beginning of period  | 7,431            | 8,475          |
| CASH, end of period  | \$ 7,031         | \$ 7,435       |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>                     |                  |                |
| Interest paid  | \$ 677           | \$ 181         |
| Income taxes paid  | \$ 783           | \$ 634         |
| <b>NON CASH OPERATING ACTIVITY</b>   |                  |                |

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|  |    |    |    |     |
|--|----|----|----|-----|
| Non cash stock issued for services                       | \$ | 91 | \$ | -   |
| Non cash stock options issued to employees and directors | \$ | 74 | \$ | 251 |

The accompanying notes are an integral part of these financial statements

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BUTLER NATIONAL CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands)  
(unaudited)

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 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 for the fiscal year ended April 30, 2012. In our opinion, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three and six months ended October 31, 2012 are not indicative of the results of operations that may be expected for the fiscal year ended April 30, 2013.

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

2. Net Income (Loss) Per Share: The Company follows ASC 260 that requires the reporting of both basic and diluted earnings (loss) per share. Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. In accordance with ASC 260, any anti-dilutive effects on net earnings (loss) per share are excluded. Potential common shares as of October 31, 2012 are 65,683,551.

3. Research and Development: We invested in research and development activities. The amount invested in the six months ended October 31, 2012 and 2011 was approximately \$797 and \$779 respectively.

4. Borrowings: At October 31, 2012, the Company had one line of credit totaling \$1 million. The unused line at October 31, 2012 was \$98. During the current year these funds were primarily used for the purchase of inventory for the modifications and avionics operations.

At October 31, 2012, there were several notes collateralized by aircraft security agreements totaling \$2,303. These notes were used for the purchase and modifications of these collateralized aircraft.

There are three notes at a bank totaling \$1,812 for real estate located in Olathe, Kansas and Tempe, Arizona. The due date for these notes is in March 2013, and August 2016.

One note totaling \$339 remains for real estate purchased in June 2009 in Dodge City, Kansas.

One note with a balance of \$330 is collateralized by the first and second position on all assets of the company. There are several other notes collateralized by automobiles and equipment totaling an additional \$169.

One note was entered into with Konami Gaming, Inc. effective August 1, 2012, in the amount of \$1,733. The purchase of the gaming system was installed at Boot Hill Casino in mid-August and has a current remaining balance of \$1,593.

5. Leases: BHCMC, LLC ("BHCMC") as tenant entered into a lease dated May 1, 2011, and amended via an addendum dated January 1, 2012 (collectively, the "Lease"), with BHC Investment Company, L.C. ("BHCI") as landlord for a total obligation of \$7,423. BHCI provided funds to BHCMC for the purchase of certain intangible items and gaming related items related to the Boot Hill Casino and Resort. Commencing on January 1, 2012, BHCMC is obligated to make a

minimum payment to BHCI of \$177 per month until September 30, 2017. The remaining balance on the obligation is \$6,536.

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On August 24, 2012, BHCMC and BHCI entered into a second lease (“Second Lease”) of \$2,500 for tenant improvements related to expansion of the Boot Hill Casino and Resort. Commencing on November 1, 2012, BHCMC is obligated to make a minimum payment to BHCI of approximately \$55 per month until November 30, 2017.

6. Other Assets: Other assets include an intangible asset of \$5,500 related to the Kansas Expanded Lottery Act Management Contract privilege fee and JET autopilot intellectual property of \$2,055. BHCMC, LLC expects the intangible assets for the Kansas Expanded Lottery Act contract privilege fee of \$5,500 to have value over the remaining life of the Management Contract with the State of Kansas which will end in December 2024. There is no assurance of Management Contract renewal. The privilege fee will be fully amortized by the projected end of the Management Contract. Based on the projected sales of the Legacy line of “JET” products it was determined that it would be fully amortized within 15 years.

7. Stockholders’ Equity: On May 8, 2012, the Company issued 238,750 shares of Company common stock to Reign Strategy & Investment Group, LLC (“Reign”). The expense will be amortized over the term of the agreement for a total amount of \$91 thousand based on market value at date of issue. These shares were issued in consideration for Reign’s marketing and consulting services related to increasing public awareness and shareholder interest in the Company.

The issuance of stock by the Company to Reign is exempt from registration pursuant to Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended. Reign has represented to the Company and the Company believes that Reign is an “accredited investor” as defined in Rule 501(a) of Regulation D.

8. Stock Options: Approximately 7.2 million stock options were issued on December 31, 2010. Previously issued stock options were time-vesting and did not include share price performance targets. All of the newly issued stock options expire December 31, 2015.

The exercise price for the incentive stock options is \$0.49 (closing price as of December 31, 2010). The Board of Directors approved the issuance of incentive stock options on December 31, 2010 with the goals of increasing shareholder value, expanding the number of managers participating in the program, and increasing the percentage of compensation tied to share price performance.

The incentive stock options are allocated in three groups with two conditions for vesting. The first condition is stock price and the second condition is time:

Year 1: Target \$0.92

2,420,688 options that can be exercised on or after December 31, 2011 if and when the share price reaches \$0.92

Year 2: Target \$1.41

2,420,688 options that can be exercised on or after December 31, 2012 if and when the share price reaches \$1.41

Year 3: Target \$1.90

2,420,688 options that can be exercised on or after December 31, 2013 if and when the share price reaches \$1.90

At October 31, 2012 we had 7,262,064 outstanding stock options with an average exercise price of \$1.42.

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

THROUGHOUT THIS ITEM 2 ALL NON TABULAR FINANCIAL RESULTS ARE PRESENTED IN THOUSANDS OF U.S. DOLLARS EXCEPT WHERE MILLIONS OF DOLLARS IS INDICATED.

