

UNIVERSAL SECURITY INSTRUMENTS INC  
Form 10-Q  
February 18, 2016

**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, 2015

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

**52-0898545**  
(I.R.S. Employer

incorporation or organization) 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 16, 2016, the number of shares outstanding of the registrant's common stock was 2,312,887.



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

	(unaudited) December 31, 2015	(audited) March 31, 2015
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 227,138	\$ 49,427
Funds held by factor	-	631,906
Accounts receivable:		
Trade, less allowance for doubtful accounts	202,566	381,254
Receivables from employees	60,610	53,990
Receivable from Hong Kong Joint Venture	96,516	135,768
	359,692	571,012
Amount due from factor	2,580,354	1,217,311
Inventories – finished goods	4,597,465	3,852,182
Prepaid expenses	212,519	438,745
<b>TOTAL CURRENT ASSETS</b>	<b>7,977,168</b>	<b>6,760,583</b>
INVESTMENT IN HONG KONG JOINT VENTURE	12,082,513	12,943,280
PROPERTY AND EQUIPMENT – NET	79,821	104,618
INTANGIBLE ASSET - NET	68,193	71,547
OTHER ASSETS	6,000	26,000
<b>TOTAL ASSETS</b>	<b>\$ 20,213,695</b>	<b>\$ 19,906,028</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Line of credit - factor	\$ 1,628,214	\$ -
Accounts payable	423,229	668,846
Accounts payable - Hong Kong Joint Venture	876,524	299,985
Accrued liabilities:		
Payroll and employee benefits	100,261	69,180

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Commissions and other	197,798	111,020
<b>TOTAL CURRENT LIABILITIES</b>	<b>3,226,026</b>	<b>1,149,031</b>
<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; 2,312,887 shares issued and outstanding at December 31, 2015 and March 31, 2015, respectively	23,129	23,129
Additional paid-in capital	12,885,841	12,885,841
Retained earnings	3,225,780	4,588,332
Accumulated other comprehensive income	852,919	1,259,695
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>16,987,669</b>	<b>18,756,997</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 20,213,695</b>	<b>\$ 19,906,028</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 December 31,	
	2015	2014
Net sales	\$ 4,112,908	\$ 2,371,016
Cost of goods sold – acquired from Joint Venture	2,727,122	1,726,909
Cost of goods sold – other	77,418	261,772
<b>GROSS PROFIT</b>	<b>1,308,368</b>	<b>382,335</b>
Research and development expense	147,640	150,651
Selling, general and administrative expense	1,141,668	992,284
Operating income (loss)	19,060	(760,600 )
Other (expense) income:		
Loss from investment in Hong Kong Joint Venture	(186,097 )	(346,730 )
Interest (expense) income	(7,135 )	5,958
<b>NET LOSS</b>	<b>\$ (174,172 )</b>	<b>\$ (1,101,372 )</b>
Loss per share:		
Basic and diluted	(0.08 )	(0.48 )
Shares used in computing net loss per share:		
Weighted average basic and diluted shares outstanding	2,312,887	2,312,887

*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)**

	Nine Months Ended December 31,	
	2015	2014
Net sales	\$ 10,327,622	\$ 7,109,344
Cost of goods sold - acquired from Joint Venture	7,231,947	5,039,056
Cost of goods – other	220,224	582,949
<b>GROSS PROFIT</b>	<b>2,875,451</b>	<b>1,487,339</b>
Research and development expense	495,071	572,597
Selling, general and administrative expense	3,459,284	3,299,019
Operating loss	(1,078,904 )	(2,384,277 )
Other (expense) income:		
Loss from investment in Hong Kong Joint Venture	(263,530 )	(595,159 )
Interest (expense) income	(20,118 )	22,951
<b>NET LOSS</b>	<b>\$ (1,362,552 )</b>	<b>\$ (2,956,485 )</b>
Loss per share:		
Basic and diluted	(0.59 )	(1.28 )
Shares used in computing net loss per share:		
Weighted average basic and diluted shares outstanding	2,312,887	2,312,887

*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 Dec. 31,		Nine Months Ended Dec. 31,	
	2015	2014	2015	2014
NET LOSS	\$ (174,172 )	\$ (1,101,372 )	\$ (1,362,552 )	\$ (2,956,485 )
Other Comprehensive (Loss) Income:				
Company's portion of Hong Kong Joint Venture's other comprehensive (loss) income:				
Currency translation	(268,350 )	-	(268,350 )	(20,396 )
Unrealized (loss) gain on investment securities	(12,966 )	(2,843 )	(138,426 )	35,243
Total Other Comprehensive (Loss) Income	(281,316 )	(2,843 )	406,776 )	14,847
COMPREHENSIVE LOSS	\$ (455,488 )	\$ (1,104,215 )	\$ (1,769,328 )	\$ (2,941,638 )

