

UNIVERSAL SECURITY INSTRUMENTS INC
Form 10-Q
August 14, 2007

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

FORM 10-Q

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

For the Quarterly period ended June 30, 2007

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.)

7-A Gwynns Mill Court
Owings Mills, Maryland
(Address of principal executive offices)

21117
(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 if the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer Accelerated filer Non-Accelerated Filer

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 14, 2007, the number of shares outstanding of the registrant's common stock was 2,481,078.

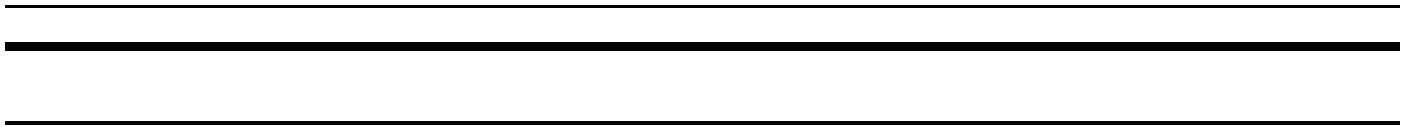


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PART I - FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

| | June 30, 2007 Unaudited | March 31, 2007 Audited |
|---|----------------------------|---------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 336,541 | \$ 240,545 |
| Accounts receivable: | | |
| Trade less allowance for doubtful accounts of \$15,000 | 3,204,500 | 2,555,895 |
| Employees | 18,650 | 22,073 |
| | 3,223,150 | 2,577,968 |
| Amount due from factor | 7,959,306 | 7,158,597 |
| Inventories, net of allowance for obsolete inventory of \$40,000 | 12,183,418 | 11,318,734 |
| Prepaid expenses | 349,192 | 237,666 |
| TOTAL CURRENT ASSETS | 24,051,607 | 21,533,510 |
| DEFERRED TAX ASSET | 810,933 | 808,566 |
| INVESTMENT IN JOINT VENTURE | 9,672,034 | 9,072,284 |
| PROPERTY AND EQUIPMENT - NET | 4,103,184 | 3,030,060 |
| GOODWILL | 1,890,304 | 1,732,562 |
| OTHER ASSETS | 15,486 | 18,486 |
| TOTAL ASSETS | \$ 40,543,548 | \$ 36,195,468 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Current portion of note payable - factor | \$ 3,687,379 | \$ 2,254,966 |
| Current portion of notes payable - other | 211,639 | 231,625 |
| Current portion of lease obligation | 92,084 | 74,394 |
| Accounts payable | 6,530,743 | 6,777,283 |
| Accrued liabilities: | | |
| Litigation reserve | 724,192 | 703,193 |
| Payroll and employee benefits | 737,695 | 622,083 |
| Commissions and other | 660,257 | 691,981 |
| TOTAL CURRENT LIABILITIES | 12,643,989 | 11,355,525 |
| LONG-TERM OBLIGATIONS: | | |
| Note payable - factor, net of current portion | 2,031,115 | - |
| Capital lease obligations, net of current portion | 131,086 | 168,062 |
| Long-term obligations | 86,000 | - |
| COMMITMENTS AND CONTINGENCIES | - | - |
| Minority interest | - | - |
| SHAREHOLDERS' EQUITY | | |
| Common stock, \$.01 par value per share; authorized 20,000,000 shares; issued and outstanding 2,481,078 and 2,475,612 shares at June 30, 2007 and March 31, 2007, respectively | 24,822 | 24,756 |

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| | | |
|--|---------------|---------------|
| Additional paid-in capital | 13,308,824 | 13,214,025 |
| Retained earnings | 12,142,554 | 11,545,304 |
| Other comprehensive income (loss) | 175,158 | (112,204) |
| TOTAL SHAREHOLDERS' EQUITY | 25,651,358 | 24,671,881 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 40,543,548 | \$ 36,195,468 |

