NAPCO SECURITY TECHNOLOGIES, INC
Form 10-Q
November 09, 2015

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 AND EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED: **SEPTEMBER 30, 2015**

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM __________ TO __________.

Commission File number: 0-10004

NAPCO SECURITY TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware	11-2277818
(State or other jurisdiction of incorporation of organization)	(IRS Employer Identification Number)

333 Bayview Avenue

Amityville, New York	11701
(Address of principal executive offices)	(Zip Code)

(631) 842-9400

(Registrant’s telephone number including area code)

(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 and Exchange Act of 1934 during the preceding 12 months (or 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 during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition 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

Number of shares outstanding of each of the issuer’s classes of common stock, as of: November 4, 2015

COMMON STOCK, $.01 PAR VALUE PER SHARE 18,950,893

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2015	June 30, 2015
	(unaudited)	(audited)
	(in thousands, except for share data)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,806	$ 2,346
Accounts receivable, net of reserves and allowances	15,269	17,994
Inventories	23,168	22,757
Prepaid expenses and other current assets	957	1,046
Income tax receivable	24	—
Deferred income taxes	900	880
Total Current Assets	43,124	45,023
Inventories - non-current	4,612	4,113
Deferred income taxes	625	634
Property, plant and equipment, net	6,162	6,234
Intangible assets, net	8,749	8,886
Other assets	144	147
TOTAL ASSETS	$ 63,416	$ 65,037
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long term debt	$ 1,600	$ 1,600
Accounts payable	3,468	3,954
Accrued expenses	1,528	1,624
Accrued salaries and wages	2,363	2,250
Accrued income taxes	—	5
Total Current Liabilities	8,959	9,433
Long-term debt, net of current maturities	7,700	9,100

Total Liabilities	16,659	18,533
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common Stock, par value $0.01 per share; 40,000,000 shares authorized; 21,049,243 and 21,049,243 shares issued; and 18,949,936 and 18,966,028 shares outstanding, respectively	210	210
Additional paid-in capital	16,165	16,133
Retained earnings	40,714	40,399
	57,089	56,742
Less: Treasury Stock, at cost (2,099,307 and 2,083,215 shares, respectively)	(10,332)	(10,238)
TOTAL STOCKHOLDERS' EQUITY	46,757	46,504
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 63,416	$ 65,037

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three months ended September 30,	
	2015	2014
	(In thousands, except share and per share data)	
Net sales	$ 18,149	$ 17,336
Cost of sales	12,512	12,081
Gross Profit	5,637	5,255
Selling, general, and administrative expenses	5,313	5,009
Operating Income	324	246
Other expense:		
Interest expense, net	49	55
Other, net	4	(5)
Income before Income Taxes	271	196
Income tax (benefit) expense	(44)	37
Net Income	$ 315	$ 159
Net Income per share:		
Basic	$ 0.02	$ 0.01
Diluted	$ 0.02	$ 0.01
Weighted average number of shares outstanding:		
Basic	18,965,000	19,412,000
Diluted	18,986,000	19,412,000

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Three months ended September 30,	
	2015	2014
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 315	$ 159
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	344	372
Provision for doubtful accounts	(75)	(15)
Deferred income taxes	(11)	55
Stock based compensation expense	32	33
Changes in operating assets and liabilities:		
Accounts receivable	2,800	2,989
Inventories	(910)	(1,410)
Prepaid expenses and other current assets	89	140
Income tax receivable	(23)	(48)
Other assets	—	5
Accounts payable, accrued expenses and accrued income taxes	(474)	(10)
Net Cash Provided by Operating Activities	2,087	2,270
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant, and equipment	(133)	(103)
Net Cash Used in Investing Activities	(133)	(103)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	(1,400)	(400)
Cash paid for purchase of treasury stock	(94)	(509)
Net Cash Used in Financing Activities	(1,494)	(909)
Net Increase in Cash and Cash Equivalents	460	1,258
CASH AND CASH EQUIVALENTS - Beginning	2,346	2,483
CASH AND CASH EQUIVALENTS - Ending	$ 2,806	$ 3,741
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest paid, net	$ 52	$ 56
Income taxes paid	$ —	$ 30

NON-CASH FINANCING ACTIVITIES:		
Shares surrendered and held in treasury for common stock options exercised	$ —	$ —
Shares surrendered and cancelled for shares for common stock options exercised	$ —	$ —

See accompanying notes to condensed consolidated financial statements.

