

ADVANTAGE TECHNOLOGIES GROUP INC
Form 10-Q
August 14, 2008

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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2008

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File number 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 (I.R.S. Employer Identification No.)
organization)

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

Indicate by check mark whether the registrant is a large accelerated filer, 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 Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer Accelerated
filer
Non-accelerated filer 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

Shares outstanding of the issuer's \$.01 par value common stock as of July 30, 2008 were
10,273,015.

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ADVANTAGE TECHNOLOGIES GROUP, INC.
Form 10-Q
For the Period Ended June 30, 2008

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ADVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED BALANCE SHEETS

| | June 30, 2008 (Unaudited) | September 30, 2007 (Audited) |
|---|---------------------------------|---------------------------------------|
| Assets | | |
| Current assets: | | |
| Cash | \$ 16,367 | \$ 60,993 |
| Accounts receivable, net allowance of \$281,000 and \$261,000, respectively | 5,082,459 | 6,709,879 |
| Income Tax Receivable | 246,831 | 153,252 |
| Inventories, net of allowance for excess and obsolete inventory of \$1,447,000 and \$697,000, respectively | 33,775,791 | 31,464,527 |
| Deferred income taxes | 1,005,000 | 678,000 |
| Total current assets | 40,126,448 | 39,066,651 |
| Property and equipment, at cost: | | |
| Land and buildings | 7,139,684 | 6,488,731 |
| Machinery and equipment | 3,222,578 | 3,144,927 |
| Leasehold improvements | 205,797 | 205,797 |
| | 10,568,059 | 9,839,455 |
| Less accumulated depreciation and amortization | (2,618,655) | (2,341,431) |
| Net property and equipment | 7,949,404 | 7,498,024 |
| Other assets: | | |
| Deferred income taxes | 633,000 | 679,000 |
| Goodwill | 1,560,183 | 1,560,183 |
| Other assets | 161,474 | 204,843 |
| Total other assets | 2,354,657 | 2,444,026 |
| Total assets | \$ 50,430,509 | \$ 49,008,701 |

See notes to unaudited consolidated financial statements.

ADVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED BALANCE SHEETS

| | June 30, 2008, (Unaudited) | September 30, 2007 (Audited) |
|--|----------------------------------|---------------------------------------|
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 3,516,194 | \$ 4,301,672 |
| Accrued expenses | 1,152,392 | 1,331,890 |
| Bank revolving line of credit | 1,779,703 | 1,735,405 |
| Notes payable – current portion | 1,859,533 | 1,427,693 |
| Dividends payable | - | 210,000 |
| Total current liabilities | 8,307,822 | 9,006,660 |
| Notes payable | 16,326,817 | 5,845,689 |
| Other liabilities | 249,016 | - |
| Stockholders' equity: | | |
| Preferred stock, 5,000,000 shares authorized, \$1.00 par value, at stated value: | | |
| Series B, 7% cumulative; 300,000 shares issued and outstanding with a stated value of \$40 per share | - | 12,000,000 |
| Common stock, \$.01 par value; 30,000,000 shares authorized; 10,293,115 and 10,270,756 shares issued, respectively | 102,931 | 102,708 |
| Paid-in capital | (6,290,165) | (6,383,574) |
| Retained earnings | 31,930,268 | 28,454,024 |
| Accumulated other comprehensive income: | | |
| Unrealized (loss) gain on interest rate swap, net of tax | (142,016) | 37,358 |
| | 25,601,018 | 34,210,516 |
| Less: Treasury stock, 21,100 shares at cost | (54,164) | (54,164) |
| Total stockholders' equity | 25,546,854 | 34,156,352 |
| Total liabilities and stockholders' equity | \$ 50,430,509 | \$ 49,008,701 |

See notes to unaudited consolidated financial statements.

ADVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)