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

| | Three Months Ended June 30, | |
|---|-----------------------------|---------------------|
| | 2007 | 2006 |
| Net sales | \$ 12,955,431 | \$ 8,038,437 |
| Cost of goods sold | 9,877,428 | 5,257,920 |
| GROSS PROFIT | 3,078,003 | 2,780,517 |
| Research and development expense | 69,890 | 52,312 |
| Selling, general and administrative expense | 2,254,692 | 1,846,813 |
| Loss on currency translation | (42,165) | - |
| Operating income | 711,256 | 881,392 |
| Other income (expense): | | |
| Interest income | - | 16,597 |
| Interest expense | (90,128) | (7,500) |
| INCOME BEFORE EARNINGS FROM AFFILIATES | 621,128 | 890,489 |
| Equity in earnings of Joint Venture | 599,750 | 1,052,979 |
| NET INCOME BEFORE TAXES and MINORITY INTEREST | 1,220,878 | 1,943,468 |
| Provision for income tax | 429,876 | 366,000 |
| NET INCOME BEFORE MINORITY INTEREST | 791,002 | 1,577,468 |
| Minority interest | - | - |
| NET INCOME | \$ 791,002 | \$ 1,577,468 |
| Net income per common share amounts: | | |
| Basic | \$ 0.32 | \$ 0.68 |
| Diluted | \$ 0.31 | \$ 0.62 |
| Weighted average number of common shares outstanding: | | |
| Basic | 2,479,979 | 2,309,601 |
| Diluted | 2,533,733 | 2,534,371 |

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

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

| | Three Months Ended June 30, | |
|---|-----------------------------|---------------------|
| | 2007 | 2006 |
| OPERATING ACTIVITIES | | |
| Net income | \$ 791,002 | \$ 1,577,468 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 76,345 | 3,212 |
| Earnings of the Joint Venture | (599,750) | (1,052,979) |
| Changes in operating assets and liabilities: | | |
| Increase in accounts receivable and amounts due from factor | (1,082,855) | (289,478) |
| Increase in inventories and prepaid expenses | (971,253) | (1,235,301) |
| Decrease in accounts payable and accrued expenses | (548,974) | (253,589) |
| Increase in deferred tax asset | (2,367) | - |
| NET CASH (USED IN) OPERATING ACTIVITIES | (2,337,852) | (1,250,667) |
| INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (1,149,469) | - |
| NET CASH (USED IN) INVESTING ACTIVITIES | (1,149,469) | - |
| FINANCING ACTIVITIES: | | |
| Tax benefit from exercise of stock options | 44,178 | 366,000 |
| Borrowings net of repayments from Commercial Bank | 3,463,528 | - |
| Payments of notes payable acquired in acquisition | (19,986) | - |
| Payments of lease obligation | (19,286) | - |
| Proceeds from issuance of common stock from exercise of employee stock options | 50,779 | 389,409 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 3,519,213 | 755,409 |
| Impact of foreign currency on cash | 64,104 | - |
| INCREASE (DECREASE) IN CASH | 95,996 | (459,258) |
| Cash at beginning of period | 240,545 | 3,015,491 |
| CASH AT END OF PERIOD | \$ 336,541 | \$ 2,520,233 |
| Supplemental information: | | |
| Interest paid | \$ 90,128 | \$ 17,941 |

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Statement of Management

The consolidated financial statements include the accounts of Universal Security Instruments, Inc. (USI or the Company) and its majority owned subsidiaries. Significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim 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 consolidated financial statements should be read in conjunction with the Company's March 31, 2007 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.

All share and per share amounts included in the consolidated financial statements have been retroactively adjusted to reflect a 4-for-3 stock dividend paid on October 16, 2006 to shareholders of record on September 25, 2006.

Acquisition

On October 2, 2006, 2113824 Ontario, Inc., a newly formed wholly owned subsidiary of the Company, acquired two-thirds of the issued and outstanding capital stock of International Conduits, Inc. (Icon) and Intube, Inc. (Intube). Icon and Intube are based in Toronto, Canada and manufacture and distribute electrical mechanical tubing (EMT) steel conduit. Icon also sells home safety products primarily purchased from USI. The purchase price for the capital stock of Icon and Intube was \$1,923,623 in cash. The primary purpose of the Icon and Intube acquisition was to expand our product offering and service the commercial construction market. On April 2, 2007, Icon and Intube were amalgamated (merged) under the laws of the Province of Ontario, Canada to form one corporation. All operations were continued under International Conduits, Inc. (Icon).

The acquisition described above was accounted for under the purchase method of accounting. Accordingly, the purchase price has been allocated to reflect the fair value of assets and liabilities acquired at the date of acquisition. The goodwill from the acquisition is fully allocated to the Company's Canadian operations.