REFERENCE TO EXHIBIT 99 OF THE COMPANY'S ANNUAL REPORT ON FORM 10-K

Statements made in this report, filed with the Securities and Exchange Commission, communications to stockholders, press releases, and oral statements made by representatives of the Company that are not historical in nature, or that state the Company or management intentions, hopes, beliefs, expectations or predictions of the future, may constitute "forward-looking statements" within the meaning of Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements can often be identified by the use of forward-looking terminology, such as "could," "should," "will," "intended," "continue," "believe," "may," "expect," "hope," "anticipate," "goal," "forecast," "plan," "guidance" or "estimate" or the negative of these words, variations thereof or similar expressions. Forward-looking statements are not guarantees of future performance or results. They involve risks, uncertainties, and assumptions. It is important to note that any such performance and actual results, financial condition or business, could differ materially from those expressed in such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the Cautionary Statements and Risk Factors, filed as Exhibit 99 and Item 1A. Risk Factors to the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2012 are incorporated herein by reference. Other unforeseen factors not identified herein could also have such an effect. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results, financial condition or business over time.

Management Overview

Management is focused on increasing long-term shareholder value from increased cash generation, earnings growth, and prudently managing capital expenditures. We plan to do this by continuing to drive increased revenue from product and service innovations, strategic acquisitions, and targeted marketing programs.

Our revenue is primarily derived from two very different business segments; aerospace products and professional services. These segments operate through various Butler National Corporation subsidiaries and affiliates listed in the Company's fiscal year 2012 annual report on form 10K.

Aerospace products derives its revenue by designing, engineering, manufacturing, installing, servicing, and repairing products for classic and current production aircraft. These products include JET autopilot service and repairs, AVCON provisions for special mission equipment installations, KINGS avionics equipment sales, service, and installation, and BUTLER National electronic controls and safety equipment manufacture and sales. Aerospace customers range in size from owners and operators of small single engine airplanes to owners and operators of large commercial and military aircraft. Aerospace products are sold to and serviced for customers located in many countries of the world.

Aerospace is the legacy part of the Butler National business. Organized over 50 years ago, this business is based upon design engineering and installation innovations to enhance and support products related to airplanes and ground support equipment. These new products included: in the 1960's, aircraft electronic load sharing and system switching equipment, a number of airplane electronic navigation instruments, radios and transponders; in the 1970's, ground based VOR navigation equipment sold worldwide and GPS equipment as we know it today in civilian use; in the 1980's, special mission modifications to business jets for aerial surveillance and conversion of passenger configurations to cargo; in the 1990's, classic aviation support of aging airplanes with enhanced protection of electrical

systems through transient suppression devices (TSD), control electronics for military weapon systems and improved aerodynamic control products (Avcon Fins) allowing stability at higher gross weights for additional special mission applications; in the 2000's, improved accuracy of the airspeed and altimeter systems to allow less vertical separation between flying airplanes (RVSM) and acquisition of the JET autopilot product line to support and replace aged electronic equipment in the classic fleet of Learjet airplanes; and in the 2010's, the acquisition of Kings Avionics to provide additional classic airplane support by retrofit of avionics from the past 40 years to modern state of the art equipment for sale worldwide using FAA supplemental type certification to make the installations (STC) acceptable to foreign governments for installation abroad.



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Aerospace continues to be a focus for new product design and development. We expect this segment will continue to grow in the future. To address the three to five year business cycles related to the aerospace industry, in the 1990's, we began providing professional services to markets outside the aerospace industry.

Professional services derives its revenue from (a) professional management services in the gaming industry through Butler National Service Corporation ("BNSC") and BHCMC, LLC ("BHCMC"), (b) licensed architectural services to the business community through BCS Design, and (c) monitoring services to owners and operators of intelligence gathering systems through Butler National Services, Inc. ("BNSI").

Professional services grew from the experiences gained from the BNSI monitoring products and services of the 1980's including SCADA systems and products including digital voice technology for the telephone industry and nuclear plant and civil defense warning systems. BNSI sold these professional services and products to utilities and municipalities resulting in relatively stable revenue streams. The defense warning products were sold in the 1980's to a third party leaving only the current BNSI service business in Florida.

In the early 1990's, management determined that more revenue stable business units were needed to sustain the Company. Members of the Board of Directors had contacts with several American Indian tribes, others members were associated with gaming operators in Las Vegas and the 1988 Indian Gaming Regulatory Act (IGRA) which was relatively new to the industry. We reached out to various Indian tribes with land in the area to explore the opportunities for operations under IGRA. This resulted in the "Stables" an Indian owned casino on Modoc Indian land opened in September 1988 developed and managed by BNSC. The Stables Management Agreement has been available on the website maintained by the National Indian Gaming Commission ("NIGC"). The Stables Management Agreement was subsequently amended by various amendments dated April 30, 2003 (the "First Amendment"), November 30, 2006 (the "Second Amendment"), October 19, 2009 (the "Third Amendment") and September 22, 2011 (the "Fourth Amendment"). The result of the First Amendment, Second Amendment, Third Amendment and Fourth Amendment is to provide that twenty (20%) of Net Profits from The Stables are distributed to BNSC, to end per the management agreement the participation of the Miami Indian tribe from the business and to extend the duration of the Stables Management Agreement through September 30, 2018. BCS Design has also assisted with the design, construction and continued refurbishment of this venture.