5

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2015

NOTE 1 - Nature of Business and Summary of Significant Accounting Policies

Nature of Business:

Napco Security Technologies, Inc. and Subsidiaries (the "Company") is a diversified manufacturer of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products for commercial and residential use. These products are used for commercial, residential, institutional, industrial and governmental applications, and are sold worldwide principally to independent distributors, dealers and installers of security equipment.

The Company's fiscal year begins on July 1 and ends on June 30. Historically, the end users of the Company's products want to install its products prior to the summer; therefore sales of its products historically peak in the period April 1 through June 30, the Company's fiscal fourth quarter, and are reduced in the period July 1 through September 30, the Company's fiscal first quarter. In addition, demand is affected by the housing and construction markets.

Significant Accounting Policies:

Basis of Presentation

The unaudited condensed consolidated financial statements of the Company, including these notes, have been prepared by the Company in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the rules and regulations promulgated by the U.S. Securities and Exchange Commission (the “SEC”). Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been omitted or condensed. However, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended June 30, 2015 and the notes thereto included in the

Company’s Annual Report on Form 10-K filed with the SEC on September 10, 2015. Results of consolidated operations for the interim periods are not necessarily indicative of a full year’s operating results. The unaudited condensed consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiaries. All material inter-company accounts and transactions have been eliminated.

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent gains and losses at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Critical estimates include management's judgments associated with reserves for sales returns and allowances, concentration of credit risk, inventory reserves, intangible assets and income taxes. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The methods and assumptions used to estimate the fair value of the following classes of financial instruments were: Current Assets and Current Liabilities - The carrying amount of cash, certificates of deposits, current receivables and payables and certain other short-term financial instruments approximate their fair value as of September 30, 2015 due to their short-term maturities; Long-Term Debt - The carrying amount of the Company’s long-term debt, including the current portion, at September 30, 2015 in the amount of $9,300,000 approximates fair value.

Cash and Cash Equivalents

Cash and cash equivalents include approximately $460,000 of short-term time deposits at September 30, 2015 and June 30, 2015. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company has cash balances in banks in excess of the maximum amount insured by the FDIC and other international agencies as of September 30, 2015 and June 30, 2015. The Company has historically not experienced any credit losses with balances in excess of FDIC limits.

Accounts receivable is stated net of the reserves for doubtful accounts of $100,000 and $175,000 and for returns and other allowances of $930,000 and $1,260,000 as of September 30, 2015 and June 30, 2014, respectively. Our reserves for doubtful accounts and for returns and other allowances are subjective critical estimates that have a direct impact on reported net earnings. These reserves are based upon the evaluation of accounts receivable agings, specific exposures, sales levels and historical trends.

Inventories

Inventories are valued at the lower of cost or fair market value, with cost being determined on the first-in, first-out (FIFO) method. The reported net value of inventory includes finished saleable products, work-in-process and raw materials that will be sold or used in future periods. Inventory costs include raw materials, direct labor and overhead. The Company’s overhead expenses are applied based, in part, upon estimates of the proportion of those expenses that are related to procuring and storing raw materials as compared to the manufacture and assembly of finished products. These proportions, the method of their application, and the resulting overhead included in ending inventory, are based in part on subjective estimates and actual results could differ from those estimates.

In addition, the Company records an inventory obsolescence reserve, which represents any excess of the cost of the inventory over its estimated market value, based on various product sales projections. This reserve is calculated using an estimated obsolescence percentage applied to the inventory based on age, historical trends, requirements to support forecasted sales, and the ability to find alternate applications of its raw materials and to convert finished product into alternate versions of the same product to better match customer demand. In addition, and as necessary, the Company may establish specific reserves for future known or anticipated events. There is inherent professional judgment and subjectivity made by both production and engineering members of management in determining the estimated obsolescence percentage.