The results of these acquisitions, had they been consummated at the beginning of each period shown, are included in the pro forma information below. This unaudited pro forma information does not necessarily reflect the results of operations that would have occurred had the acquisitions taken place at the beginning of each three month period and is not necessarily indicative of results that may be obtained in the future.

| | Three Months Ended June 30, | |
|-------------------------------------|--------------------------------|--------------|
| | 2007 | 2006 |
| Revenue | \$ 3,269,773 | \$ 4,422,475 |
| Net (loss) Income | (415,799) | 20,917 |
| (Loss)/Earnings per share (diluted) | (\$0.16) | \$ 0.01 |

Goodwill

Goodwill represents the excess of the purchase price above the fair value of the net assets acquired. Goodwill is evaluated for impairment annually or when events or circumstances occur indicating that goodwill might be impaired.

In accordance with FAS No. 142, "Goodwill and Other Intangible Assets," the evaluation is a two-step process that begins with an estimation of the fair value of the reporting units. The first step assesses potential impairment and the second step measures that impairment. The measurement of possible impairment is based on the comparison of the fair value of each reporting unit with the book value of its assets.

Income Taxes

A provision for federal and state income taxes of \$429,876 and \$366,000 has been provided for the three month period ended June 30, 2007 and 2006, respectively. For income tax purposes, this provision is reduced by a \$44,178 and \$366,000 benefit derived from deductions associated with the exercise of employee stock options for the three month periods ended June 30. Under FAS 123, the tax benefit of this deduction has been treated as a credit to additional paid in capital and will not require a cash payment for income taxes. For the three month period ended June 30, 2007, federal and state income taxes are \$388,469 and \$41,407, respectively.

On April 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 prescribes a recognition threshold that a tax position is required to meet before recognition in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues.

In connection with the adoption of FIN 48, the Company recorded a liability of approximately \$86,000 for income taxes, interest and penalties related to unrecognized tax benefits. Simultaneously, the Company recorded a reduction to retained earnings. With the adoption of FIN 48, the Company has chosen to treat interest and penalties related to uncertain tax liabilities as income tax expense.

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 three months ended June 30, 2007 and 2006:

| | 2007 | 2006 |
|---------------------------|--------------|------------|
| Net sales | \$ 8,961,882 | 9,043,990 |
| Gross profit | 2,338,140 | 3,387,793 |
| Net income | 1,080,789 | 2,244,414 |
| Total current assets | 13,793,083 | 11,706,237 |
| Total assets | 25,458,275 | 22,141,256 |
| Total current liabilities | 6,779,592 | 7,239,877 |

During the three months ended June 30, 2007 and 2006, respectively, the Company purchased \$6,271,324 and \$3,670,969 of products from the Joint Venture. At June 30, 2007 and March 31, 2006, the Company had amounts payable to the Joint Venture of \$250,000 and \$500,000, respectively. For the quarters ended June 30, 2007 and 2006, the Company has adjusted its equity in earnings of the Joint Venture to reflect a reduction of \$59,355 and \$69,228 for inter-company profit in inventory as required by US GAAP.

Foreign Currency Translation

The financial statements of the Company's foreign subsidiaries acquired in October 2006 have been translated into U.S. dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation" and SFAS No. 130, "Reporting Comprehensive Income." Translation adjustments are included in other comprehensive income. All balance sheet accounts of foreign subsidiaries are translated into U.S. dollars at the current exchange rate at the balance sheet date. Statement of operations items are translated at the average foreign currency exchange rates. The resulting foreign currency translation adjustment is recorded in accumulated other comprehensive income (loss). The Company has no other components of comprehensive income (loss). Gains and losses from foreign currency transactions are included in the consolidated statements of income. The Company maintains cash in foreign

banks to support its operations in Canada and Hong Kong.

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Capital Lease Obligation

The Company's Canadian subsidiary is party to capital lease agreements to lease equipment for various periods from 2007 through 2011. Minimum amounts payable for equipment leases for each of the next four years and in aggregate are as follows:

| | |
|------------------------------------|------------|
| 2008 | \$ 77,550 |
| 2009 | 103,368 |
| 2010 | 49,549 |
| 2011 | 24,750 |
| Total minimum lease payments | 255,217 |
| Less: amount representing interest | (32,047) |
| | 223,170 |
| Less: current portion | 92,084 |
| | \$ 131,086 |

Business Segments

The Company conducts its business through two operating segments based on geographic location.