| | Three Months Ended June | | Nine Months Ended June | |
|--|-------------------------|---------------|------------------------|---------------|
| | 30, | | 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net new sales income | \$ 8,217,666 | \$ 12,736,809 | \$ 25,784,944 | \$ 34,407,063 |
| Net refurbished sales income | 3,641,314 | 3,363,937 | 11,958,121 | 9,982,106 |
| Net service income | 1,354,822 | 1,462,355 | 4,061,924 | 3,963,000 |
| Total income | 13,213,802 | 17,563,101 | 41,804,989 | 48,352,169 |
| Costs of sales | 8,871,483 | 10,560,250 | 26,295,946 | 29,602,339 |
| Cost of service | 978,771 | 925,209 | 2,829,611 | 2,771,020 |
| Gross profit | 3,363,548 | 6,077,642 | 12,679,432 | 15,978,810 |
| Operating, selling, general and administrative expenses | 2,036,948 | 2,326,063 | 6,049,377 | 6,354,750 |
| Depreciation and amortization | 51,485 | 42,071 | 134,353 | 112,884 |
| Income from operations | 1,275,115 | 3,709,508 | 6,495,702 | 9,511,176 |
| Interest expense | 307,611 | 145,097 | 719,978 | 446,232 |
| Income before income taxes | 967,504 | 3,564,411 | 5,775,724 | 9,064,944 |
| Provision for income taxes | 362,000 | 1,354,000 | 2,166,000 | 3,445,000 |
| Net income | 605,504 | 2,210,411 | 3,609,724 | 5,619,944 |
| Other comprehensive income: | | | | |
| Unrealized gain or (loss) on interest rate swap (net of taxes) | 348,034 | 5,821 | (142,016) | (18,785) |
| Comprehensive income | \$ 953,538 | \$ 2,216,232 | \$ 3,467,708 | \$ 5,601,159 |
| Net income | \$ 605,504 | \$ 2,210,411 | \$ 3,609,724 | \$ 5,619,944 |
| Preferred dividends | - | 210,000 | 133,480 | 630,000 |
| Net income attributable to common stockholders | \$ 605,504 | \$ 2,000,411 | \$ 3,476,244 | \$ 4,989,944 |
| Earnings per share: | | | | |
| Basic | \$ 0.06 | \$ 0.20 | \$ 0.34 | \$ 0.49 |
| Diluted | \$ 0.06 | \$ 0.19 | \$ 0.34 | \$ 0.49 |
| Shares used in per share calculation | | | | |
| Basic | 10,272,015 | 10,237,089 | 10,260,149 | 10,234,534 |
| Diluted | 10,309,673 | 10,265,335 | 10,319,979 | 10,239,981 |

See notes to unaudited consolidated financial statements.

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

| | Nine Months Ended June 30, | |
|---|-------------------------------|--------------|
| | 2008 | 2007 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 3,609,724 | \$ 5,619,944 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 134,353 | 112,884 |
| Provision for losses on accounts receivable | 33,879 | 121,000 |
| Provision for excess and obsolete inventory | 795,302 | 311,000 |
| Deferred income tax (benefit) expense | (174,000) | 6,000 |
| Share based compensation expense | 28,214 | 61,411 |
| Change in: | | |
| Receivables | 1,499,962 | (1,698,236) |
| Inventories | (3,106,566) | (1,805,621) |
| Other assets | 197,049 | 259,985 |
| Accounts payable | (785,478) | (281,389) |
| Accrued expenses | (179,498) | 1,159,704 |
| Net cash provided by operating activities | 2,052,941 | 3,866,682 |
| Cash Flows from Investing Activities | | |
| Additions to machinery and equipment | (80,320) | (314,170) |
| Disposal of Machinery and Equipment | 3,500 | - |
| Additions of Land and Building | (653,283) | (3,326,150) |
| Acquisition of business and certain assets | - | (166,951) |
| Net cash (used in) investing activities | (730,103) | (3,807,271) |
| Cash Flows from Financing Activities | | |
| Net borrowings (payments) under bank revolving line of credit | 44,298 | (1,237,319) |
| Proceeds from notes payable | 12,000,000 | 2,760,291 |
| Repurchase of preferred stock | (12,000,000) | - |
| Payments on notes payable | (1,087,032) | (1,038,461) |
| Proceeds from stock options exercised | 18,750 | 21,460 |
| Payments of preferred dividends | (343,480) | (630,000) |
| Net cash (used in) financing activities | (1,367,464) | (124,029) |
| Net (decrease) in cash | (44,626) | (64,618) |
| Cash, beginning of period | 60,993 | 98,898 |
| Cash, end of period | 16,367 | 34,280 |
| Supplemental Cash Flow Information | | |
| Cash paid for interest | 635,357 | 440,686 |
| Cash paid for income taxes | 2,419,329 | 2,304,382 |

Supplemental Schedule of Non-Cash Financing Activities

| | | |
|--|-----------|----------|
| Unrealized (loss) on interest rate swap | (249,016) | (29,785) |
| Deferred tax on interest rate swap | 107,000 | 11,000 |
| Unrealized loss on interest rate swap net of tax | (142,016) | (18,785) |

See notes to unaudited consolidated financial statements.

Notes to unaudited consolidated financial statements

Note 1 - Basis of Presentation

The accompanying unaudited consolidated 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 financial statements not misleading. The consolidated financial statements as of September 30, 2007 have been audited by an independent registered public accounting firm. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

Reclassifications

Certain reclassifications have been made to the fiscal 2007 financial statements to conform to the fiscal 2008 presentation.

Note 2 - Description of Business

ADDvantage Technologies Group, Inc., through its subsidiaries Tulsat Corporation, ADDvantage Technologies Group of Nebraska, Inc. (dba Tulsat-Nebraska), NCS Industries, Inc., ADDvantage Technologies Group of Missouri, Inc., (dba ComTech Services), ADDvantage Technologies Group of Texas, Inc. (dba Tulsat-Texas), Tulsat – Atlanta, LLC, Jones Broadband International, Inc., and Tulsat-Pennsylvania LLC (dba Broadband Remarketing International) (collectively, the "Company"), sells new and refurbished cable television equipment throughout North America and Latin America in addition to being a repair center for various cable companies. All significant intercompany balances and transactions have been eliminated in consolidation. In addition, each subsidiary represents a separate operating segment of the Company and all are aggregated for segment reporting purposes.

