

UNIVERSAL SECURITY INSTRUMENTS INC  
Form 10-Q  
August 16, 2013

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the Quarterly period ended June 30, 2013

OR

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

**Commission file number 001-31747**

**UNIVERSAL SECURITY INSTRUMENTS, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**11407 Cronhill Drive, Suite A  
Owings Mills, Maryland**

**52-0898545**  
(I.R.S. Employer  
Identification No.)

**21117**

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(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(410)  
363-3000**

Inapplicable

(Former name, former address and former fiscal year if changed from last report.)

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

Indicate by check mark whether the registrant 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 if 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. 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

At August 6, 2013, the number of shares outstanding of the registrant's common stock was 2,287,887.

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**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	(Unaudited) June 30, 2013	March 31, 2013 (As revised)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,488,034	\$ 2,438,892
Accounts receivable:		
Trade less allowance for doubtful accounts of approximately \$57,000 at June 30, 2013 and March 31, 2013	189,627	153,175
Receivable from employees	65,150	65,375
Receivable from Hong Kong Joint Venture	640,669	419,219
	895,446	637,769
Amount due from factor	1,985,218	2,281,662
Inventories, net of allowance for obsolete inventory of \$70,000 at June 30, 2013 and March 31, 2013	5,002,976	4,341,652
Prepaid expenses	637,207	598,686
<b>TOTAL CURRENT ASSETS</b>	<b>10,008,881</b>	<b>10,298,661</b>
DEFERRED TAX ASSET	2,479,901	2,310,835
INVESTMENT IN HONG KONG JOINT VENTURE	14,998,034	14,906,573
PROPERTY AND EQUIPMENT – NET	143,179	152,201
INTANGIBLE ASSET – NET	79,373	80,491
OTHER ASSETS	38,134	38,134
<b>TOTAL ASSETS</b>	<b>\$ 27,747,502</b>	<b>\$ 27,786,895</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 586,688	\$ 548,388
Accounts payable to Hong Kong Joint Venture	137,283	-
Accrued liabilities:		
Payroll and employee benefits	94,478	103,890

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Commissions and other	48,024	75,712
<b>TOTAL CURRENT LIABILITIES</b>	<b>866,473</b>	<b>727,990</b>
Long-term obligation – other	25,000	25,000
<b>COMMITMENTS AND CONTINGENCIES</b>	<b>-</b>	<b>-</b>
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, \$.01 par value per share; authorized 20,000,000 shares; 2,287,887 shares issued and outstanding at June 30, 2013 and March 31, 2013, respectively	22,879	22,879
Additional paid-in capital	12,771,490	12,749,256
Retained earnings	12,865,830	12,885,360
Accumulated other comprehensive income	1,195,830	1,376,410
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>26,856,029</b>	<b>27,033,905</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 27,747,502</b>	<b>\$ 27,786,895</b>

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

**UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	Three Months Ended	
	June 30,	
	2013	2012
Net sales	\$3,005,669	\$3,059,352
Cost of goods sold – acquired from Joint Venture	2,157,412	1,981,585
Cost of goods sold – other	98,933	99,422
<b>GROSS PROFIT</b>	<b>749,324</b>	<b>978,345</b>
Research and development expense	126,636	126,146
Selling, general and administrative expense	1,089,744	1,359,924
Operating loss	(467,056 )	(507,725 )
Other income:		
Investment and interest income	6,419	9,647
<b>LOSS BEFORE EQUITY IN EARNINGS OF JOINT VENTURE</b>	<b>(460,637 )</b>	<b>(498,078 )</b>
Equity in earnings (loss) of Hong Kong Joint Venture	272,041	(46,254 )
Loss from operations before income taxes	(188,596 )	(544,332 )
Income tax benefit	169,066	181,744
<b>NET LOSS</b>	<b>\$(19,530 )</b>	<b>\$(362,588 )</b>
Loss per share:		
Basic	(0.01 )	(0.16 )
Diluted	(0.01 )	(0.16 )
Shares used in computing net loss per share:		
Basic	2,287,887	2,326,662
Diluted	2,287,887	2,326,662

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



**UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF**

**COMPREHENSIVE LOSS**

**(Unaudited)**

	Three Months Ended	
	June 30,	
	2013	2012
NET LOSS	\$(19,530 )	\$(362,588)
Other Comprehensive Income (Loss)		
Company's portion of Hong Kong Joint Venture's:		
Currency translation	(6,485 )	210,310
Investment securities	(174,095)	24,812
COMPREHENSIVE LOSS	\$(200,110)	\$(127,466)

