UNIVERSAL SECURITY INSTRUMENTS INC
Form 10-Q
February 13, 2012

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 December 31, 2011

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

11407 Cronhill Drive, Suite A

Owings Mills, Maryland	21117
(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 x 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 x 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 x

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

At February 10, 2012, the number of shares outstanding of the registrant's common stock was 2,346,450.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	(unaudited) December 31, 2011	(audited) March 31, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 4,728,238	$ 6,728,593
Accounts receivable:		
Trade, less allowance for doubtful accounts of approximately $75,000 at December 31, 2011 and $90,000 at March 31, 2011	242,936	276,463
Notes receivable – employees	69,592	69,666
Receivable from Hong Kong Joint Venture	573,440	301,380
	885,968	647,509
Amount due from factor	1,314,522	1,569,126
Inventories, net of allowance for obsolete inventory of $70,000 at December 31, 2011 and $100,000 at March 31, 2011	4,928,140	3,534,011
Prepaid expenses	481,429	519,356
TOTAL CURRENT ASSETS	12,338,297	12,998,595
DEFERRED TAX ASSET	2,154,767	2,002,561
INVESTMENT IN HONG KONG JOINT VENTURE	13,256,930	13,149,614
PROPERTY AND EQUIPMENT – NET	177,755	203,440
INTANGIBLE ASSET – NET	86,079	89,434
OTHER ASSETS	40,134	40,134
TOTAL ASSETS	$ 28,053,962	$ 28,483,778
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 683,743	$ 794,014
Hong Kong Joint Venture accounts payable	539,291	453,480
Accrued liabilities:		
Payroll and employee benefits	122,965	177,298
Commissions and other	30,975	33,700
TOTAL CURRENT LIABILITIES	1,376,974	1,458,492

Long-term obligation	25,000	25,000
COMMITMENTS AND CONTINGENCIES	-	-
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value per share; authorized 20,000,000 shares; issued and outstanding, 2,366,848 shares at December 31, 2011 and 2,387,887 shares at March 31, 2011	23,668	23,879
Additional paid-in capital	13,029,245	13,135,198
Retained earnings	13,599,075	13,841,209
TOTAL SHAREHOLDERS' EQUITY	26,651,988	27,000,286
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 28,053,962	$ 28,483,778

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

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UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended December 31, 2011	2010
Net sales	$ 3,186,197	$ 2,475,511
Cost of goods sold – acquired from Joint Venture	2,213,232	1,723,931
Cost of goods sold – other	154,438	-
GROSS PROFIT	818,527	751,580
Selling, general and administrative expense	1,035,531	1,061,936
Research and development expense	139,332	181,986
Operating loss	(356,336)	(492,342)
Other income:		
Interest income	22,668	63,219
LOSS BEFORE EQUITY IN EARNINGS OF JOINT VENTURE	(333,668)	(429,123)
Equity in earnings of Joint Venture	284,440	373,322
Loss from operations before income taxes	(49,228)	(55,801)
Income tax benefit	116,454	75,346
NET INCOME	$ 67,226	$ 19,545
Income per share:		
Basic	0.03	0.01
Diluted	0.03	0.01
Shares used in computing net income per share:		
Basic	2,377,211	2,387,887
Diluted	2,383,093	2,395,865

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Nine Months Ended December 31, 2011	2010
Net sales	$ 9,695,013	$ 9,871,310
Cost of goods sold – acquired from Joint Venture	6,422,979	5,818,014
Cost of goods sold – other	579,910	1,126,330
GROSS PROFIT	2,692,124	2,926,966
Selling, general and administrative expense	3,219,764	3,348,699
Research and development expense	433,857	503,519
Operating loss	(961,497)	(925,252)
Other income (expense):		
Interest income	43,683	173,271
Interest expense	-	(4,179)
LOSS BEFORE EQUITY IN EARNINGS OF JOINT VENTURE	(917,814)	(756,160)
Equity in earnings of Joint Venture	526,114	1,225,326
(Loss) income from operations before income taxes	(391,700)	469,166
Income tax benefit	149,566	100,622
NET (LOSS) INCOME	$ (242,134)	$ 569,788
(Loss) income per share:		
Basic	(0.10)	0.24
Diluted	(0.10)	0.24
Shares used in computing net income per share:		
Basic	2,384,315	2,387,887
Diluted	2,384,315	2,395,341