Note 3 – Earnings Per Share

Basic and diluted net earnings per share were computed in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share." Basic net earnings per share is computed by dividing net earnings available to common shareholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period and excludes the dilutive effect of stock options. Diluted net earnings per share gives effect to all potentially dilutive common stock equivalents during a period. In computing diluted net earnings per share, 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 stock options.

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|--------------------------------|--------------|-------------------------------|--------------|
| | 2008 | 2007 | 2008 | 2007 |
| Basic EPS Computation: | | | | |
| Net income attributable to common stockholders | \$ 605,504 | \$ 2,000,411 | \$ 3,476,244 | \$ 4,989,944 |

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| | | | | |
|---|------------|--------------|--------------|--------------|
| Weighted average outstanding common shares | 10,272,015 | 10,237,089 | 10,260,149 | 10,234,534 |
| Earnings per Share – Basic | \$ 0.06 | \$ 0.20 | \$ 0.34 | \$ 0.49 |
| Diluted EPS Computation: | | | | |
| Net income attributable to common stockholders | \$ 605,504 | \$ 2,000,411 | \$ 3,476,244 | \$ 4,989,944 |
| Weighted average outstanding common shares | 10,272,015 | 10,237,089 | 10,260,149 | 10,234,534 |
| Potentially dilutive securities | | | | |
| Effect of dilutive stock options | 37,658 | 28,246 | 59,830 | 5,447 |
| Weighted average shares outstanding - assuming dilution | 10,309,673 | 10,265,335 | 10,319,979 | 10,239,981 |
| Earnings per Share – Diluted | \$ 0.06 | \$ 0.19 | \$ 0.34 | \$ 0.49 |

Note 4 – Line of Credit and Notes Payable

On November 27, 2007 the Company executed the Fourth Amendment to Revolving Credit and Term Loan Agreement (“Fourth Amendment”) with its primary financial lender, Bank of Oklahoma. The Fourth Amendment renewed the \$7.0 Million Revolving Line of Credit (“Line of Credit”) and extended the maturity date to November 30, 2010. The Fourth Amendment also extended the maturity of and increased the \$8.0 Million Term Loan Commitment to \$16.3 million.

At June 30, 2008, a \$1.8 million balance was outstanding under a \$7.0 million line of credit due November 30, 2010, with interest payable quarterly on the prevailing 30-day LIBOR rate plus 1.4% (3.87% at June 30, 2008). \$5.2 million of the \$7.0 million line of credit was available to the Company to borrow at June 30, 2008. 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 less any outstanding term note balances. Among other financial covenants, the line of credit agreement provides that the Company must 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.

Cash receipts are applied from the Company's lockbox account directly against the bank line of credit, and checks clearing the bank are funded from the line of credit. The resulting overdraft balance, consisting of outstanding checks, was \$0.6 million at June 30, 2008 and is included in the bank revolving line of credit.

The outstanding balance of the \$8.0 million Term Loan prior to being amended on November 27, 2007 was \$4.3 million. The \$12.0 million of additional funds available under the amended \$16.3 million Term Loan were fully advanced upon executing the Fourth Amendment and the proceeds were used to redeem all of the issued and outstanding shares of the Company's Series B 7% Cumulative Preferred Stock. These shares of preferred stock were beneficially held by David E. Chymiak, Chairman of the Company, and Kenneth A. Chymiak, President and Chief Executive Officer of the Company, and his spouse. The outstanding balance on this note was \$15.5 million at June 30, 2008. The note is due on November 30, 2012, with quarterly payments beginning the last business day of February 2008 of approximately \$0.4 million plus accrued interest. The note bears interest at the prevailing 30-day LIBOR rate plus 1.4% (3.87% as of June 30, 2008).

The Revolving Line of Credit and Term Loan Agreement also includes a Term Loan Commitment of \$2.8 million. This loan was secured to finance the purchase of the Company's headquarters facility located in Broken Arrow, Oklahoma on November 20, 2006. The outstanding balance on this note was \$2.5 million at June 30, 2008. The note is due on November 20, 2021, with monthly principal payments of \$15,334 plus accrued interest. Interest on the outstanding note balance accrues at the prevailing 30-day LIBOR rate plus 1.4% (3.87% at June 30, 2008).

The Company's other note payable of \$0.2 million, secured by real estate, is due in monthly payments through 2013 with interest at 5.5% through March 2008, converting thereafter to prime minus .25%.