From this experience with IGRA and the success of the Indian gaming industry, we determined that the IGRA model may be applicable for state owned gaming. We spent Butler National Corporation innovation, legal and market development funds to design and encourage the use of an Indian owned gaming model in the State of Kansas. From these efforts, Kansas enacted the Kansas Expanded Lottery Act (KELA) in 2007 allowing four state owned casinos to be developed in Kansas. In 2007, BNSC made application to manage a state owned casino. In 2008, BNSC was awarded a fifteen year term to manage the Boot Hill Casino and Resort in Dodge City, Kansas pursuant to a Lottery Gaming Facility Management Contract (the "Boot Hill Casino Management Contract"). The Boot Hill Casino Management Contract was amended on December 29, 2009 (the "First Amendment to the Boot Hill Casino Management Contract") to bring the definition of "Fiscal Year" in line with the fiscal year of BNSC (May 1 to April 30). BHCMC was organized to be the manager of the casino in Dodge City. The casino opened in December 2009.

By 2009, Butler National Corporation was clearly established into two segments; the professional services and aerospace products business segments.

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## Results Overview

The six months ending October 31, 2012 revenue increased 3% to \$27.0 million compared to \$26.3 million in the six months ending October 31, 2011. The six month increase in revenue reflects additional professional services revenue (up 7%) driven by increased revenue from gaming activities and a decrease in aerospace products revenue (down 6%). We anticipate future domestic military spending reductions and continued slow growth of the United States economy.

The six months ending October 31, 2012 net income decreased 32.5% to \$382 compared to \$566 in the six months ending October 31, 2011. Diluted earnings per share remained the same at \$0.01 for the six months ending October 31, 2012 and October 31, 2011. We continue focusing on our margin expansion initiatives, including efficiencies in our implementation and operational processes and controlling general and administrative expenses. The six months ending October 31, 2012, operating margin was 7%, a decrease of one percentage point from our margin of 8% in the six months ending October 31, 2011.

## RESULTS OF OPERATIONS

## SIX MONTHS ENDING OCTOBER 31, 2012 COMPARED TO SIX MONTHS ENDING OCTOBER 31, 2011

| (dollars in thousands)            | Six<br>Months<br>Ended<br>Oct. 31,<br>2012 | Percent<br>of total<br>revenue | Six<br>Months<br>Ended<br>Oct. 31,<br>2011 | Percent<br>of total<br>revenue | Percent<br>Change<br>2011-2012 |
|-----------------------------------|--|--------------------------------|--|--------------------------------|--------------------------------|
| Revenues:                         |  |                                |  |                                |                                |
| Professional services             | \$ 18,977                                  | 70%                            | \$ 17,737                                  | 67%                            | 7%                             |
| Aerospace products                | 8,028                                      | 30%                            | 8,550                                      | 33%                            | (6)%                           |
| <b>Total revenues</b>             | <b>27,055</b>                              | <b>100%</b>                    | <b>26,287</b>                              | <b>100%</b>                    | <b>3%</b>                      |
| Costs and expenses:               |  |                                |  |                                |                                |
| Cost of professional services     | 10,507                                     | 39%                            | 9,992                                      | 38%                            | 5%                             |
| Cost of aerospace products        | 6,101                                      | 23%                            | 5,513                                      | 21%                            | 11%                            |
| Marketing and advertising         | 2,117                                      | 8%                             | 3,137                                      | 12%                            | (33)%                          |
| Employee benefits                 | 1,004                                      | 4%                             | 1,509                                      | 6%                             | (33)%                          |
| Depreciation and amortization     | 1,456                                      | 5%                             | 936  | 4%                             | 56%                            |
| General, administrative and other | 3,836                                      | 14%                            | 3,147                                      | 12%                            | 22%                            |
| <b>Total costs and expenses</b>   | <b>25,021</b>                              | <b>93%</b>                     | <b>24,234</b>                              | <b>92%</b>                     | <b>3%</b>                      |
| <b>Operating income</b>           | <b>\$ 1,984</b>                            | <b>7%</b>                      | <b>\$ 2,053</b>                            | <b>8%</b>                      | <b>(3)%</b>                    |

## Revenues:

Revenue increased 3% to \$27.0 million in the six months ended October 31, 2012, as compared to \$26.3 million in the six months ended October 31, 2011.

- Professional services derives its revenue from professional management services in the gaming industry through BNSC and BHCMC, licensed architectural services to the business community through BCS Design and monitoring services to owners and operators of SCADA through BNSI. Revenue from professional services increased 7% to \$19.0 million in the six months ended October 31, 2012 from \$17.7 million in the six months ended October 31, 2011. The increase in professional services revenue was driven by increased revenue from gaming activities.

- Aerospace products derives its revenue by designing, engineering, manufacturing, installing, servicing and repairing products for classic and current production aircraft. Aerospace products revenue decreased 6% for the six months to \$8.0 million at October 31, 2012 compared to \$8.6 million at October 31, 2011. We anticipate future domestic military spending reductions and continued slow growth of the United States economy.

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Costs and expenses:

Costs and expenses related to Professional services and Aerospace products include the cost of engineering, labor, materials, equipment utilization, control systems, security and occupancy.

Costs and expenses increased 3% in the six months ended October 31, 2012 to \$25.0 million compared to \$24.2 million in the six months ended October 31, 2011. Costs and expenses were 93% of total revenue in the six months ended October 31, 2012, as compared to 92% of total revenue in the six months ended October 31, 2011. The increased costs and expenses as a percent of total revenue in the six months ended October 31, 2012 were primarily driven by an increase in labor and material costs.

Marketing and advertising expenses as a percent of total revenue was 8% in the six months ended October 31, 2012, as compared to 12% in six months ended October 31, 2011. These expenses decreased 33% to \$2.1 million in the six months ended October 31, 2012, from \$3.1 million in the six months ended October 31, 2011. Marketing and advertising expenses include advertising, sales and marketing labor, gaming development costs, and casino and product promotions. Boot Hill Casino marketing expenses increased \$405 thousand, however other gaming development expenses decreased. The Boot Hill Casino increase was primarily attributable to growth in the professional services business reflecting a marketing plan to target specific marketing sectors in the Wild West market to increase destination casino revenue. The Boot Hill Casino and Resort definition of the Wild West market includes the area east from the Rocky Mountains to the Mississippi River and the southern Canadian border to the northern border of Mexico.