Historically, the combined U.S. operations of the Company and its wholly-owned subsidiary, USI Electric, Inc., are operated from the Baltimore, Maryland and Naperville, Illinois offices, respectively, marketing a line of home safety devices such as smoke alarms, carbon monoxide alarms, and ground fault circuit interrupter (GFCI) devices to retail customers and to the electrical distribution trade.

The Company's Canadian operations consist of the operations of its majority-owned subsidiary, Icon, acquired by the Company in October 2006 and operated from offices in Toronto, Ontario, with sales in both Canada and the United States. The primary product line of the Canadian segment is EMT conduit sold to the electrical distribution trade. Icon also sells home safety devices purchased primarily from the Company.

USI had sales of EMT conduit of \$935,417 through its distribution network. Icon's sales of safety products during the quarter ended June 30, 2007 totaled \$108,449.

For the period ended June 30, 2007, no inter-company allocation of expenses has been made between the Company and Icon.

The following chart provides segmental information on the U.S. and Canadian operations of the Company for the three months ended June 30, 2007 (all figures are presented in U.S. dollars):

| | U.S. Operations | Canadian Operations |
|---|-----------------|---------------------|
| Net sales | \$ 10,449,343 | \$ 2,506,088 |
| Cost of sales | 7,734,009 | 2,143,419 |
| Gross profit | 2,715,334 | 362,669 |
| Selling, general and administrative, and research and development | 1,621,867 | 744,880 |
| Operating income (loss) | 1,093,467 | (382,211) |
| Equity in earnings of Joint Venture | 599,750 | - |
| Interest income (expense) | (58,497) | (31,631) |
| Net income (loss) before taxes | 1,634,720 | (413,842) |

| | | |
|--------------------------------------|-----------|-----------|
| Provision for income taxes (benefit) | 429,876 | - |
| Net income (loss) | 1,204,844 | (413,842) |

Net Income Per Common Share

Basic earnings per common share is 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.

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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 period ended June 30, 2007 and 2006 is as follows:

| | Three Months Ended June 30, | |
|--|-----------------------------|-----------|
| | 2007 | 2006 |
| Weighted average number of common shares outstanding for basic EPS | 2,479,979 | 2,309,601 |
| Shares issued upon the assumed exercise of outstanding stock options | 53,754 | 224,770 |
| Weighted average number of common and common equivalent shares outstanding for diluted EPS | 2,533,733 | 2,534,371 |

At June 30, 2007 and 2006, there were no securities outstanding whose issuance would have an anti-dilutive effect on the earnings per share calculation.

Credit Facility

In June 2007, Icon entered into a credit agreement with CIT Financial, Ltd. to provide a term loan and a line of credit facility.

The term loan in the amount of US\$3,000,000 is repayable in thirty-six (36) equal monthly principal installments of US\$83,333 plus interest at the Canadian prime rate plus .25% (6.0% at June 30, 2007). The loan is collateralized by all of the assets of Icon and by the corporate guarantees of the Company. The balance outstanding at June 30, 2007 is US \$3,031,116.

The line of credit facility is in the maximum amount of US\$7,000,000, with borrowings based on specified percentages of accounts receivable and inventory of Icon. Amounts borrowed under the facility bear interest at the Canadian prime rate plus .25% (6.0% at June 30, 2007) and are payable with interest upon demand. The facility is collateralized by all of the assets of Icon and by the corporate guarantee of the Company. The balance outstanding at June 30, 2007 is US\$1,654,967.

Notes Payable - Other

Notes payable - other consists of three notes payable to former stockholders of Icon, the Company's majority-owned subsidiary. The notes are payable in three remaining monthly installments of principal and interest totaling \$15,343, with a balloon payment in October 2007 of \$180,789. The notes are non-collateralized, bear interest at 4.0%, and are guaranteed by the Company.

Stock Based Compensation

As of June 30, 2007, under the terms of the Company's Non-Qualified Stock Option Plan, as amended, 877,777 shares of our common stock are reserved for the granting of stock options, of which 873,545 have been issued, leaving 4,232 available for issuance.

Adoption of SFAS No. 123R. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which requires compensation costs related to share-based payment transactions to be recognized in financial statements. SFAS No. 123R eliminates the intrinsic value method of accounting available under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, which generally resulted in no compensation expense being recorded in the financial statements related to the grant of stock options to employees if certain conditions were met.