Note 5 – Derivative Financial Instruments

In 2004, the Company entered into an interest rate swap to effectively fix the interest rate of the \$8.0 million term note at 6.13%. Upon entering into this interest rate swap, the Company designated this derivative as a cash flow hedge by documenting the Company's risk management objective and strategy for undertaking the hedge along with methods for assessing the swap's effectiveness in accordance with Statement of Financial Accounting Standards 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS 133"). On November 20, 2007 the Company terminated this swap agreement upon amending and extending the \$8.0 million term note to \$16.3 million. The Company received approximately \$25,000 upon termination of this agreement which represented the fair value of the swap on that date and offset this gain against interest expense in the current year.

Additionally, on November 27, 2007, the Company entered into a new interest rate swap agreement to effectively fix the interest rate on the \$16.3 million term note at 5.92%. The notional value of the interest rate swap amortizes quarterly with payments that mirror the \$16.3 million term note. Upon entering into this interest rate swap, the Company designated this derivative as a cash flow hedge by documenting the Company's risk management objective and strategy for undertaking the hedge along with methods for assessing the swap's effectiveness in accordance with SFAS 133. The fair value of the hedge, which incorporates both an "effective" portion and "ineffective" portion, has been recorded on the Company's Consolidated Balance Sheet. The effective portion of the change in the fair value of this interest rate swap during the period has been reflected in the other comprehensive income section of the Consolidated Statements of Income and Comprehensive Income. The ineffective portion of the change in the fair value of the interest rate swap was recognized as interest expense in the current period and was not significant. At June 30, 2008, the notional value of the swap was \$15.5 million and the fair value of the interest rate swap was approximately \$0.2 million, which is included in other liabilities on the Company's Consolidated Balance Sheet.

Note 6 – Stock Option Plans

The 1998 Incentive Stock Plan (the "Plan") provides for the award to officers, directors, key employees and consultants of stock options and restricted stock. 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 June 30, 2008, 1,024,656 shares of common stock were reserved for the exercise of stock awards under the 1998 Incentive Stock Plan. Of the shares reserved for exercise of stock awards, 744,656 shares were available for future grants.

A summary of the status of the Company's stock options for the nine months ended June 30, 2008 is presented below.

| | 2008 | |
|-----------------------------------|---------|------------------------|
| | Shares | Wtd. Avg. Ex. Price |
| Outstanding at September 30, 2007 | 117,850 | \$ 4.20 |
| Granted | - | - |
| Exercised | 6,000 | 3.13 |
| Canceled | - | - |
| Outstanding at June 30, 2008 | 111,850 | \$ 4.26 |
| Exercisable at June 30, 2008 | 104,350 | \$ 4.15 |

In the first quarter of fiscal year 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment ("SFAS 123R"). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, be recognized as compensation costs in the financial statements based on their grant date fair value. Compensation expense for stock based awards is included in the operating, selling, general and administrative expense section of the consolidated statements of income and comprehensive income.

The Company estimates the fair value of the options granted using the Black-Scholes option valuation model and the assumptions shown in the table below. 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, consistent with SFAS 123R and Securities and Exchange Commission Staff Accounting Bulletin No. 107 (SAB No. 107). 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. A summary of the Company's current estimates are presented below.

| | Nine Months Ended |
|------------------------------------|-------------------|
| | June 30, 2008 |
| Average expected life | 5.0 years |
| Average expected volatility factor | 25% |
| Average risk-free interest rate | 4.45% |
| Average expected dividend yield | ----- |

For the nine months ended June 30, 2008, the Company recorded compensation expense of \$4,882 representing the amortizing fair value of the unvested options granted prior to fiscal 2008. As of June 30, 2008, compensation costs related to unvested stock awards not yet recognized in the statements of operations totaled \$5,265 which will be recognized over the remaining two year vesting term.

On March 5, 2008 the Company issued restricted shares under the plan totaling 16,359 shares to directors as part of their 2008 compensation. 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 \$70,000, of which \$46,668 is included in prepaid assets on the Company's June 30, 2008 balance sheet, and is being recognized as compensation expense over the 12 month holding period.

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. These forward-looking statements generally are identified by the words "believe," "will," "would," "will be," "will continue," "will likely result," and similar 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, formation of competitors, changes in governmental regulation or taxation, changes in our personnel and other such factors. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise. Readers should carefully review the risk factors described under Item 1A of our Annual Report on Form 10-K filed for the year ended September 30, 2007 and in other documents we file from time to time with the Securities and Exchange Commission.

Overview

The following MD&A is intended to help the reader understand the results of operations, financial condition, and cash flows of ADDvantage Technologies Group, Inc. MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to the financial statements ("Notes").

We are a Value Added Reseller ("VAR") for select Cisco and Motorola new products and we are a distributor for several other manufacturers of cable television ("CATV") equipment. We also specialize in the sale of surplus new and refurbished previously-owned CATV equipment to CATV operators and other broadband communication companies. It is through our development of these vendor relationships that we have focused our initiative to market our products and services to the larger cable multiple system operators ("MSOs") and Telecommunication Companies ("Telcoms"). These customers provide an array of different communications services as well as compete in their ability to offer subscribers 'Triple Play' transmission services, including data, voice and video.