Employee benefits expenses as a percent of total revenue was 4% in the six months ended October 31, 2012, compared to 6% in the six months ended October 31, 2011. These expenses decreased 33% to \$1.0 million in the six months ended October 31, 2012, from \$1.5 million in the six months ended October 31, 2011. These expenses include the employers' share of all federal, state and local taxes, paid time off for vacation, holidays and illness, employee health and life insurance programs and employer matching contributions to retirement plans. The decreased expenses are related to a decrease in the number of employees in professional services.

Depreciation and amortization expenses as a percent of total revenue was 5% in the six months ended October 31, 2012, compared to 4% in the six months ended October 31, 2011. These expenses increased 56% to \$1.5 million in the six months ended October 31, 2012, from \$936 thousand in the six months ended October 31, 2011. These expenses include depreciation related to owned assets being depreciated over various useful lives and amortization of intangible items including the Kansas privilege fee related to the Boot Hill Casino and Resort being expensed over the term of the gaming contract with the State of Kansas. BHCMC, LLC depreciation and amortization expense for the six months ended October 31, 2012 was \$487 compared to \$20 at October 31, 2011.

General, administrative and other expenses as a percent of total revenue was 14% in the six months ended October 31, 2012, compared to 12% in the six months ended October 31, 2011. These expenses increased 22% to \$3.8 million in fiscal 2012, from \$3.1 million in fiscal 2011. The increase reflects the increase in the number of administrative personnel in professional services, the increased legal fees and expenses and the outside professional consulting fees related to working within the Kansas gaming regulations.

Other income (expense):

Interest and other expenses were \$678 thousand in the six months ended October 31, 2012 compared with interest and other expenses of \$181 thousand in the six months ended October 31, 2011, an increase of \$497 thousand, 275%, from the six months ended October 31, 2011 to the six months ended October 31, 2012. Interest of \$524 thousand was related to obligations of BHCMC, LLC.



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## Operations by Segment

We have two operating segments, professional services and aerospace products. The professional services segment includes revenue contributions and expenditures associated with monitoring services for SCADA systems owned by others, professional architectural services and casino management services. Aerospace products derives its revenue by designing, engineering, manufacturing, installing, servicing and repairing products for classic and current production aircraft.

The following table presents a summary of our operating segment information for the six months ended October 31, 2012 and October 31, 2011:

| (dollars in thousands)   | Six<br>Months<br>Ended<br>Oct. 31,<br>2012 | Percent of<br>Revenue | Six<br>Months<br>Ended<br>Oct. 31,<br>2011 | Percent of<br>Revenue | Percent<br>Change<br>2011-2012 |
|--|--|-----------------------|--|-----------------------|--------------------------------|
| <b>Professional Services</b>   |  |                       |  |                       |                                |
| <b>Revenues</b>  |  |                       |  |                       |                                |
| Boot Hill Casino and Resort  | \$ 16,584                                  | 87%                   | \$ 15,555                                  | 88%                   | 7%                             |
| Management/Professional Services   | 2,393                                      | 13%                   | 2,182                                      | 12%                   | 10%                            |
| Net Revenue  | 18,977                                     | 100%                  | 17,737                                     | 100%                  | 7%                             |
| <b>Costs of professional services</b>  |  |                       |  |                       |                                |
| Expenses   | 10,507                                     | 55%                   | 9,992                                      | 56%                   | 5%                             |
| Total costs and expenses   | 6,464                                      | 34%                   | 6,622                                      | 37%                   | (2)%                           |
| Professional services operating income (loss)<br>before noncontrolling interest in BHCMC,<br>LLC | 16,971                                     | 89%                   | 16,614                                     | 94%                   | 2%                             |
| Noncontrolling interest in BHCMC, LLC  | 2,006                                      | 11%                   | 1,123                                      | 6%                    | 79%                            |
| Professional services operating income (loss)<br>after noncontrolling interest in BHCMC,<br>LLC  | (726)                                      | 4%                    | (920)                                      | 5%                    | (21)%                          |
| Professional services operating income (loss)<br>after noncontrolling interest in BHCMC,<br>LLC  | \$ 1,280                                   | 7%                    | \$ 203                                     | 1%                    | 531%                           |

| (dollars in thousands)                     | Six<br>Months<br>Ended<br>Oct. 31,<br>2012 | Percent of<br>Revenue | Six<br>Months<br>Ended<br>Oct. 31,<br>2011 | Percent of<br>Revenue | Percent<br>Change<br>2011-2012 |
|--|--|-----------------------|--|-----------------------|--------------------------------|
| <b>Aerospace Products</b>                  |  |                       |  |                       |                                |
| <b>Revenues</b>                            |  |                       |  |                       |                                |
| Costs of aerospace products                | \$ 8,028                                   | 100%                  | \$ 8,550                                   | 100%                  | (6)%                           |
| Expenses                                   | 6,101                                      | 76%                   | 5,513                                      | 64%                   | 11%                            |
| Total costs and expenses                   | 1,949                                      | 24%                   | 2,107                                      | 25%                   | (7)%                           |
| Aerospace products operating income (loss) | 8,050                                      | 100%                  | 7,620                                      | 89%                   | 6%                             |
| Professional Services                      | \$ (22)                                    | (0)%                  | \$ 930                                     | 11%                   | (102)%                         |

## Professional Services

- Revenue from professional services increased 7% to \$19.0 million in the six months ended October 31, 2012 from \$17.7 million in the six months ended October 31, 2011. The increase in professional services revenue was driven by increased revenue from gaming activities.