The Company also regularly reviews the period over which its inventories will be converted to sales. Any inventories expected to convert to sales beyond 12 months from the balance sheet date are classified as non-current.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost less accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred; costs of major renewals and improvements are capitalized. At the time property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation are eliminated from the asset and accumulated depreciation accounts and the profit or loss on such disposition is reflected in income.

Depreciation is recorded over the estimated service lives of the related assets using primarily the straight-line method. Amortization of leasehold improvements is calculated by using the straight-line method over the estimated useful life of the asset or lease term, whichever is shorter.

Intangible Assets

Intangible assets determined to have indefinite lives are not amortized but are tested for impairment at least annually. Intangible assets with definite lives are amortized over their useful lives. Intangible assets are reviewed for impairment at least annually at the Company's fiscal year end of June 30 or more often whenever there is an indication that the carrying amount may not be recovered.

The Company's acquisition of substantially all of the assets and certain liabilities of G. Marks Hardware, Inc. ("Marks") in August 2008 included intangible assets recorded at fair value on the date of acquisition. The intangible assets are amortized over their estimated useful lives of twenty years (customer relationships) and seven years (non-compete agreement). The Marks trade name was deemed to have an indefinite life.

Changes in intangible assets are as follows (in thousands):

	September 30, 2015			June 30, 2015		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Customer relationships	$9,800	$ (6,951)	$2,849	$9,800	$ (6,820)	$2,980
Non-compete agreement	340	(340)	—	340	(334)	6
Trade name	5,900	—	5,900	5,900	—	5,900
	$16,040	$ (7,291)	$8,749	$16,040	$ (7,154)	$8,886

7

Amortization expense for intangible assets subject to amortization was approximately $137,000 and $166,000 for the three months ended September 30, 2015 and 2014, respectively. Amortization expense for each of the next five fiscal years is estimated to be as follows: 2016 - $529,000; 2017 - $441,000; 2018 - $371,000; 2019 - $313,000 and 2020 - $264,000. The weighted average amortization period for intangible assets was 12.9 years and 13.7 years at September 30, 2015 and 2014, respectively.

Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets in question may not be recoverable. Impairment would be recorded in circumstances where undiscounted cash flows expected to be generated by an asset are less than the carrying value of that asset.

Revenue Recognition

The Company recognizes revenue when the following criteria are met: (i) persuasive evidence of an agreement exists, (ii) there is a fixed and determinable price for the Company's product or service, (iii) shipment and passage of title occurs or service has been provided, and (iv) collectability is reasonably assured. Revenues from product sales are recorded at the time the product is shipped or delivered to the customer pursuant to the terms of the sale. Revenues for services are recorded at the time the service is provided to the customer pursuant to the terms of sale. The Company reports its sales on a net sales basis, with net sales being computed by deducting from gross sales the amount of actual sales returns and other allowances and the amount of reserves established for anticipated sales returns and other allowances.

Sales Returns and Other Allowances

The Company analyzes sales returns and is able to make reasonable and reliable estimates of product returns based on the Company’s past history. Estimates for sales returns are based on several factors including actual returns and based on expected return data communicated to it by its customers. Accordingly, the Company believes that its historical returns analysis is an accurate basis for its allowance for sales returns. Actual results could differ from those estimates. As a percentage of gross sales, sales returns, rebates and allowances were 7% and 8% for the each of the three months ended September 30, 2015 and 2014, respectively.

Advertising and Promotional Costs

Advertising and promotional costs are included in "Selling, General and Administrative" expenses in the consolidated statements of operations and are expensed as incurred. Advertising expense for the three months ended September 30, 2015 and 2014 was $558,000 and $544,000, respectively.

Research and Development Costs

Research and development costs incurred by the Company are charged to expense as incurred and are included in "Cost of Sales" in the consolidated statements of operations. Company-sponsored research and development expense for the three months ended September 30, 2015 and 2014 was $1,489,000 and $1,311,000, respectively.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company measures and recognizes the tax implications of positions taken or expected to be taken in its tax returns on an ongoing basis.

Net Income Per Share

Basic net income per common share (Basic EPS) is computed by dividing net income by the weighted average number of common shares outstanding. Diluted net income per common share (Diluted EPS) is computed by dividing net income by the weighted average number of common shares and dilutive common share equivalents and convertible securities then outstanding.