Result of Operations

Comparison of Results of Operations for the Three Months Ended June 30, 2008 and June 30, 2007

Net Sales. Net sales decreased \$4.4 million, or 25%, to \$13.2 million for the third quarter of fiscal 2008 from \$17.6 million for the same period of fiscal 2007. New equipment sales declined by \$4.5 million, or 35%, to \$8.2 million in the third quarter of fiscal 2008 from \$12.7 million in the third quarter of fiscal 2007. Sales continued to remain at reduced volumes during the third quarter as certain large MSOs continued to delay their upgrade projects while other MSOs have been able to obtain the equipment necessary for scheduled capital projects directly from the manufacturer without interruption or delay. Sales to the Company's top five customers declined \$3.5 million compared to third quarter 2007 volumes, accounting for over 80% of the total decline in sales. Refurbished equipment sales increased \$0.2 million, or 6%, to \$3.6 million in the third quarter of fiscal 2008, from \$3.4 million for the same period last year. Sales of refurbished products increased primarily due to sales of our legacy digital converter boxes which grew approximately \$0.6 million over the three months ended June 30, 2007. Repair service revenue decreased \$0.1 million, to \$1.4 million in the third quarter of fiscal year 2008 compared to \$1.5 million in the same period of fiscal 2007. Repairs declined slightly in comparison to last year's third quarter numbers but remained consistent with the

first and second quarter of the current fiscal year. The Company continues to expect increased repair services during the remainder of the year as several large MSOs continue to delay rebuild projects and experience increased failure in older equipment.

Costs of Sales. Costs of sales includes (i) the costs of new and refurbished equipment, on a weighted average cost basis, sold during the period, (ii) the costs of equipment used in repairs, (iii) the related transportation costs, and (iv) the labor and overhead directly related to these sales. Costs of sales decreased \$1.6 million, or 14%, to \$9.9 million in the third quarter of fiscal 2008 from \$11.5 million for the same period in fiscal 2007. This decrease was primarily due to the decrease in new product sales for the period. Cost of sales was also impacted by a \$0.7 million charge to increase our obsolescence reserve which consisted primarily of a \$0.5 million reserve increase to cover approximately 32,000 Scientific Atlanta legacy converter boxes that we have deemed unsellable. We originally acquired these boxes from Adelphia in 2006 as part of a bulk purchase of 100,000 Scientific Atlanta and Motorola boxes for \$1.75 million. Our remaining Scientific Atlanta boxes have been deemed unsellable as the vast majority of the waivers that were granted last July by the FCC that allow domestic operators to continue to acquire these legacy boxes have expired. The lack of domestic sales opportunities coupled with the limited international opportunities to sell our legacy Scientific Atlanta digital converter boxes have led us to reduce the carrying costs on these boxes to their potential scrap value.

Gross Profit. Gross profit decreased \$2.7 million, or 44%, to \$3.4 million in the third quarter of fiscal 2008 from \$6.1 million for the same period in fiscal 2007. The decline in gross margin consisted of \$2.0 million due to reduced sales volumes and margins as well as an increased charge to cost of sales totaling approximately \$0.7 million to reserve for obsolete inventory discussed earlier. Gross profit margins decreased to 25.5% in the third quarter of fiscal 2008 from 34.6% in the third quarter of fiscal 2007. Gross profit margins on sales declined in all product lines during the quarter as reduced demand for new products from customers created additional competition from other CATV equipment suppliers and additional charges to increase our obsolete inventory reserve.

Operating, Selling, General and Administrative Expenses. Operating, selling, general and administrative expenses include personnel costs (including fringe benefits, insurance and taxes), occupancy, communication and professional services, among other less significant cost categories. Operating, selling, general and administrative expenses for the third quarter of fiscal 2008 were \$2.1 million which represented a decrease of \$0.3 million from the \$2.4 million reported in the same period of fiscal 2007. This decline resulted from a reduction in accrued bonuses of \$0.3 million during the quarter due to the current profitability expectations for the fiscal year.

Income from Operations. Income from operations declined \$2.4 million, or 65%, to \$1.3 million for the third quarter of fiscal 2008 from \$3.7 million for the same period of fiscal 2007. Income from operations primarily decreased as a result of the decrease in sales for the period offset by reduced operating, selling, general and administrative expenses.

Interest Expense. On November 27, 2007 we amended our \$8.0 million term note with our primary financial lender to \$16.3 million and extended the maturity to November 30, 2012. The outstanding balance of the \$8.0 million term loan prior to the amendment was \$4.3 million. The \$12.0 million of additional funds available under the amended \$16.3 million term loan were fully advanced at closing and the proceeds were used to redeem all of the issued and outstanding shares of our Series B 7% Cumulative Preferred Stock. The impact on income available to holders of common stock from the increased interest expense is expected to be fully offset by the elimination of dividends paid on the outstanding preferred shares. Also on November 27, 2007, we entered into an interest rate swap agreement to effectively fix the interest on the new \$16.3 million quarterly amortizing note at 5.92%. Interest on the remaining debt instruments, which had outstanding principal balances totaling \$4.2 million as of June 30, 2008, fluctuates periodically based on the specific criteria outlined in the corresponding debt agreements. Interest expense for the third quarter of fiscal 2008 was \$0.3 million, or an increase of \$0.2 million over the \$0.1 million of interest expense reported in the third quarter of fiscal 2007. The increased interest expense resulted primarily from the additional borrowings under the amended \$16.3 million term note.

