UNIVERSAL SECURITY INSTRUMENTS INC
Form 10-Q
November 19, 2014

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 September 30, 2014

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	**52-0898545**
(State or other jurisdiction of incorporation or organization)	(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 November 14, 2014, 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. FINANCIAL STATEMENTS

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2014	March 31, 2014
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,788,927	$ 2,050,993
Accounts receivable:		
Trade less allowance for doubtful accounts	298,338	686,228
Receivable from employees	65,244	67,583
Receivable from Hong Kong Joint Venture	134,253	137,360
	497,835	891,171
Amount due from factor	1,122,482	1,397,951
Inventories	2,841,982	4,194,213
Prepaid expenses	382,137	406,012
TOTAL CURRENT ASSETS	7,633,363	8,940,340
INVESTMENT IN HONG KONG JOINT VENTURE	14,080,131	14,144,069
PROPERTY AND EQUIPMENT – NET	124,977	146,212
INTANGIBLE ASSET - NET	73,783	76,020
OTHER ASSETS	38,134	38,134
TOTAL ASSETS	$ 21,950,388	$ 23,344,775
LIABILITIES AND SHAREHOLDERS’ EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 778,295	$ 606,314
Due to Hong Kong Joint Venture	-	28,681
Accrued liabilities:		
Payroll and employee benefits	81,710	78,054
Commissions and other	210,540	72,512

TOTAL CURRENT LIABILITIES	1,070,545	785,561
Long-term obligation – other	25,000	25,000
COMMITMENTS AND CONTINGENCIES	-	-
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value per share; authorized 20,000,000 shares; 2,312,887 shares issued and outstanding at September 30, 2014 and March 31, 2014, respectively	23,129	23,129
Additional paid-in capital	12,885,841	12,885,841
Retained earnings	6,738,055	8,435,116
Accumulated other comprehensive income	1,207,818	1,190,128
TOTAL SHAREHOLDERS' EQUITY	20,854,843	22,534,214
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 21,950,388	$ 23,344,775

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 September 30, 2014	2013
Net sales	$ 2,223,943	$ 3,195,611
Cost of goods sold – acquired from Joint Venture	1,601,148	1,974,681
Cost of goods sold – other	129,279	411,775
GROSS PROFIT	493,516	809,155
Research and development expense	259,982	94,508
Selling, general and administrative expense	1,119,244	1,031,746
Operating loss	(885,710)	(317,099)
Other income:		
Interest income and other	9,348	5,403
LOSS BEFORE EQUITY IN EARNINGS OF JOINT VENTURE	(876,362)	(311,696)
Equity in (loss) earnings of Joint Venture	(77,850)	232,379
Loss from operations before income taxes	(954,212)	(79,317)
Provision for income tax expense	-	2,479,901
NET LOSS	$ (954,212)	$ (2,559,218)
Loss per share:		
Basic	(0.41)	(1.12)
Diluted	(0.41)	(1.12)
Shares used in computing net loss per share:		
Basic	2,312,887	2,287,887
Diluted	2,312,887	2,287,887

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)

	Six Months Ended September 30,	
	2014	2013
Net sales	$ 4,738,328	$ 6,201,280
Cost of goods sold - acquired from Joint Venture	3,312,147	4,132,093
Cost of goods – other	321,177	510,708
GROSS PROFIT	1,105,004	1,558,479
Research and development expense	421,946	221,144
Selling, general and administrative expense	2,306,735	2,121,490
Operating loss	(1,623,677)	(784,155)
Other income :		
Interest income and other	16,993	11,822
LOSS BEFORE EQUITY IN EARNINGS OF JOINT VENTURE	(1,606,684)	(772,333)
Equity in (loss) earnings of Joint Venture	(90,377)	504,420
Loss from operations before income taxes	(1,697,061)	(267,913)
Provision for income tax expense	-	2,310,835
NET LOSS	$ (1,697,061)	$ (2,578,748)
Loss per share:		
Basic	(0.73)	(1.13)
Diluted	(0.73)	(1.13)
Shares used in computing net loss per share:		
Basic	2,312,887	2,287,887
Diluted	2,312,887	2,287,887

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF

COMPREHENSIVE (LOSS) INCOME

(Unaudited)