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine months ended December 31, 2011	2010
OPERATING ACTIVITIES		
Net (loss) income	$(242,134)	$569,788
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,100	43,428
Earnings of the Joint Venture	(526,114)	(1,225,326)
Investment earnings	-	(173,271)
Stock based compensation	3,706	-
Changes in operating assets and liabilities:		
Decrease in accounts receivable and amounts due from factor	16,145	2,881,769
Increase in inventories and prepaid expenses	(1,356,202)	(172,510)
Increase in accounts payable and accrued expenses	(81,518)	(1,381,854)
Increase in deferred taxes and other assets	(152,206)	(113,806)
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(2,305,223)	428,218
INVESTING ACTIVITIES:		
Purchase of assets held for sale	-	(3,449,359)
Proceeds from sale of assets held for investment	-	7,451,249
Investment earnings	-	173,271
Dividends received from Joint Venture	418,798	473,765
Purchase of property and equipment	(4,060)	(33,528)
NET CASH PROVIDED BY INVESTING ACTIVITIES	414,738	4,615,398
FINANCING ACTIVITIES		
Repurchase of common stock	(109,870)	-
NET CASH (USED BY) FINANCING ACTIVITIES	(109,870)	-
NET (DECREASE) INCREASE IN CASH	(2,000,355)	5,043,616
Cash at beginning of period	6,728,593	2,253,631
CASH AT END OF PERIOD	$4,728,238	$7,297,247
Supplemental information:		
Interest paid	$-	$4,179

The accompanying notes are an integral part of these 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. Significant intercompany 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, 2011 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 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 "Joint Venture"), that has manufacturing facilities in the People's Republic of China, for the manufacturing of security products. The following represents summarized balance sheet and income statement information of the Joint Venture as of and for the nine months ended December 31, 2011 and 2010:

	2011	2010

Net sales	$17,441,872	$19,391,269
Gross profit	4,238,962	5,495,467
Net income	1,384,839	2,537,991
Total current assets	15,019,874	13,042,670
Total assets	32,609,488	31,890,519
Total current liabilities	4,209,137	4,730,928

During the nine months ended December 31, 2011 and 2010, respectively, the Company purchased $7,231,925 and $5,818,014 of products from the Joint Venture. For the nine month period ended December 31, 2011 and 2010, the Company has adjusted its earnings of the Joint Venture to reflect a decrease of $158,494 and an increase of $35,867, respectively, for changes to Inter-Company profit 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 significant, unusual or extraordinary 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. The Company follows the financial pronouncement that gives guidance 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.

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 sells the majority of its short-term receivables arising in the ordinary course of business to our factor. At the time a receivable is sold 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 December 31, 2011, an allowance of $75,000 has been provided for estimated 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 and nine months ended December 31, 2011 excludes 97,000 of outstanding "out-of-the-money" stock options. Diluted income per common share for the nine months ended December 31, 2011 excludes 25,000 "in-the-money" stock options, as their effect is anti-dilutive. As a result, the weighted average number of common shares outstanding is identical for both basic and diluted income per share for the nine months ended December 31, 2011.

A reconciliation of the weighted average shares of common stock utilized in the computation of basic and diluted earnings per share for the three and nine month periods ended December 31, 2011 and 2010 is as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Weighted average number of common shares outstanding for basic EPS	2,377,211	2,387,887	2,384,315	2,387,887
Shares issued upon the assumed exercise of outstanding stock options	5,882	7,978	0	7,454
Weighted average number of common and common equivalent shares outstanding for diluted EPS	2,383,093	2,395,865	2,384,315	2,395,341

Shareholders' Equity

Stock Repurchase Program. In October 2011, the Company announced a stock buyback program and authorized the purchase of up to 100,000 shares of common stock. Shares may be purchased from time to time under this program in the open market, through block trades and/or in negotiated transactions.

From inception through December 31, 2011, a total of 21,039 shares were repurchased at an average price of $5.22 per share.

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 December 31, 2011. 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 fair value of the options granted is approximately $171,000 at December 31, 2011. 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 is 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 in fiscal 2011.

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 December 31, 2011, we recorded $3,706 of stock-based compensation cost as general and administrative expense in our statement of operations. No forfeitures have been estimated.

As of December 31, 2011, the unrecognized compensation cost related to share-based compensation arrangements that we expect to vest is $166,752 that will be recognized over a period of twenty-three months as the options vest. The aggregate intrinsic value of currently exercisable options was $0 at December 31, 2011.

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 accounting principles generally accepted in the United States of America (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.

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 through 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 and nine month periods ended December 31, 2011 and 2010 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. The Company has applied for patents for these new products. Before these products can be sold, independent testing agencies