Income Taxes. The provision for income taxes for the third quarter of fiscal 2008 was \$0.4 million, or 37.5% of profit before taxes, compared to \$1.4 million, or 38.0% of profit before taxes for the same period last year. Our estimated effective tax rate for 2008 decreased slightly due to the expected utilization of certain investment tax credits to reduce our state taxes.

Comparison of Results of Operations for the Nine months ended June 30, 2008 and June 30, 2007

Net Sales. Net sales decreased by \$6.6 million, or 14%, to \$41.8 million for the nine months ended June 30, 2008 from \$48.4 million for the same period in fiscal 2007. New equipment sales declined \$8.6 million, or 25%, to \$25.8 million for the nine months ended June 30, 2008 from \$34.4 million for the same period in fiscal 2007. The decline in new product sales resulted primarily from sales to our top five customers whose volumes declined \$8.6 million from the same period of fiscal 2007. The decline in sales to these top MSO customers resulted from their continued delays in upgrades expected to be performed during the period as well as an improvement in the manufacturers' ability to deliver needed equipment, with minimal interruption or delay, directly to these large customers. Sales of refurbished products grew \$2.0 million, or 20%, to \$12.0 million for the nine months ended June 30, 2008 from \$10.0 million for the same period fiscal 2007. Sales of our legacy digital converter box product line represented \$1.9 million of the increased sales in this product line. Repair service revenues increased \$0.1 million, or 3%, to \$4.1 million for the nine months ended June 30, 2008 from \$4.0 million for the same period of fiscal 2007. The increase in service revenues results from higher volumes of equipment failures as certain customers delay equipment upgrades and then incur additional out of warranty equipment failures.

Costs of Sales. Costs of sales includes (i) the costs of new and refurbished equipment, on a weighted average cost basis, sold during the period, (ii) the equipment costs used in repairs, (iii) the related transportation costs, and (iv) the labor and overhead directly related to these sales. Costs of sales decreased \$3.3 million, or 10%, to \$29.1 million for the nine months ended June 30, 2008 from \$32.4 million for the same period of fiscal 2007. The decrease in cost of sales was directly related to the decrease in revenues during the year offset by the increase in our obsolescence reserve.

Gross Profit. Gross profit decreased \$3.3 million, or 21%, to \$12.7 million for the nine months ended June 30, 2008 from \$16.0 million for the same period of fiscal 2007. The decrease in gross profit was a result of the decrease in sales for the period. Gross profit margins decreased to 30.3% during the first nine months of fiscal 2008 from 33.0% in the same period last year. Gross profit margins declined across all product lines by approximately \$0.3 million primarily from product line mix changes and increased price pressures from other competitors due to the overall decline in CATV equipment purchasing during the period. Our gross margin was also impacted due to the increase in our obsolete inventory reserve of approximately \$0.8 million over the amount reserved during the first nine months of 2007. Our obsolete inventory reserve increased primarily due to certain legacy digital converter boxes that have been deemed unsellable.

Operating, Selling, General and Administrative Expenses. Operating, selling, general and administrative expenses include personnel costs (including fringe benefits, insurance and taxes), occupancy, communication and professional services, among other less significant cost categories. Operating, selling, general and administrative expenses declined \$0.3 million to \$6.2 million during the first nine months of 2008 from \$6.5 million reported in same period of fiscal 2007. During the first nine months we incurred reduced bonus accrual, property taxes and rental costs, which combined to a savings of approximately \$0.4 million. This savings was offset by \$0.2 million of increased professional services primarily from consultants we hired to assist us with meeting the internal control assessment requirements of the Sarbanes Oxley Act of 2002. We expect these increased professional fees to continue through the remainder of the year but do not believe they will have a material impact on our overall financial performance.

Income from Operations. Income from operations decreased \$3.0 million, or 32%, to \$6.5 million for the nine months ended June 30, 2008 from \$9.5 million for the same period last year. Income from operations decreased primarily due to decreased product sales and an increase in our reserve for obsolete inventory.

Interest Expense. As discussed previously, on November 27, 2007 we amended our \$8.0 million term note with our primary financial lender to \$16.3 million, extended the maturity to November 30, 2012 and entered into an interest

rate swap to effectively fix the rate on this increased debt at 5.92%. Interest on our remaining debt instruments, which had outstanding principal balances totaling \$4.2 million as of June 30, 2008, fluctuates periodically based on the specific criteria outlined in the corresponding debt agreements. Interest expense for the nine months ended June 30, 2008 was \$0.7 million, or an increase of \$0.3 million over the \$0.4 million of interest expense reported during the same period in fiscal 2007. The increased interest expense was associated with the additional borrowings under the amended \$16.3 million term note.