*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)**

	Nine Months Ended December 31,	
	2015	2014
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (1,362,552 )	\$ (2,956,485 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	28,151	34,995
Loss from investment in Hong Kong Joint Venture	263,530	595,159
Changes in operating assets and liabilities:		
Decrease in funds held by Factor	631,906	-
(Increase) decrease in accounts receivable and amounts due from factor	(1,151,723 )	757,136
(Increase) decrease in inventories, prepaid expenses, and other	(499,057 )	658,774
Increase in accounts payable and accrued expenses	448,781	241,455
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(1,640,964 )</b>	<b>(668,966 )</b>
<b>INVESTING ACTIVITIES:</b>		
Cash distributions from Joint Venture	190,461	-
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>190,461</b>	<b>-</b>
<b>FINANCING ACTIVITIES:</b>		
Net proceeds from Line of Credit - Factor	1,628,214	-
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>1,628,214</b>	<b>-</b>
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>177,711</b>	<b>(668,966 )</b>
Cash at beginning of period	49,427	2,050,993
<b>CASH AT END OF PERIOD</b>	<b>\$ 227,138</b>	<b>\$ 1,382,027</b>
<b>SUPPLEMENTAL INFORMATION:</b>		
Interest paid	\$ 20,118	-
Income taxes paid	-	-

*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)**

**Basis of Presentation**

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 condensed consolidated balance sheet as of March 31, 2015, which was derived from audited financial statements, 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 accounting principles generally accepted in the United States of America (US-GAAP) have been condensed or omitted. The interim condensed consolidated financial statements should be read in conjunction with the Company's March 31, 2015 audited financial statements filed with the Securities and Exchange Commission (SEC) on Form 10-K filed on August 25, 2015. The interim operating results are not necessarily indicative of the operating results for the full fiscal year.

**Going Concern, Liquidity, and Management Plans**

The accompanying condensed consolidated financial statements have been prepared on the basis that the Company will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. Our history of operating losses, declining revenues in prior years, and limited financing options raises substantial doubt about our ability to continue as a going concern. The Company had net losses of \$1,362,552 for the nine months ended December 31, 2015, and \$3,704,985 and \$4,450,244 for the fiscal years ended March 31, 2015 and 2014, respectively. The Company is monitoring its liquidity and working capital position in light of continued operating losses, and decreases in its cash and working capital position over the past four fiscal years of operations. In addition to the expanded factoring agreement with Merchant Factors Corporation (Merchant) as discussed below, the Company has negotiated payment terms on its trade accounts payable to the Hong Kong Joint Venture. The payment terms on the trade accounts payable to the Hong Kong Joint Venture provide ninety day repayment terms on up to \$1,000,000 of purchases of the Company's new sealed product line. The Company also believes that its cash position can be improved by a combination of reductions in inventory and by lowering expenses. In addition, the Company is prepared to initiate changes in its operations, if needed, to reduce its operating costs while maintaining its current level of customer service. However, there are potential risks, including that the Company's revenues may not reach levels required to return to profitability, costs may exceed the Company's estimates, or the Company's working capital needs

may be greater than anticipated. Any of these factors may change the Company's expectation of cash usage in the remainder of the fiscal year ending March 31, 2016, and beyond, or may significantly affect the Company's level of liquidity. These financial statements do not include any adjustments that might result from the Company not being able to continue as a going concern.

### **Line of Credit – Factor**

On January 15, 2015, the Company entered into an expanded financing and discount factoring agreement with Merchant for the purpose of factoring the Company's trade accounts receivable and to provide financing secured by finished goods inventory. The agreement replaces the financing and factoring agreement with CIT which was terminated on the same date. In accordance with the provisions of the Discount Factoring Agreement with Merchant, the Company may take advances, recorded as a liability of the Company, equal to eighty percent (80%) of the uncollected non-recourse factored trade accounts receivable balance less applicable factoring commissions. Additionally, the Discount Factoring Agreement with Merchant enables the Company to borrow up to fifty percent (50%) of eligible inventories subject to a borrowing limitation on inventory of \$1,000,000. As of December 31, 2015, our borrowings under the Discount Factoring Agreement with Merchant totaled \$1,628,214 and the Company had remaining availability under the discount factoring agreement of approximately \$1,016,000. The cumulative balance of advances on factored trade accounts receivable and borrowing on inventories is secured by all of the Company's trade accounts receivable and inventories, are repaid periodically as collections are made by Merchant but are otherwise due upon demand, and bears interest at the prime commercial rate of interest, as published, plus two percent (Effective rate 5.50% at December 31, 2015). Advances under the factoring agreement are made at the sole discretion of Merchant, based on their assessment of the receivables, inventory and our financial condition at the time of each request for an advance.

## Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with 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.

## Revenue Recognition

We recognize sales upon shipment of products net of applicable provisions for any discounts or allowances. The shipping date from our warehouse is the appropriate point of revenue recognition since upon shipment we have substantially completed our obligations which entitle us to receive the benefits represented by the revenues, and the shipping date provides a consistent point within our control to measure revenue. Customers may not return, exchange or refuse acceptance of goods without our approval. The Company will also enter into contracts with a customer to grant pre-approved rights of return of up to fifty percent of products sold on certain invoices to provide for and gain acceptance within certain markets. In the event a pre-approved right of return is granted, revenue recognition is deferred until the right of return expires. We have established allowances to cover anticipated doubtful accounts based upon historical experience.