In the six months ended October 31, 2012 Boot Hill Casino and Resort received gross receipts for the State of Kansas of \$21.8 million compared to \$21.4 million for the six months ended October 31, 2011. Mandated fees, taxes and distributions reduced gross receipts by \$6.8 million resulting in net gaming revenue of \$15.0 million for the six months ended October 31, 2012 compared to \$13.8 million for the six months ended October 31, 2011 an increase of 8.3%.

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The remaining management and professional services revenue include professional management services in the gaming industry, licensed architectural services, food, beverage, and retail from Boot Hill Casino and Resort, and monitoring services for SCADA systems. Management and professional services revenue increased 2.2% to \$4.0 million in the six months ended October 31, 2012 from \$3.9 million in the six months ended October 31, 2011. Gaming related revenue including food, beverage, and retail increased 6.9% to \$1.8 million for the six months ended October 31, 2012 compared to \$1.6 million for the six months ended October 31, 2011. Professional services revenue including architectural, engineering and monitoring services increased 13% to \$2.4 million for the current six months ended October 31, 2012.

- Costs increased 5% in the six months ended October 31, 2012 to \$10.5 million compared to \$10.0 million in the six months ended October 31, 2011. Costs were 55% of segment total revenue in the six months ended October 31, 2012, as compared to 56% of segment total revenue in the six months ended October 31, 2011.
- Expenses decreased 2% in the six months ended October 31, 2012 to \$6.5 million compared to \$6.6 million in the six months ended October 31, 2011. Expenses were 34% of segment total revenue in the six months ended October 31, 2012, as compared to 37% of segment total revenue in the six months ended October 31, 2011.

Aerospace Products

- Revenue decreased 6% from \$8.0 million in the six months ended October 31, 2012 compared to \$8.6 million in the six months ended October 31, 2011. This decrease is attributable to reduced revenue of \$522 thousand in the aerospace segment. We anticipate future domestic military spending reductions and continued slow growth of the United States economy.
- Costs increased in the six months ended October 31, 2012 to \$6.1 million compared to \$5.5 million in the six months ended October 31, 2011. Costs were 76% of segment total revenue in the six months ended October 31, 2012, as compared to 64% of segment total revenue in the six months ended October 31, 2011.
- Expenses decreased 7% in the six months ended October 31, 2012 at \$1.9 million compared to \$2.1 million in the six months ended October 31, 2011. Expenses were 24% of segment total revenue in the six months ended October 31, 2012, as compared to 25% of segment total revenue in the six months ended October 31, 2011.

Employees

Other than persons employed by our gaming subsidiaries there are 99 full time and 2 part time employees on October 31, 2012 compared to 111 full time and 3 part time employees on October 31, 2011. As of December 3, 2012, staffing is 99 full time and 1 part time employees. Our staffing at Boot Hill Casino & Resort on October 31, 2012 was 215 full time and 78 part time employees. At December 3, 2012 there are 210 full time employees and 73 part time employees. None of the employees are subject to any collective bargaining agreements.



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## SECOND QUARTER FISCAL 2013 COMPARED TO SECOND QUARTER FISCAL 2012

| (dollars in thousands)            | Three<br>Months<br>Ended<br>Oct. 31,<br>2012 | Percent<br>of total<br>revenue | Three<br>Months<br>Ended<br>Oct. 31,<br>2011 | Percent<br>of total<br>revenue | Percent<br>Change<br>2011-2012 |
|-----------------------------------|--|--------------------------------|--|--------------------------------|--------------------------------|
| <b>Revenues:</b>                  |  |                                |  |                                |                                |
| Professional services             | \$ 9,170                                     | 68%                            | \$ 9,139                                     | 65%                            | 0%                             |
| Aerospace products                | 4,367  | 32%                            | 5,002  | 35%                            | (13)%                          |
| <b>Total revenues</b>             | <b>13,537</b>                                | <b>100%</b>                    | <b>14,141</b>                                | <b>100%</b>                    | <b>(4)%</b>                    |
| <b>Costs and expenses:</b>        |  |                                |  |                                |                                |
| Cost of professional services     | 5,370  | 40%                            | 5,015  | 35%                            | 7%                             |
| Cost of aerospace products        | 3,177  | 23%                            | 2,577  | 18%                            | 23%                            |
| Marketing and advertising         | 997  | 7%                             | 2,192  | 16%                            | (55)%                          |
| Employee benefits                 | 522  | 4%                             | 751  | 5%                             | (30)%                          |
| Depreciation and amortization     | 745  | 6%                             | 473  | 3%                             | 58%                            |
| General, administrative and other | 2,027  | 15%                            | 1,754  | 12%                            | 16%                            |
| <b>Total costs and expenses</b>   | <b>12,838</b>                                | <b>95%</b>                     | <b>12,762</b>                                | <b>90%</b>                     | <b>1%</b>                      |
| <b>Operating income</b>           | <b>\$ 699</b>                                | <b>5%</b>                      | <b>\$ 1,379</b>                              | <b>10%</b>                     | <b>(49)%</b>                   |

## Revenues:

Revenue decreased 4% to \$13.5 million in the three months ended October 31, 2012, as compared to \$14.1 million in the three months ended October 31, 2011.

- Professional services derives its revenue from professional management services in the gaming industry through BNSC and BHCMC, licensed architectural, and engineering services to the business community through BCS Design and monitoring services to owners and operator of SCADA through BNSI. Revenue from professional services were relatively unchanged at \$9.2 million in the three months ended October 31, 2012 from \$9.1 million in the three months ended October 31, 2011. The increase in professional services revenue was driven by increased revenue from gaming activities.
- Aerospace products derives its revenue by designing, engineering, manufacturing, installing, servicing and repairing products for classic and current production aircraft. Aerospace products revenue decreased 13% for the three months to \$4.4 million at October 31, 2012, compared to \$5.0 million at October 31, 2011. This decrease is attributable to decreases in all aerospace products. We anticipate future domestic military spending reductions and continued slow growth of the United States economy.