Effective April 1, 2006, we adopted SFAS No. 123R using the modified prospective method. Under this method, compensation costs for all awards granted after the date of adoption and the unvested portion of previously granted awards will be measured at an estimated fair value and included in operating expenses or capitalized as appropriate over the vesting period during which an employee provides service in exchange for the award. Accordingly, prior period amounts presented have not been restated to reflect the adoption of SFAS No. 123R.

As a result of adopting SFAS No. 123R, net income for the three months ended June 30, 2007 was reduced by \$6,438. No portion of employees' compensation, including stock compensation expense, was capitalized during the period.

During the three month period ended June 30, 2007, 5,466 shares of our common stock have been issued as a result of the exercise of the options granted under the plan. The tax benefit, for income tax purposes, of \$44,178 from the exercise of these stock options is presented as a cash flow from financing activities.

Fair Value Determination. Under SFAS No. 123R, we have elected to continue using the Black-Scholes option pricing model to determine fair value of our awards on date of grant. We will reconsider the use of the Black-Scholes model if additional information becomes available in the future that indicates another model would be more appropriate, or if grants issued in future periods have characteristics that cannot be reasonably estimated under this model.

Stock Option Activity. During the three month period ended June 30, 2007, no stock options were granted.

Stock Compensation Expense. We have elected to continue straight-line amortization of stock-based compensation expense over the requisite service period. Prior to the adoption of SFAS No. 123R, we recognized the effect of forfeitures in our pro forma disclosures as they occurred. In accordance with the new standard, we have estimated forfeitures and are only recording expense on shares we expect to vest. For the three months ended June 30, 2007, we recorded \$6,438 of stock-based compensation cost as general and administrative expense in our statement of operations. No forfeitures have been estimated. No portion of employees' compensation including stock compensation expense was capitalized during the period.

As of June 30, 2007, there was \$21,161 of unrecognized compensation cost related to share-based compensation arrangements that we expect to vest. This cost will be fully amortized within three years. The aggregate intrinsic value of currently exercisable options was \$611,526 at June 30, 2007.

Recently Issued Accounting Pronouncements

Fair Value Measurements: In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurement (SFAS 157)*. This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has not yet determined the impact that the implementation of SFAS 157 will have on its results of operations or financial condition.

The Fair Value Option for Financial Assets and Financial Liabilities: In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, including an amendment of FASB Statements No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the "fair value option"). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. This accounting standard is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The effect, if any, of adopting SFAS No. 159 on the Company's financial position and results of operations has not been finalized.

Reclassifications

Certain prior year amounts have been reclassified in order to conform with current year presentation.

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", "anticipate", "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 months ended June 30, 2007 and 2006 relate to the operational results of the Company only. A discussion and analysis of the Hong Kong Joint Venture's operational results for these periods is presented below under the heading "Joint Venture."

During October 2006, we acquired a majority interest in Icon, our Canadian subsidiary which manufactures and distributes EMT steel conduit. As we previously announced, we believe that this acquisition will further leverage our existing U.S. electrical distribution network and diversify our revenue streams within the commercial market. For the quarter ended June 30, 2007, our U.S. operations had sales of \$935,417 from EMT conduit products, while our Canadian subsidiary generated \$2,397,639 in EMT conduit sales and \$108,449 in safety product sales. For the quarter, our Canadian operations' gross profit margin was 14.39% and reported an operating loss of \$382,211 and a net loss of \$413,842. Management believes that we must focus on increasing EMT conduit production capacity for our Canadian operations thereby increasing revenues and gross profit margins to achieve profitability in our Canadian operations. To further these goals, we have increased the production capacity of the Canadian facility and have focused sales efforts to Canadian and U.S. customers.

Our reported results of operations for the three months ended June 30, 2007 include our Canadian operations. We acquired the Canadian operations in the third fiscal quarter of the fiscal year ended March 31, 2007. Accordingly, we reported the results of our Canadian operations in our first fiscal quarter of 2008 and discuss these results only in the section below for the three months ended June 30, 2007.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2007 and 2006

Sales. Net sales for the three months ended June 30, 2007 were \$12,955,431 compared to \$8,038,437 for the comparable three months in the prior fiscal year, an increase of \$4,916,994 (61.17%). The primary reasons for the

increase in net sales volumes was that our sales included \$2,506,088 in sales by our Canadian operations and \$3,310,994 of sales by our U.S. operations to a national home improvement retailer. Sales of our core product lines to the electrical distribution trade, including smoke alarms, carbon monoxide alarms and GFCI units decreased by \$900,088 due to a decrease in new home construction during the 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 23.8% and 34.6% of sales for the quarters ended June 30, 2007 and 2006, respectively. The decrease in gross profit margin was primarily due to a lower gross profit margin realized by our Canadian operations and lower gross margins on sales to a national home improvement retailer.