## Joint Venture

The Company and its joint venture partner, 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 nine months ended December 31, 2015 and 2014:

	2015	2014
	<u>(Unaudited)</u>	<u>(Unaudited)</u>
Net sales	\$ 15,002,160	\$ 12,508,403
Gross profit	2,779,556	1,989,858
Net loss	(359,513 )	(1,521,820 )

Total current assets	10,689,736	12,758,188
Total assets	29,543,358	32,804,224
Total current liabilities	5,079,527	6,025,207
Total liabilities	5,079,527	6,025,207

During the nine months ended December 31, 2015 and 2014, the Company purchased \$5,811,404 and \$4,844,335, respectively, of products directly from the Hong Kong Joint Venture for resale. For the nine month periods ended December 31, 2015 and 2014, the Company has adjusted its earnings of the Hong Kong Joint Venture to reflect an increase of \$41,317 and a decrease of \$165,751, 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 may 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 a valuation allowance is provided whenever it is more likely than not that a deferred tax asset will not be realized. The Company established a full valuation allowance on its deferred tax assets to recognize that net operating losses, and research and foreign tax credits expiring in future periods will likely not be realized. This determination was made based on continued taxable losses which cause uncertainty as to whether the Company will generate sufficient taxable income to use the deferred tax assets prior to expiration. Our ability to realize the tax benefits associated with the deferred tax assets depends primarily upon the timing of future taxable income and the expiration dates of the components of the deferred tax assets. If sufficient future taxable income is generated, we may be able to offset a portion of future tax expenses.

### **Accounts Receivable and Amount Due From Factor**

The Company assigns the majority of its short-term receivables arising in the ordinary course of business to our factor on a non-recourse basis. 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 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 related to Amounts Due from Factor has been provided. At December 31, 2015 and 2014, an allowance of approximately \$57,000 has been provided for uncollectible trade accounts receivable.

### **Net Loss 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. There were no potentially dilutive common stock equivalents outstanding during the three or nine month periods ended December 31, 2015 or 2014. As a result, basic and diluted weighted average common shares outstanding are identical for the three and nine month periods ended December 31, 2015 and 2014.

### **Contingencies**

The Company is involved in various claims and routine litigation matters. In the opinion of management, after consultation with legal counsel, the outcomes of such matters are not anticipated to have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows in future years.

### **Recent Accounting Pronouncements**

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-15, *Disclosure of Uncertainties about an Entities Ability to Continue as a Going Concern*, which is included in *Accounting Standards Codification (ASC) 205, Presentation of Financial Statements*. This update provides an explicit requirement for management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosure in certain circumstances. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The Company has elected to early adopt ASU 2014-15. (See previous section entitled Going Concern, Liquidity and Management Plans.)

**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 elsewhere in this report and listed under “Item 1A – Risk Factors” in our Annual Report on Form 10-K for the year ended March 31, 2015, as filed with the SEC on August 25, 2015.

**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 condensed consolidated 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 of accounting. Accordingly, the following discussion and analysis of the three and nine month periods ended December 31, 2015 and 2014 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. We have been granted ten patents (including six for the new technologies and features), and 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 December 31, 2015 and 2014**

*Sales.* Net sales for the three months ended December 31, 2015 were \$4,112,908 compared to \$2,371,016 for the comparable three months in the prior fiscal year, an increase of \$1,741,892 (73.5%). The primary reason for the increase in net sales volumes relates to the introduction and sales of the Company's new sealed product line and increased sales of carbon monoxide alarms during our third fiscal quarter.

*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 31.8% and 16.1% of sales for the quarters ended December 31, 2015 and 2014, respectively. The increase in gross profit margin was primarily due to the mix of products sold reflecting an increase in the sale of higher gross profit margin sealed battery products.

*Expenses.* Research and development expenses were \$147,640 for the three month period ended December 31, 2015 compared to \$150,651 for the comparable quarter of the prior year, a decrease of \$3,011 (2.0%). The primary reason for the decrease is the reduction of expenditures to independent testing facilities associated with the new sealed product line.

Selling, general and administrative expenses were \$1,141,668 at December 31, 2015, compared to \$992,284 for the comparable three months in the prior year. As a percentage of net sales, these expenses decreased to 27.8% for the three month period ended December 31, 2015, from 41.9% for the 2014 period. The decrease of these costs as a percentage of net sales was primarily due to higher net sales as compared to certain expenses that do not increase directly with increased sales.

*Interest Expense and Other.* Our net interest expense, was \$7,135 for the quarter ended December 31, 2015, compared to net interest income of \$5,958 for the quarter ended December 31, 2014 as a result of borrowings on the line of credit. Net interest expense or income is dependent upon amounts borrowed from the Factor netted against interest earned on balances maintained in an interest bearing account with our factor in the prior year.