Income Taxes. The provision for income taxes for the first nine months of fiscal 2008 was \$2.2 million, or 37.5% of profit before taxes, compared to \$3.4 million, or 38% of profit before taxes for the same period last year. Our estimated effective tax rate for 2008 decreased slightly as we expect to utilize certain investment tax credits which will result in reduced state taxes.

Recently issued Accounting Standards

In May 2008, the FASB issued Statement of Financial Accounting Standard (“SFAS”) No. 162, The Hierarchy of Generally Accepted Accounting Principles. The purpose of this standard is to provide a consistent framework for determining what accounting principles should be used when preparing U.S. GAAP financial statements. SFAS 162 categorizes accounting pronouncements in a descending order of authority. In the instance of potentially conflicting accounting principles, the standard in the highest category must be used. This statement will be effective 60 days after the SEC approves the Public Company Accounting and Oversight Board’s related amendments. We do not expect the adoption of SFAS 162 to have a material effect on our financial statement.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133, which requires additional disclosures about the objectives of the derivative instruments and hedging activities, the method of accounting for such instruments under SFAS No. 133 and its related interpretations, and a tabular disclosure of the effects of such instruments and related hedged items on our financial position, financial performance, and cash flows. SFAS No. 161 is effective for us beginning January 1, 2009. We are currently assessing the disclosure requirements of SFAS No. 161 and plan on including the required information in our first quarter fiscal 2009 financial statements, if not adopted earlier.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations, which replaces SFAS No. 141. The statement retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141R is effective for us beginning July 1, 2009 and will apply prospectively to business combinations completed on or after that date. We do not expect the adoption of SFAS No. 141R to have a material effect on our financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements. SAB No. 108 requires analysis of misstatements being both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. We adopted SAB No. 108 in the first quarter of fiscal year 2007 and its adoption had no impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for us beginning October 1, 2008. We do not expect the adoption of SFAS No. 157 to have a material effect on our financial statements.

In June 2006, the FASB issued Interpretation Number (“FIN”) No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In fiscal 2006, we elected early adoption of FIN No. 48 and there was no impact on our financial statements.

In June 2006, the FASB ratified the Emerging Issues Task Force ("EITF") consensus on EITF issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43." EITF Issue No. 06-2 requires companies to accrue the costs of compensated absences under a sabbatical or similar benefit arrangement over the requisite service period. EITF issue No. 06-2 was effective for us beginning October 1, 2007 and the adoption of EITF Issue No. 06-2 did not result in a material adjustment to our financial statements.

Critical Accounting Policies

Note 1 to the Consolidated Financial Statements in Form 10-K for fiscal 2007 includes a summary of the significant accounting policies or methods used in the preparation of our Consolidated 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 accounting principles generally accepted in the United States 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. 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

Inventory consists of new and used electronic components for the cable television industry. Inventory is stated at the lower of cost or market. Market is defined principally as net realizable value. Cost is determined using the weighted average method.

We market our products primarily to MSOs and other users of cable television equipment who are seeking products that can be shipped on a same-day basis, or seeking products which manufacturers have discontinued. Our position in the industry requires us to carry large inventory quantities relative to quarterly sales, but also allows us to realize high overall gross profit margins on our sales. Carrying these significant inventories represents our greatest risk. 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 we make in a reasonable period. Our investment in inventory is predominantly new products purchased from manufacturers and surplus-new products, which are unused products purchased from other distributors or MSOs.

In order to address the risks associated with our investment in inventory, we regularly review inventory quantities on hand and reduce the carrying value by recording a provision for excess and obsolete inventory based primarily on inventory aging and forecasts of product demand and pricing. The broadband industry is characterized by changing customer demands and changes in technology that could result in significant increases or decreases of inventory pricing or increases in excess or obsolete quantities on hand. Our estimates of future product demand may prove to be inaccurate, in which case the provision required for excess and obsolete inventory may have been understated or overstated. Although every effort is made to ensure the accuracy of internal forecasting, any significant changes in demand or prices could have a significant impact on the carrying value of our inventory and reported operating

results. As of June 30, 2008 we have reduced inventories by maintaining an allowance for excess and obsolete inventories totaling \$1.4 million.

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 creditworthiness, current economic trends and changes in our customer payment terms. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness, 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, additional allowances may be required. At June 30, 2008, accounts receivable, net of allowance for doubtful accounts of \$0.3 million, amounted to \$5.1 million.

Liquidity and Capital Resources

We finance our operations primarily through internally generated funds and a bank line of credit. During the first nine months of fiscal 2008, we generated approximately \$2.1 million of cash flow from operations which included \$0.6 million of borrowings under the line of credit, that was reclassified to accounts payable at the end of the quarter. The cash flow generated from operations was also impacted by the \$3.1 million increase in inventory since the beginning of the fiscal year.