The following provides a reconciliation of information used in calculating the per share amounts for the three months ended September 30 (in thousands, except per share data):

	Net Income		Weighted Average Shares		Net Income per Share	
	2015	2014	2015	2014	2015	2014
Basic EPS	$315	$159	18,965	19,412	$ 0.02	$ 0.01
Effect of Dilutive Securities:						
Stock Options	—	—	21	—	—	—
Diluted EPS	$315	$159	18,986	19,412	$ 0.02	$ 0.01

Options to purchase 170,000 and 145,500 shares of common stock for the three months ended September 30, 2015 and 2014, respectively, were not included in the computation of Diluted EPS because their inclusion would be anti-dilutive. These options were still outstanding at the end of the respective periods.

Stock-Based Compensation

The Company has established two share incentive programs as discussed in Note 7.

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the vesting period. Determining the fair value of share-based awards at the grant date requires assumptions and judgments about expected volatility and forfeiture rates, among other factors.

Stock-based compensation costs of $32,000 and $33,000 were recognized for three months ended September 30, 2015 and 2014, respectively. The effect on both Basic and Diluted Earnings per share was $0.00 for the three months ended September 30, 2015 and 2014.

Foreign Currency

All assets and liabilities of foreign subsidiaries are translated into U.S. Dollars at fiscal period-end exchange rates. Income and expense items are translated at average exchange rates prevailing during the fiscal year. The realized and unrealized gains and losses associated with foreign currency translation, as well as related other comprehensive income, were not material for the three months ended September 30, 2015 and 2014.

Comprehensive Income

For the three months ended September 30, 2015 and 2014, the Company's operations did not give rise to material items includable in comprehensive income, which were not already included in net income. Accordingly, the Company's comprehensive income approximates its net income for all periods presented.

Segment Reporting

The Company’s reportable operating segments are determined based on the Company's management approach. The management approach is based on the way that the chief operating decision maker organizes the segments within an enterprise for making operating decisions and assessing performance. The Company's results of operations are reviewed by the chief operating decision maker on a consolidated basis and the Company operates in only one segment. The Company has presented required geographical data in Note 11, and no additional segment data has been presented.

Shipping and Handling Revenues and Costs

The Company records the amount billed to customers for shipping and handling in net sales ($131,000 and $127,000 in the three months ended September 30, 2015 and 2014, respectively) and classifies the costs associated with these revenues in cost of sales ($216,000 and $241,000 in the three months ended September 30, 2015 and 2014, respectively).

Recently Issued Accounting Standards

In July 2015, the FASB issued ASU 2015-11 “Inventory (Topic 330): Simplifying the Measurement of Inventory” (ASU 2015-11). The amendments in ASU 2015-11 simplify the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. ASU 2015-11 is effective for the Company’s quarter ended September 30, 2017. Early application is permitted. We have not early adopted ASU 2015-11. The new guidance must be applied prospectively after the date of adoption. We are in the process of evaluating the adoption of this ASU, and do not expect this to have a material effect on our consolidated results of operations and financial condition.

In May 2014, the FASB issued authoritative guidance that defines how companies should report revenues from contracts with customers. The standard requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It provides companies with a single comprehensive five-step principles-based model to use in accounting for revenue and supersedes current revenue recognition requirements, including most industry-specific and transaction-specific revenue guidance. In August 2015, the FASB deferred the effective date of the new revenue standard by one year. As a result, the new standard would not be effective for the Company until fiscal 2019. In addition, the FASB is allowing companies to early adopt this guidance for the Company’s fiscal 2018. The guidance permits an entity to apply the standard retrospectively to all prior periods presented, with certain practical expedients, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company will apply this new guidance when it becomes effective and has not yet selected a transition method. The Company is currently evaluating the impact of adoption on its consolidated financial statements.

NOTE 2 - Business and Credit Concentrations

An entity is more vulnerable to concentrations of credit risk if it is exposed to risk of loss greater than it would have had if it mitigated its risk through diversification of customers. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance. The Company had one customer with an accounts receivable balance that comprised 18% of the Company’s accounts receivable at September 30, 2015 and 22% of the Company’s accounts receivable at June 30, 2015. Sales to any one customer did not exce