## Costs and expenses:

Costs and expenses related to Professional services and Aerospace products include the cost of engineering, labor, materials, equipment utilization, control systems, security and occupancy.

Costs and expenses increased 1% in the three months ended October 31, 2012 to \$12.8 million compared to \$12.7 million in the three months ended October 31, 2011. Costs and expenses were 95% of total revenue in the three months ended October 31, 2012, as compared to 90% of total revenue in the three months ended October 31, 2011.

Marketing and advertising expenses as a percent of total revenue was 7% in the three months ended October 31, 2012, as compared to 16% in three months ended October 31, 2011. These expenses decreased 55% to \$997 thousand in the three months ended October 31, 2012, from \$2.2 million in the three months ended October 31, 2011. Marketing and advertising expenses include advertising, sales and marketing labor, gaming development costs, and casino and product promotions. Boot Hill Casino marketing expenses increased and were primarily attributable to growth in the professional services business reflecting a marketing plan to target specific marketing sectors in the Wild West market to increase destination casino revenue. The Boot Hill Casino and Resort definition of the Wild West market includes the area east from the Rocky Mountains to the Mississippi River and the southern Canadian border to the northern border of Mexico.

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Employee benefits expenses as a percent of total revenue was 4% in the three months ended October 31, 2012, compared to 5% in the three months ended October 31, 2011. These expenses decreased 30% to \$522 thousand in the three months ended October 31, 2012, from \$751 thousand in the three months ended October 31, 2011. These expenses include the employers' share of all federal, state and local taxes, paid time off for vacation, holidays and illness, employee health and life insurance programs and employer matching contributions to retirement plans. The decreased expenses are related to a decrease in the number of employees in professional services.

Depreciation and amortization expenses as a percent of total revenue was 6% in the three months ended October 31, 2012, compared to 3% in the three months ended October 31, 2011. These expenses increased 58% to \$745 thousand in the three months ended October 31, 2012, from \$473 thousand in the three months ended October 31, 2011. These expenses include depreciation related to owned assets being depreciated over various useful lives and amortization of intangible items including the Kansas privilege fee related to the Boot Hill Casino and Resort being expensed over the term of the gaming contract with the State of Kansas. BHCMC, LLC depreciation and amortization expense for the three months ended October 31, 2012 was \$261 compared to \$10 at October 31, 2011.

General, administrative and other expenses as a percent of total revenue was 15% in the three months ended October 31, 2012, compared to 12% in the three months ended October 31, 2011. These expenses increased 16% to \$2.0 million in fiscal 2012, from \$1.8 million in fiscal 2011. The increase reflects the increase in number of administrative personnel in professional services, the increased legal fees and expenses and the outside professional consulting fees related to working within the Kansas gaming regulations.

Other income (expense):

Interest and other expenses were \$332 thousand in the three months ended October 31, 2012 compared with interest and other expenses of \$93 thousand in the three months ended October 31, 2011, an increase of \$239 thousand, 257%, from the three months ended October 31, 2011 to the three months ended October 31, 2012. Interest of \$262 thousand was related to obligations of BHCMC, LLC.

Operations by Segment

We have two operating segments, professional services and aerospace products. The professional services segment includes revenue contributions and expenditures associated with monitoring services for SCADA systems owned by others, professional architectural services and casino management services. Aerospace products derives its revenue by designing, engineering, manufacturing, installing, servicing and repairing products for classic and current production aircraft.

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The following table presents a summary of our operating segment information for the three months ended October 31, 2012 and October 31, 2011:

| (dollars in thousands)   | Three<br>Months<br>Ended<br>Oct. 31,<br>2012 | Percent of<br>Revenue | Three<br>Months<br>Ended<br>Oct. 31,<br>2011 | Percent of<br>Revenue | Percent<br>Change<br>2011-2012 |
|--|--|-----------------------|--|-----------------------|--------------------------------|
| Professional Services Revenues   |  |                       |  |                       |                                |
| Boot Hill Casino and Resort  | \$ 8,038                                     | 88%                   | \$ 8,083                                     | 88%                   | (1)%                           |
| Management/Professional Services   | 1,132  | 12%                   | 1,056  | 12%                   | 7%                             |
| Net Revenue  | 9,170  | 100%                  | 9,139  | 100%                  | 0%                             |
| Costs of professional services   | 5,370  | 59%                   | 5,015  | 55%                   | 7%                             |
| Expenses   | 3,162  | 34%                   | 3,942  | 43%                   | (20)%                          |
| Total costs and expenses   | 8,532  | 93%                   | 8,957  | 98%                   | (5)%                           |
| Professional services operating income (loss) before noncontrolling interest in BHCMC, LLC | 638  | 7%                    | 182  | 2%                    | 251%                           |
| Noncontrolling interest in BHCMC, LLC  | (186)  | 2%                    | 522  | 6%                    | (64)%                          |
| Professional services operating income (loss) after noncontrolling interest in BHCMC, LLC  | \$ 452                                       | 5%                    | \$ (340)                                     | (4)%                  | (233)%                         |

| (dollars in thousands)                     | Three<br>Months<br>Ended<br>Oct. 31,<br>2012 | Percent of<br>Revenue | Three<br>Months<br>Ended<br>Oct. 31,<br>2011 | Percent of<br>Revenue | Percent<br>Change<br>2011-2012 |
|--|--|-----------------------|--|-----------------------|--------------------------------|
| Aerospace Products Revenues                | \$ 4,367                                     | 100%                  | \$ 5,002                                     | 100%                  | (13)%                          |
| Costs of aerospace products                | 3,177  | 73%                   | 2,577  | 52%                   | 23%                            |
| Expenses                                   | 1,129  | 26%                   | 1,228  | 25%                   | (8)%                           |
| Total costs and expenses                   | 4,306  | 99%                   | 3,805  | 76%                   | 13%                            |
| Aerospace products operating income (loss) | \$ 61  | 1%                    | \$ 1,197                                     | 24%                   | (95)%                          |