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



**UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three Months Ended June 30,	
	2013	2012
<b>OPERATING ACTIVITIES</b>		
Net Loss	\$(19,530 )	\$(362,588 )
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in deferred taxes	(169,066 )	(151,620 )
Depreciation and amortization	10,140	13,738
Stock based compensation	22,234	-
(Earnings) Loss of the Hong Kong Joint Venture	(272,041 )	46,254
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable and amounts due from factor	38,767	(53,802 )
Increase in inventories and prepaid expenses	(669,727 )	(170,472 )
Decrease in accounts payable and accrued expenses	108,365	360,529
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(950,858 )</b>	<b>(317,961 )</b>
<b>INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	-	(8,704 )
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>-</b>	<b>(8,704 )</b>
<b>FINANCING ACTIVITIES</b>		
Repurchase of common stock	-	(40,087 )
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>-</b>	<b>(40,087 )</b>
Cash at beginning of period	2,438,892	3,186,274
<b>CASH AT END OF PERIOD</b>	<b>\$1,488,034</b>	<b>\$2,819,522</b>
Supplemental information:		
Interest paid	-	-
Income taxes	-	-

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



**UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Statement of Management**

The condensed consolidated financial statements include the accounts of Universal Security Instruments, Inc. (USI or the Company) and its majority owned subsidiaries. Except for the consolidated balance sheet as of March 31, 2013, which was derived from audited financial statements (as revised), the accompanying condensed consolidated financial statements are unaudited. Significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim condensed consolidated financial statements include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. The interim condensed consolidated financial statements should be read in conjunction with the Company's March 31, 2013 audited financial statements filed with the Securities and Exchange Commission on Form 10-K. The interim operating results are not necessarily indicative of the operating results for the full fiscal year.

**Use of Estimates**

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (US-GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

**Joint Venture**

The Company and its co-venturer, a Hong Kong corporation, each owns a 50% interest in a Hong Kong joint venture, Eyston Company Limited (the "Hong Kong Joint Venture"), that manufactures security products in its facilities located in the People's Republic of China. The following represents summarized balance sheet and income statement information of the Hong Kong Joint Venture as of and for the three months ended June 30, 2013 and 2012:

	2013	2012
Net sales	\$6,250,349	\$5,398,549
Gross profit	1,810,813	1,331,734
Net income	527,078	166,819
Total current assets	13,579,390	14,248,158
Total assets	34,993,836	33,001,260
Total current liabilities	4,930,630	4,112,479

During the three months ended June 30, 2013 and 2012 the Company purchased \$2,138,627 and \$2,544,466, respectively, of products directly from the Hong Kong Joint Venture for resale. For the three month period ended June 30, 2013 and 2012 the Company has adjusted its earnings of the Joint Venture to reflect an increase of \$56,973 and \$129,663, respectively, to eliminate inter-Company profit on purchases held by the Company in inventory.

### **Income Taxes**

We calculate our interim tax provision in accordance with the guidance for accounting for income taxes in interim periods. At the end of each interim period, we estimate the annual effective tax rate and apply that tax rate to our ordinary quarterly pre-tax income. The tax expense or benefit related to discrete events during the interim period is recognized in the interim period in which those events occurred. In addition, the effect of changes in enacted tax laws or rates or tax status is recognized in the interim period in which the change occurs.

The Company recognizes a liability or asset for the deferred tax consequences of temporary differences between the tax basis of assets or liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. The deferred tax assets are reviewed periodically for recoverability and valuation allowances are provided whenever it is more likely than not that a deferred tax asset will not be realized. Accordingly, the Company established a valuation allowance of \$300,000 on its deferred tax asset during the year ended March 31, 2013 to recognize that certain foreign tax credits expiring over the next two fiscal years will likely not be realized. . Our ability to realize the remaining deferred tax assets depends primarily upon the generation of sufficient future taxable income to allow for the utilization of our deductible temporary differences and tax planning strategies. If such estimates or assumptions change in the future, we may be required to record valuation allowances against some or all of the deferred tax assets resulting in additional income tax expense in our consolidated statement of operations. As of June 30, 2013, we believe that it is more likely than not that we will realize the benefit of our remaining deferred tax assets.

The Company follows ASC 740-10 that gives guidance to tax positions related to the recognition and measurement of a tax position taken or expected to be taken in a tax return and requires that we recognize in our financial statements the impact of a tax position, if that position is more likely than not to be sustained upon an examination, based on the technical merits of the position. Interest and penalties related to income tax matters are recorded as income tax expenses. The Company has recorded a long-term liability of \$25,000 for an uncertain income tax position, tax penalties and any imputed interest thereon

### **Financing Receivables**

Management considers amounts due from the Company's factor to be "financing receivables". Trade accounts receivable, other receivables, and receivables from our Hong Kong Joint Venture are not considered by management to be financing receivables.