	Three Months Ended Sept. 30,		Six Months Ended Sept. 30,	
	2014	2013	2014	2013
NET LOSS	$ (954,212)	$ (2,559,218)	$ (1,697,061)	$ (2,578,748)
Other Comprehensive Income (Loss)				
Company's portion of Hong Kong Joint Venture's other comprehensive income (loss):				
Currency translation	6,312	(8,485)	(20,396)	(15,330)
Investment securities	(27,490)	46,353	38,086	(127,742)
Total Comprehensive Income (Loss)	(21,178)	37,868	17,690	(143,072)
COMPREHENSIVE LOSS	$ (975,390)	$ (2,521,350)	$ (1,679,371)	$ (2,721,820)

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 CASH FLOWS

(Unaudited)

	Six Months Ended September 30, 2014	2013
OPERATING ACTIVITIES		
Net loss	$ (1,697,061)	$ (2,578,748)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Decrease in deferred taxes	-	2,310,835
Depreciation and amortization	23,472	20,319
Stock base compensation	-	44,468
Loss (earnings) of the Joint Venture	90,377	(504,420)
Changes in operating assets and liabilities:		
Decrease in accounts receivable and amounts due from factor	668,805	639,170
Decrease (Increase) in inventories and prepaid expenses	1,367,357	(1,465,059)
Increase (Decrease) in accounts payable and accrued expenses	284,984	(145,693)
NET CASH PROVIDED BY (USED) IN OPERATING ACTIVITIES	737,934	(1,679,128)
INVESTING ACTIVITIES:		
Purchase of property and equipment	-	-
Dividends received from Joint Venture	-	257,638
NET CASH PROVIDED BY INVESTING ACTIVITIES	-	257,638
NET INCREASE (DECREASE) IN CASH	737,934	(1,421,490)
Cash at beginning of period	2,050,993	2,438,892
CASH AT END OF PERIOD	$ 2,788,927	$ 1,017,402
SUPPLEMENTAL INFORMATION:		
Interest paid	-	-
Income taxes	-	-

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. Except for the condensed consolidated balance sheet as of March 31, 2014, 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 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, 2014 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 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 Joint Venture as of and for the six months ended September 30, 2014 and 2013:

	2014	2013
Net sales	$8,520,500	$12,762,882
Gross profit	1,841,037	3,681,014
Net (Loss) income	(494,854)	1,165,070
Total current assets	17,222,188	15,019,984
Total assets	34,811,711	35,206,745
Total current liabilities	7,084,981	4,925,122

During the six months ended September 30, 2014 and 2013 the Company purchased $2,424,356 and $4,326,557, respectively, of products directly from the Hong Kong Joint Venture for resale. For the six month periods ended September 30, 2014 and 2013 the Company has adjusted its earnings of the Joint Venture to reflect an increase of $165,799 and $145,041, 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 of approximately $2,311,000 on its deferred tax assets during the year ended March 31, 2014 to recognize that certain foreign tax credits expiring in future periods will likely not be realized. This determination was made based on continued taxable losses during fiscal 2014 that were not in line with projections, as well as product offering delays 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.

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.

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. 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 September 30, 2014 and 2013, an allowance of approximately $57,000 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 and six month periods ended September 30, 2013 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 and six month periods ended September 30, 2013. There were no potentially dilutive common stock equivalents outstanding during the three months ended September 30, 2014.

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Weighted average number of common shares outstanding for basic EPS	2,312,887	2,287,887	2,312,887	2,287,887
Shares issued upon the assumed exercise of outstanding stock options	-	-	-	-
Weighted average number of common and common equivalent shares outstanding for diluted EPS	2,312,887	2,287,887	2,312,887	2,287,887

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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 were issued. 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. These options expired December 14, 2013, with no forfeiture or exercise activity.

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 and were exercised in March 2014.

For the six month period ended September 30, 2013, we recorded $44,468 of stock-based compensation cost as general and administrative expense in our statement of operations.

Contingencies

From time to time, the Company is involved in various lawsuits and legal matters. It is the opinion of management, based on consultation with legal counsel, that material losses from litigation are not reasonably likely.

Recent Accounting Pronouncements Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers," which requires an entity to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. The new standard will replace most of the existing revenue recognition standards in U.S. GAAP when it becomes effective on January 1, 2017. Early adoption is not permitted. The new standard can be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of the change recognized at the date of the initial application. We are currently assessing the impact the adoption of ASU 2014-09 will have on our condensed consolidated financial position, results of operations and cash flows.

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

As used throughout this Report, "we," "our," "the Company&rdq