## Professional Services

- Revenue from professional services increased 0.3% to \$9.2 million in the three months ended October 31, 2012 from \$9.1 million in the three months ended October 31, 2011. The increase in professional services revenue was driven by increased revenue from gaming activities.

In the quarter ended October 31, 2012 Boot Hill Casino and Resort received gross receipts for the State of Kansas of \$10.7 million compared to \$10.7 million for the three months ended October 31, 2011. Mandated fees, taxes and distributions reduced gross receipts by \$3.5 million resulting in net gaming revenue of \$7.2 million for the three months ended October 31, 2012 compared to \$7.2 million for the three months ended October 31, 2011.

The remaining management and professional services revenue includes professional management services in the gaming industry, licensed architectural services, food, beverage, and retail from Boot Hill Casino and Resort, and monitoring services for SCADA systems. Management and professional services revenue decreased 2% to \$1.9 million in the three months ended October 31, 2012 from \$2.0 million in the three months ended October 31, 2011. Gaming related revenue including food, beverage, and retail decreased 13.2% to \$785 thousand for the three months ended October 31, 2012 compared to \$905 thousand for the three months ended October 31, 2011. Professional services revenue including architectural, engineering and monitoring services increased 7% to \$1,132 thousand for the current three months ended October 31, 2012.

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- Costs increased 7% in the three months ended October 31, 2012 to \$5.4 million compared to \$5.0 million in the three months ended October 31, 2011. Costs were 59% of segment total revenue in the three months ended October 31, 2012, as compared to 55% of segment total revenue in the three months ended October 31, 2011.
- Expenses decreased 20% in the three months ended October 31, 2012 to \$3.2 million compared to \$3.9 million in the three months ended October 31, 2011. Expenses were 34% of segment total revenue in the three months ended October 31, 2012, as compared to 43% of segment total revenue in the three months ended October 31, 2011.

## Aerospace Products

- Revenue decreased 13% from \$4.4 million in the three months ended October 31, 2012 compared to \$5.0 million in the three months ended October 31, 2011. This decrease is attributable to reduced Aerospace revenue of \$635 thousand. We anticipate future domestic military spending reductions and continued slow growth of the United States economy.
- Costs increased 23% to \$3.2 million in the three months ended October 31, 2012 from \$2.6 million in the three months ended October 31, 2011. Costs were 73% of segment total revenue in the three months ended October 31, 2012, as compared to 52% of segment total revenue in the three months ended October 31, 2011.
- Expenses decreased 8% in the three months ended October 31, 2012 at \$1.1 million compared to \$1.2 million in the three months ended October 31, 2011. Expenses were 26% of segment total revenue in the three months ended October 31, 2012, as compared to 25% of segment total revenue in the three months ended October 31, 2011.

## Liquidity and Capital Resources (in thousands)

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 2013 and beyond.

On May 1, 2011, BHC Investment Company exercised the option to acquire 100% of the Class A Preferred Interest in BHCMC, LLC. The ownership structure of BHCMC, LLC is now:

| Membership Interest | Members of Board of Managers | Equity Ownership | Income (Loss) Sharing |
|---------------------|------------------------------|------------------|-----------------------|
| Class A             | 3                            | 20%              | 40%                   |
| Class B             | 4                            | 80%              | 60%                   |

BHCMC, LLC, rents the casino building under the terms of a 25 year lease from BHC Development L.C. "BHCD". Butler National Corporation, its management, or subsidiaries have no ownership interest in BHCI or BHCD.

The terms of the agreement between the Kansas Lottery and BNSC/BHCMC require the completion of an addition to the Boot Hill Casino and Resort. We may need additional funding to complete this expansion if not completed by a franchised vendor. The phase II development of an adjacent hotel and community owned special events center was funded by a third parties, is completed, and open to the public. The remaining phase II construction requirements are in process, and are expected to be completed by early 2013. Phase II expansion of the unfinished gaming floor space built during Phase I construction and tenant improvements is estimated to cost approximately \$8 million and is being funded by tenant improvement leases, gaming machine leases, and current casino earnings, with minimum exposure to Butler National Corporation. The Phase II expansion includes the interior finish of 15,000 square feet of casino shell and 216 additional gaming machines. At completion Boot Hill Casino and Resort will have approximately 800 gaming machines on the floor.



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Analysis and Discussion of Cash Flow

During the six months ended October 31, 2012 our cash position decreased by \$400. We had net income of \$1,108. Cash flows from operating activities provided \$2,965. Non-cash activities consisting of depreciation and amortization contributed \$1,520 and stock options issued to employees and directors contributed \$74. Stock issued for services contributed \$91. The following items decreased our cash position. Customer deposits and receivables decreased by \$571 while inventories decreased by \$123. Prepaid expenses and other current assets decreased our cash by \$557, while a decrease of accounts payable and accrued expenses increased our cash by an additional \$435.

Cash used in investing activities was \$6,952. We invested \$389 to purchase used modification equipment and aircraft, and \$6,563 to fund the Phase II development project at Boot Hill Casino and Resort.