During the first nine months we also invested an additional approximate \$0.7 million to complete two warehouse construction projects in Broken Arrow, Oklahoma and Sedalia, Missouri. The new 62,500 square foot warehouse facility in Broken Arrow, Oklahoma is located at the back section of our 10 acre headquarters facility. The completed warehouse addition, which cost approximately \$1.6 million, was constructed to gain additional operating efficiencies by consolidating the operations and multiple outside warehouses of our Tulsat subsidiary into one facility. The new 18,000 square foot warehouse facility in Sedalia, Missouri, which cost approximately \$0.4 million, will expand the revenue generating capacity of this location as it increases the square footage of the operation by approximately 30% and allowed us to consolidate our Stockton, California warehouse into a more cost effective location. The combined annual savings from vacated rental properties is expected to total approximately \$0.2 million per year.

In November 2007, we executed the Fourth Amendment to Revolving Credit and Term Loan Agreement with our primary financial lender, Bank of Oklahoma. The Fourth Amendment renews the \$7.0 Million Revolving Line of Credit ("Line of Credit") and extends the maturity date to November 30, 2010. The Fourth Amendment also extends the maturity of and increases the \$8.0 Million Term Loan Commitment to \$16.3 million.

The \$7.0 Million Line of Credit will continue to be used to finance our working capital requirements. The lesser of \$7.0 million or the total of 80% of the qualified accounts receivable, plus 50% of qualified inventory, less the outstanding balances under of the term loans identified in the agreement, is available to us under the revolving credit facility. The entire outstanding balance on the revolving credit facility is due on maturity.

The outstanding balance of the \$8.0 million Term Loan prior to being amended was \$4.3 million. The \$12.0 million of additional funds available under the amended \$16.3 million Term Loan were fully advanced at closing and the proceeds were used to redeem all of the issued and outstanding shares of our Series B 7% Cumulative Preferred Stock. These shares of preferred stock were beneficially held by David A. Chymiak, Chairman of the Company, and Kenneth A. Chymiak, President and Chief Executive Officer of the Company, and his spouse. The \$16.3 million Term Loan is payable over a 5 year period with quarterly payments beginning the last business day of February 2008 of approximately \$0.4 million plus accrued interest.

The Revolving Line of Credit and Term Loan Agreement also includes a Term Loan Commitment of \$2.8 million. This loan was secured to finance the purchase of the Company's headquarters facility located in Broken Arrow, Oklahoma on November 20, 2006. The \$2.8 million Term Loan matures over 15 years and payments are due monthly at \$15,334 plus accrued interest.

During the first nine months, we paid the scheduled accrued dividends of approximately \$0.3 million, representing the final dividends earned on the outstanding Series B 7% Cumulative Preferred Stock from October 1, 2007 to November 20, 2007, as well as other scheduled note payments totaling approximately \$1.0 million.

We believe that cash flow from operations, existing cash balances and our existing line of credit provide sufficient liquidity and capital resources to meet our working capital needs.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market risk represents the risk of loss that may impact our financial position, results of operations, or cash flow due to adverse changes in market prices, foreign currency exchange rates, and interest rates. We maintain no material assets that are subject to market risk and attempt to limit our exposure to market risk on material debts by entering into swap arrangements that effectively fix the interest rates. In addition, the Company has limited market risk associated with foreign currency exchange rates as all sales and purchases are denominated in U.S. dollars.

We are exposed to market risk related to changes in interest rates on our \$7.0 million Line of Credit and our \$2.8 million Term Loan. Borrowings under these obligations bear interest at rates indexed to the 30 day LIBOR rate, which exposes us to increased costs if interest rates rise. At June 30, 2008, the outstanding borrowings subject to variable interest rate fluctuations totaled \$4.2 million, and was as high as \$7.1 million and as low as \$2.5 million at different times during the year. A hypothetical 30% increase in the published LIBOR rate, causing our borrowing costs to increase, would not have a material impact on our financial results. We do not expect the LIBOR rate to fluctuate more than 30% in the next twelve months.

In addition to these debts, we have a \$16.3 million Term Loan which also bears interest at a rate indexed to the 30 day LIBOR rate. To mitigate the market risk associated with the floating interest rate, we entered into an interest rate swap on November 27, 2007, in an amount equivalent to the \$16.3 million Term Loan. Although the note bears interest at the prevailing 30-day LIBOR rate plus 1.4%, the swap effectively fixed the interest rate at 5.92%. The fair value of this derivative will increase or decrease opposite any future changes in interest rates.

Item 4T. 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, 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.

During the period covered by this report on Form 10-Q, there have been no changes in our internal controls 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 Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to 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. |

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.

ADVANTAGE TECHNOLOGIES GROUP, INC.
(Registrant)

Date: August 13, 2008

/s/ Kenneth A. Chymiak
Kenneth A. Chymiak
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 13, 2008

/s/ Daniel E. O'Keefe
Daniel E. O'Keefe
Chief Financial Officer
(Principal Financial Officer)

Exhibit Index

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

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