The Company assigns the majority of its short-term receivables arising in the ordinary course of business to our factor. At the time a receivable is assigned to our factor the credit risk associated with the credit worthiness of the debtor is assumed by the factor. The Company continues to bear any credit risk associated with delivery or warranty issues related to the products sold.

Management assesses the credit risk of both its trade accounts receivable and its financing receivables based on the specific identification of accounts that have exceeded credit terms. An allowance for uncollectible receivables is provided based on that assessment. Changes in the allowance account from one accounting period to the next are charged to operations in the period the change is determined. Amounts ultimately determined to be uncollectible are eliminated from the receivable accounts and from the allowance account in the period that the receivables' status is determined to be uncollectible.

Based on the nature of the factoring agreement and prior experience, no allowance for uncollectible financing receivables has been provided. At June 30, 2013 and 2012, an allowance of approximately \$57,000 and \$75,000 respectively has been provided for uncollectible trade accounts receivable.

### **Net Income per Common Share**

Basic earnings per common share are computed based on the weighted average number of common shares outstanding during the periods presented. Diluted earnings per common share is computed based on the weighted average number of common shares outstanding plus the effect of stock options and other potentially dilutive common stock equivalents. The dilutive effect of stock options and other potentially dilutive common stock equivalents is determined using the treasury stock method based on the Company's average stock price.

Diluted income per common share for the three months ended June 30, 2013 and 2012 excludes 97,000 shares issuable upon the exercise of outstanding "out-of-the-money" stock options and 25,000 shares issuable upon the exercise of "in-the-money" stock options as their impact on our net loss is anti-dilutive. As a result, basic and diluted weighted average common shares outstanding are identical for the three month periods ended June 30, 2013 and 2012.

A reconciliation of the weighted average shares of common stock utilized in the computation of basic and diluted earnings per share for the three month periods ended June 30, 2013 and 2012, is as follows:

	Three Months Ended June 30,	
	2013	2012
Weighted average number of common shares outstanding for basic EPS	2,287,887	2,326,662
Shares issued upon the assumed exercise of outstanding stock options	-	-
Weighted average number of common and common equivalent shares outstanding for diluted EPS	2,287,887	2,326,662

### Shareholders' Equity

*Stock Options.* In October 2011, the shareholders approved the Company's 2011 Non-Qualified Stock Option Plan (the "Plan"). Under the terms of the Plan, 120,000 shares are reserved for the granting of stock options, of which 97,000 have been issued as of June 30, 2013. Under the provisions of the Plan, a committee of the Board of Directors determines the option price and the dates exercisable. During December 2011, ninety-seven thousand (97,000) options were granted at an option price of \$5.51 per share. The grant date fair value of the options approximated \$171,000. Fifty percent of the options vest one year after issuance, with the remaining fifty percent vesting twenty-three months after issuance. The fair value of each stock option was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions; no annual dividends, expected volatility of 57.7%, risk-free interest rate of 0.3% and expected lives of two years used for options granted during the fiscal year ended March 31, 2012.

In addition, in March 2009, 25,000 options were granted at \$3.25 for restricted shares of the Company's common stock. These options are fully vested with a right to exercise until March 2014.

For the period ended June 30, 2013, we recorded \$22,234 of stock-based compensation cost as general and administrative expense in our statement of operations. No forfeitures have been estimated. As of June 30, 2013, the unrecognized compensation cost related to share-based compensation arrangements that we expect to vest is \$33,350 that will be recognized over the remaining period of five months as the options vest. The aggregate intrinsic value of currently exercisable options was approximately \$46,000 at June 30, 2013.

### Contingencies

From time to time, the Company is involved in various lawsuits and legal matters. It is the opinion of management, based on the advice of legal counsel, that the ultimate outcome of these matters will not have a material adverse effect on the Company's financial statements.

### **Recent Accounting Pronouncements Not Yet Adopted**

Changes to U.S. GAAP are established by the Financial Accounting Standards Board (FASB) in the form of accounting standards updated (ASU's) to the FASB's Accounting Standards Codification.

The Company considers the applicability and impact of all ASU's. Recently issued ASU's were evaluated and determined to be either not applicable or are not expected to have a material impact on our consolidated financial statements.