Cash provided by financing activities was \$3,587. We reduced our debt by \$1,451 and our line of credit by \$440. We borrowed \$365 to purchase a used aircraft and \$4,233 to fund the Phase II development project at Boot Hill Casino and Resort.

Critical Accounting Policies and Estimates:

We believe that there are several accounting policies that are critical to understanding our historical and future performance, as these policies affect the reported amount of revenue and other significant areas involving management judgments and estimates. These significant accounting policies relate to revenue recognition, the use of estimates, long-lived assets, and Supplemental Type Certificates. These policies and our procedures related to these policies are described in detail below and under specific areas within this "Management Discussion and Analysis of Financial Condition and Results of Operations." In addition, Note 1 to the consolidated financial statements expands upon discussion of our accounting policies.

Revenue Recognition: Generally, we perform aircraft modifications under fixed-price contracts. Revenue from fixed-price contracts are recognized on the percentage-of-completion method, measured by the direct labor and material costs incurred compared to total estimated direct labor costs. Each quarter our management reviews the progress and performance of our significant contracts. Based on this analysis, any adjustment to sales, cost of sales and/or profit is recognized as necessary in the period they are earned. Changes in estimates of contract sales, cost of sales and profits are recognized using a cumulative catch-up, which is recognized in the current period of the cumulative effect of the change on current or prior periods. Revenue for off-the-shelf items and aircraft sales is recognized on the date of sale.

Net gaming revenue is the gross gaming win as reported by the Kansas Lottery casino reporting systems, less the mandated payments by and for the State of Kansas. Electronic games-slots and table games revenue is the aggregate of gaming wins and losses. Liabilities are recognized for chips and "ticket-in, ticket-out" coupons in the customers' possession, and for accruals related to anticipated payout of progressive jackpots. Progressive gaming machines, which contain base jackpots that increase at a progressive rate based on the number of coins played, are deducted from revenue as the amount of jackpots increase. Food, beverage, and other revenue is recorded when the service is received and paid for.

Revenue from Avionics products are recognized when shipped. Payment for these Avionics products is due within 30 days of the invoice date after shipment. Revenue for SCADA services, Gaming Management, and other Corporate/Professional Services are recognized as the service is rendered and invoiced. Payments for these service invoices are usually received within 30 days.



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 to the customer and acceptance by the customer. In the rare event of a warranty claim, the claim is processed through the normal course of business and may include additional charges to the customer. In our opinion any future warranty work would not be material to the financial statements.

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**Use of Estimates:** The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) 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 revenue and expenses during the reporting period. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements.

**Long-lived Assets:** The Company accounts for its long-lived assets in accordance with ASC Topic 360-10, formerly SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." ASC Topic 360-10 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the historical cost carrying value of an asset may no longer be appropriate. The Company assesses recoverability of the carrying value of an asset by estimating the future net cash flows expected to result from the asset, including eventual disposition. If the future net cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and fair value or disposable value.

**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 revenue 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.

## Changing Prices and Inflation

We have experienced upward pressure from inflation in 2012. From fiscal year 2011 to fiscal year 2012 a majority of the increases we experienced were in material costs. This additional cost may not be transferable to our customers resulting in lower income in the future. We anticipate fuel costs and possibly interest rates to rise in fiscal 2012 and 2013.

## Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Please see Item 7(a) of our Form 10-K for the period ended April 30, 2012, which such Item is incorporated herein by reference.

## 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 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 report on Form 10-Q and have determined that such disclosure controls and procedures are effective, based on criteria in Internal Control-Integrated Framework, issued by COSO.

**Evaluation of disclosure controls and procedures:** Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed,

summarized, and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosures.

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In connection with the preparation of this Form 10-Q, our Chief Executive Officer and our Chief Financial Officer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of October 31, 2012. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of October 31, 2012.

Internal Control Over Financial Reporting

Changes in Internal Control Over Financial Reporting: In our opinion there were no material changes in the Company internal controls over financial reporting during the six months ended October 31, 2012 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

Limitations on Controls

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

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PART II.

OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS.

BHCMC, LLC and BHC Development LC filed a lawsuit in the United States District Court on June 21, 2012 against Bally Gaming Inc. doing business as Bally Technologies for breach of contract and negligent misrepresentation, among other claims related to the performance of computer software systems. BHCMC and BHC Development seek damages in excess of \$75,000. Bally's has counterclaimed for an alleged breach of contract and an alleged continued use of the system. Bally's alleges damages in excess of \$410,099.43 which BHCMC and BHC Development deny. BHCMC and BHC Development are vigorously contesting the counterclaims.

Item 1A. RISK FACTORS.

There are no material changes to the risk factors disclosed under Item 1A of our Form 10-K for the fiscal year ended April 30, 2012.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES.

None.

Item 4. MINE SAFETY DISCLOSURES

None

Item 5. OTHER INFORMATION.

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.

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- 31.1 Certificate of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a).
- 31.2 Certificate of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a).
- 32.1 Certifications of Chief Executive Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certifications of Chief Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 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, 2012.
- 101 The following financial information from the Company's Quarterly Report on Form 10-Q for the quarter ended October 31, 2012, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Condensed Consolidated Balance Sheets as of October 31, 2012 and April 30, 2012, (ii) Condensed Consolidated Statements of Operations for the three months ended October 31, 2012 and 2011, (iii) Condensed Consolidated Statements of Operations for the six months ended October 31, 2012 and 2011, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended October 31, 2012 and 2011, and (v) the Notes to Consolidated Financial Statements, with detail tagging. In accordance with Regulation S-T, the XBRL-formatted interactive data files that comprise this Exhibit 101 shall be deemed "furnished" and not "filed."

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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)

December 13, 2012  
Date

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

December 13, 2012  
Date

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

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Exhibit Index

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