Our U.S. operations' gross profit margin for the quarter ended June 30, 2007 was 26% compared to 34.6% for the quarter ended June 30, 2006, a 24.91% decrease. The primary reason for this decrease was a reduction in the gross profit achieved on sales to a national home improvement retailer and sales of EMT products at lower gross profit margins. Our Canadian operations' gross profit margin for the quarter ended June 30, 2007 was 14.47%. We believe that increasing EMT conduit production capacity for our Canadian operations will have a significant impact on the Canadian operations' gross profit margins.

Expenses. Research and development, and selling, general and administrative expenses increased by \$467,622 from the comparable three months in the prior year. As a percentage of net sales, these expenses decreased to 18.27% for the three month period ended June 30, 2007, from 23.6% for the 2006 period.

Research and development, and selling, general and administrative expenses for our U.S. operations decreased by \$277,258 from the comparable three months in the prior year, and, as a percentage of net sales, these expenses were 15.09% for the three month period ended June 30, 2007, and 23.6% for the comparable 2006 period. The decrease in these expenses as a percentage of sales was primarily due to variable costs that did not increase at the same rate as sales. Selling, general and administrative expenses for our Canadian operations were \$702,715, or 28.04% of net sales.

Interest Expense and Income. Our interest expense, net of interest income, was \$90,128 for the quarter ended June 30, 2007, compared to net interest income of \$9,097 for the quarter ended June 30, 2006. Net interest expense resulted from borrowings by us and by our Canadian subsidiary in support of our Canadian subsidiary.

Income Taxes. During the quarter ended June 30, 2007, the Company had a net income tax expense of \$429,876. For the corresponding 2006 period, the Company has a provision for income taxes of \$366,000.

Net Income. We reported net income of \$791,002 for the quarter ended June 30, 2007, compared to net income of \$1,577,468 for the corresponding quarter of the prior fiscal year. The primary reasons for the decrease in net income is a decrease of \$453,229 in the Company's equity in the earnings of the Joint Venture from the same period of the prior year and a loss from operations of our Canadian subsidiary of \$413,842.

Net income for our U.S. operations was \$1,204,844 for the quarter ended June 30, 2007, compared to net income of \$1,577,468 for the corresponding quarter of the prior fiscal year, primarily due to decreased Joint Venture earnings. Our Canadian subsidiary had a net loss of \$413,842 for the quarter ended June 30, 2007.

FINANCIAL CONDITION AND LIQUIDITY

The Company has a Factoring Agreement which supplies both short-term borrowings and letters of credit to finance foreign inventory purchases. The maximum amount available under the Factoring Agreement is currently \$10,000,000. Based on specified percentages of our accounts receivable and inventory and letter of credit commitments and reduced by \$3,000,000 representing the Company's guarantee of the term loan facility of Icon, we had \$3,247,000 available under the Factoring Agreement. The amount borrowed under this agreement is \$359,887 as of June 30, 2007. The interest rate under the Factoring Agreement on the uncollected factored accounts receivable and any additional borrowings is equal to the prime rate of interest charged by our lender. At June 30, 2007, the prime rate was 8.25%. Borrowings are collateralized by all of our accounts receivable and inventory.

Icon, our majority-owned Canadian subsidiary, has a line of credit facility with CIT Group/Commercial Services, Inc. This facility, in the amount of US\$7,000,000 is payable on demand, bears interest at the bank's prime rate of interest plus .25% (effective rate 6.0% at June 30, 2007) and is collateralized by all of the assets of the Canadian subsidiaries and by the guarantees of the Company and its wholly owned subsidiary, 2113824 Ontario, Inc. Advances under the line of credit facility are based on specified percentages of trade accounts receivable and inventory. At June 30, 2007,

the Canadian subsidiaries had borrowed CAD \$1,752,586 (US \$1,654,967) of the total amount available under the terms of the line of credit facility.