### **Revision of Prior Period Financial Statements**

Certain amounts appearing in the condensed consolidated balance sheet as of March 31, 2013 have been revised to correct for an immaterial error and to conform to the current year's presentation. The Company had not previously recorded its proportionate share of the Hong Kong Joint Ventures other comprehensive income amounts. These consisted of the impact of foreign currency exchange rates on the translation of certain subsidiaries of the Hong Kong Joint Venture and changes in the fair value of investments held by the Hong Kong Joint Venture that are classified as available for sale. As a result, the Company adjusted the opening balance sheet of the earliest year presented, increasing its investment in the Hong Kong Joint Venture and accumulated other comprehensive income by \$1,083,603 as of April 1, 2012. The adjustments also increased its previously reported investment in the Hong Kong Joint Venture and accumulated other comprehensive income as of March 31, 2013 by \$1,376,410. Since these two components represented the only components of other comprehensive income, the Company had not previously presented a Statement of Comprehensive Income (Loss). The Company has, in the accompanying Financial Statements, presented a separate condensed consolidated statement of comprehensive loss for the three months ended June 30, 2013 and 2012.



The two components of other comprehensive income noted above decreased comprehensive loss (previously reported as net loss) for the three months ended June 30, 2012 by \$235,122 to \$127,466. For the three months in the quarters ending September 30, 2012, December 31, 2012 and March 31, 2013 other comprehensive income (loss) was \$96,927, \$(27,798) and \$(11,443); which (decreased) or increased comprehensive loss or income (previously reported as net loss or income) for the quarters then ended. For the fiscal year ending March 31, 2013 other comprehensive income was \$292,807, which decreased comprehensive loss of \$452,561 (previously reported as a net loss) to \$159,754.

The Company assessed the materiality of the error in accordance with the Securities and Exchange Commission (the SEC) Staff Accounting Bulletin Nos. 99 and 108 (SAB 99 and 108), and based on an analysis of quantitative and qualitative factors, determined that the error was immaterial to each of the prior reporting periods affected and, therefore, amendment of reports previously filed with the SEC was not required.

	Currency Translation	Investment Securities	Total
Balance – March 31, 2013	\$ 1,173,297	\$ 203,113	\$ 1,376,410
Other comprehensive loss	\$(6,485 )	\$(174,095 )	\$(180,580 )
Balance – June 30, 2013	\$ 1,166,812	\$ 29,018	\$ 1,195,830

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

As used throughout this Report, “we,” “our,” “the Company” “USI” and similar words refers to Universal Security Instruments, Inc.

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains certain forward-looking statements reflecting our current expectations with respect to our operations, performance, financial condition, and other developments. These forward-looking statements may generally be identified by the use of the words “may”, “will”, “believes”, “should”, “expects”, “anticipates”, “estimates”, and similar expressions. These statements are necessarily estimates reflecting management’s best judgment based upon current information and involve a number of risks and uncertainties. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and readers are advised that various factors could affect our financial performance and could cause our actual results for future periods to differ materially from those anticipated or projected. While it is impossible to identify all such factors, such factors include, but are not limited to, those risks identified in our periodic reports filed with the Securities and Exchange Commission, including our most recent Annual Report on Form 10-K.

**overview**

We are in the business of marketing and distributing safety and security products which are primarily manufactured by our 50%-owned Hong Kong Joint Venture. Our financial statements detail our sales and other operational results only, and report the financial results of the Hong Kong Joint Venture using the equity method. Accordingly, the following discussion and analysis of the three month periods ended June 30, 2013 and 2012 relate to the operational results of the Company. A discussion and analysis of the Hong Kong Joint Venture’s operational results for these periods is presented below under the heading “Joint Venture.”

The Company has developed new products based on new smoke and gas detection technologies, with what the Company believes are improved sensing technology and product features. To date we have applied for thirteen patents on these new technologies and features and have been granted ten patents (including six for the new technologies and features), and we are currently awaiting notification from the U.S. Patent Office regarding the three remaining patent applications. Most of our new technologies and features have been trademarked under the trade name IoPhic®

## Results of Operations

### Three Months Ended June 30, 2013 and 2012

*Sales.* Net sales for the three months ended June 30, 2013 were \$3,005,669 compared to \$3,059,352 for the comparable three months in the prior fiscal year, a decrease of \$53,683 (1.8%). The primary reason for the decrease in net sales volumes is the timing of orders received from customers.

*Gross Profit Margin.* Gross profit margin is calculated as net sales less cost of goods sold expressed as a percentage of net sales. Our gross profit margin was 24.9% and 32.0% of sales for the quarters ended June 30, 2013 and 2012, respectively. The decrease in gross profit margin was primarily due to lower margins realized due to changes in the product mix during the periods presented.

*Expenses.* Research and development expenses were comparable to the three months in the prior year.

Selling, general and administrative expenses decreased by \$270,180 from the comparable three months in the prior year. The decrease in the dollar amount of these expenses was principally due to decreased expenditures associated with advertising and promotion of our next generation of products of approximately \$202,000. As a percentage of net sales, these expenses decreased to 36.3% for the three month period ended June 30, 2013 from 44.5% for the 2012 period. The decrease in costs as a percentage was primarily due to those items discussed above.