Our non-factored accounts receivable as of the end of our last fiscal year (net of allowances for doubtful accounts) were \$2,555,895, and were \$3,204,500 as of June 30, 2007. The increase in non-factored trade accounts receivable during the first three months of the current fiscal year is due to the consolidation of accounts receivable of our acquired Canadian subsidiaries. Our prepaid expenses as of the end of our last fiscal year were \$237,666, and were \$349,192 as of June 30, 2007. The increase in prepaid expenses during the first three months of the current fiscal year is due to the timing of premium payments to various insurance carriers, and the prepayment of estimated federal and state income taxes.

Operating activities used cash of \$2,337,852 for the three months ended June 30, 2007. This was primarily due to an increase in accounts receivable and due from factor of \$1,082,855, a decrease in accounts payable and accrued expenses of \$548,974, increases in inventories and prepaid expenses of \$971,253, and earnings of the Joint Venture of \$599,750. For the same period last year, operating activities used cash of \$1,250,667, primarily as a result of unremitted earnings of the Hong Kong Joint Venture and increases in accounts receivable, inventory and prepaid expenses.

Investing activities used cash of \$1,149,469 during the three months ended June 30, 2007 as a result of the acquisition of property and equipment.

Financing activities provided cash of \$3,519,213 principally as a result of financing provided by a commercial lending corporation, net of loan repayments, of \$3,463,528. In the comparable three months in the prior year, financing activities provided \$755,409 from the issuance of common stock from the exercise of employee stock options.

We believe that funds available under the Factoring Agreement, distributions from the Joint Venture, and our line of credit facilities provide us with sufficient resources to meet our requirements for liquidity and working capital in the ordinary course of our business over the next twelve months and over the long term.

JOINT VENTURE

Net Sales. Net sales of the Joint Venture for the three months ended June 30, 2007 were \$8,961,882, compared to \$9,043,990, for the comparable period in the prior fiscal year. The decrease in net sales for the three month period was due to decreased sales of smoke alarm products to non-related customers.

Net Income. Net income for the three months ended June 30, 2007 was \$1,080,789, compared to \$2,244,414 in the comparable period last year. The 51.85% decrease in net income for the three month period was due primarily to reduced sales to non-related customers.

Gross Margins. Gross margins of the Joint Venture for the three month period ended June 30, 2007 decreased to 26.09% from 37.5% for the 2006 period. Since gross margins depend on sales volume of various products, changes in the sales mix to non-related customers caused these changes in gross margins.

Expenses. Selling, general and administrative expenses were \$1,245,860, for the three month period ended June 30, 2007, compared to \$1,143,379 in the prior year's period. As a percentage of sales, expenses were 13.90% for the three month period ended June 30, 2007, compared to 12.6% for the three month period ended December 31, 2006. The increase in selling, general and administrative expense as a percent of sales was due to lower sales.

Interest Income and Expense. Interest expense, net of interest income, was \$5,975 for the three month period ended June 30, 2007, compared to net interest income of \$72,930 for the prior year's period. Net interest expense resulted from an increase in the Joint Venture's borrowings.

Liquidity. Cash needs of the Joint Venture are currently met by funds generated from operations. During the three months ended June 30, 2007, working capital increased by \$2,313,162 from \$4,466,430 on March 31, 2006 to \$6,779,592 on June 30, 2007.

CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of our consolidated financial statements and results of operations are based on our Consolidated Financial Statements included as part of this document. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets,

liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate these estimates, including those related to bad debts, inventories, income taxes, and contingencies and litigation. We base these estimates on historical experiences and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect management's more significant judgments and estimates used in the preparation of its consolidated financial statements. For a detailed discussion on the application on these and other accounting policies, see Note A to the consolidated financial statements included in Item 8 of the Form 10-K for the year ended March 31, 2007. Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty and actual results could differ from these estimates. These judgments are based on our historical experience, terms of existing contracts, current economic trends in the industry, information provided by our customers, and information available from outside sources, as appropriate. Our critical accounting policies include:

Our revenue recognition policies are in compliance with Staff Accounting Bulletin No. 101, “*Revenue Recognition in Financial Statements*” issued by the Securities and Exchange Commission. We recognize sales upon shipment of products net of applicable provisions for any discounts or allowances. We believe that 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. We have established allowances to cover anticipated doubtful accounts based upon historical experience.

Inventories are valued at the lower of market or cost. Cost is determined on the first-in first-out method. We have recorded a reserve for obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. Management reviews the reserve quarterly.

We are subject to lawsuits and other claims, related to patents and other matters. Management is required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is based on a careful analysis of each individual issue with the assistance of outside legal counsel. The required reserves may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters.

We generally provide warranties from one to ten years to the non-commercial end user on all products sold. The manufacturers of our products provide us with a one-year warranty on all products we purchase for resale. Claims for warranty replacement of products beyond the one-year warranty period covered by the manufacturers are immaterial and we do not record estimated warranty expense or a contingent liability for warranty claims.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

No material changes have occurred in our quantitative and qualitative market risk disclosures as presented in our Annual Report Form 10-K for the year ended March 31, 2006.

ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be disclosed by us in the reports that we file or submit under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to management in a timely manner. Our Chief Executive Officer and Chief Financial Officer have evaluated this system of disclosure controls and procedures as of the end of the period covered by this quarterly report, and believe that the system is effective. There have been no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management is aware that there is a lack of segregation of duties at the Company due to the small number of employees dealing with general administrative and financial matters. However, at this time management has decided that considering the employees involved and the control procedures in place, the risks associated with such lack of segregation are insignificant and the potential benefits of adding employees to clearly segregate duties do not justify the expenses associated with such increases. Management will periodically reevaluate this situation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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 these matters will not have a material adverse effect on the Company's financial statements.

ITEM 6. EXHIBITS

Exhibit No.

- 3.1 Articles of Incorporation (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 1988, File No. 1-31747)
- 3.2 Articles Supplementary, filed October 14, 2003 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed October 31, 2002, File No. 1-31747)
- 3.3 Bylaws, as amended (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed June 13, 2007, File No. 1-31747)
- 10.1 Non-Qualified Stock Option Plan, as amended (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2003, File No. 1-31747)
- 10.2 Hong Kong Joint Venture Agreement, as amended (incorporated by reference to Exhibit 10.2 to Amendment No. 1 on Form 10-K/A to the Company's Annual Report on Form 10-K for the year ended March 31, 2006, File No. 1-31747)
- 10.3 Amended and Restated Factoring Agreement between the Registrant and The CIT Group Commercial Services Inc. ("CIT"), dated June 22, 2007 (substantially identical agreement entered into by the Registrant's wholly-owned subsidiary, USI Electric, Inc.) (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed June 26, 2007, File No. 1-31747)
- 10.4 Amended and Restated Inventory Security Agreement between the Registrant and CIT, dated June 22, 2007 (substantially identical agreement entered into by the Registrant's wholly-owned subsidiary, USI Electric, Inc.) (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed June 26, 2007, File No. 1-31747)
- 10.5 Credit Agreement between International Conduits Ltd. ("Icon") and CIT Financial Ltd. ("CIT Canada"), dated June 22, 2007 ("CIT Canada Credit Agreement") (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed June 26, 2007, File No. 1-31747)
- 10.6 General Security Agreement between CIT Canada and Icon, dated June 22, 2007, with respect to the obligations of Icon under the CIT Canada Credit Agreement (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed June 26, 2007, File No. 1-31747)
- 10.7 Guaranty made by the Registrant and USI Electric Inc., in favor of CIT Canada, dated June 22, 2007, with respect to the obligations of Icon under the CIT Canada Credit Agreement (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed June 26, 2007, File No. 1-31747)

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- 10.8 Lease between Universal Security Instruments, Inc. and National Instruments Company dated October 21, 1999 for its office and warehouse located at 7-A Gwynns Mill Court, Owings Mills, Maryland 21117 (incorporated by reference to Exhibit 10.19 to the Company's Annual Report on Form 10-K for the Fiscal Year Ended March 31, 2000, File No. 1-31747)
- 10.9 Amended and Restated Employment Agreement dated July 18, 2006 between the Company and Harvey B. Grossblatt (incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, File No. 1-31747)
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer*
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer*
- 32.1 Section 1350 Certifications*
- 99.1 Press Release dated August 14, 2007*

*Filed herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNIVERSAL SECURITY INSTRUMENTS, INC.
(Registrant)

Date: August 14, 2007

By: /s/ Harvey B. Grossblatt

Harvey B. Grossblatt
President, Chief Executive Officer

By: /s/ James B. Huff

James B. Huff
Vice President, Chief Financial Officer