

NAPCO SECURITY TECHNOLOGIES, INC
Form 10-Q
February 08, 2018

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 AND EXCHANGE
ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED: **DECEMBER 31, 2017**
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 (IRS Employer Identification
incorporation of organization) 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

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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, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer " Accelerated Filer x Non-Accelerated Filer " Smaller reporting company "

Emerging Growth Company "

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act "

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: February 7, 2018

COMMON STOCK, \$.01 PAR VALUE PER SHARE	18,708,547
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NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2017	June 30, 2017
	(unaudited) (in thousands, except for share data)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,949	\$ 3,454
Accounts receivable, net of allowance for doubtful accounts of \$175 and \$155 at December 31, 2017 and June 30, 2017, respectively, and other reserves	17,361	20,275
Inventories, net	26,687	26,212
Prepaid expenses and other current assets	1,139	1,330
Total Current Assets	49,136	51,271
Inventories - non-current, net	5,179	4,367
Deferred income taxes	1,461	644
Property, plant and equipment, net	6,710	6,543
Intangible assets, net	7,731	7,916
Other assets	270	121
TOTAL ASSETS	\$ 70,487	\$ 70,862
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 4,488	\$ 5,653
Accrued expenses	2,177	2,209
Accrued salaries and wages	1,876	2,322
Accrued income taxes	976	289
Total Current Liabilities	9,517	10,473
Long-term debt, net of current maturities	2,000	3,500
Total Liabilities	11,517	13,973

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Common Stock, par value \$0.01 per share; 40,000,000 shares authorized; 21,179,192 and 21,174,507 shares issued; and 18,826,742 and 18,844,657 shares outstanding, respectively	212		212	
Additional paid-in capital	16,790		16,638	
Retained earnings	53,894		51,771	
	70,896		68,621	
Less: Treasury Stock, at cost (2,352,450 and 2,329,850 shares, respectively)	(11,926	)	(11,732)
TOTAL STOCKHOLDERS' EQUITY	58,970		56,889	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 70,487		\$ 70,862	

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three months ended December 31,	
	2017	2016
	(In thousands, except share and per share data)	
Net sales	\$ 21,112	\$ 20,715
Cost of sales	14,272	14,098
Gross Profit	6,840	6,617
Selling, general, and administrative expenses	5,674	5,553
Operating Income	1,166	1,064
Other expense:		
Interest, net	22	18
Income before Income Taxes	1,144	1,046
Income tax (benefit) expense	(89)	) 189
Net Income	\$ 1,233	\$ 857
Net Income per share:		
Basic	\$ 0.07	\$ 0.05
Diluted	\$ 0.07	\$ 0.05
Weighted average number of shares outstanding:		
Basic	18,849,000	18,798,000
Diluted	18,883,000	18,851,000

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Six months ended December 31,	
	2017	2016
	(In thousands, except share and per share data)	
Net sales	\$ 42,286	\$ 40,883
Cost of sales	28,567	27,814
Gross Profit	13,719	13,069
Selling, general, and administrative expenses	11,494	11,289
Operating Income	2,225	1,780
Other expense:		
Interest, net	48	42
Income before Income Taxes	2,177	1,738
Income tax expense	54	313
Net Income	\$ 2,123	\$ 1,425
Net Income per share:		
Basic	\$ 0.11	\$ 0.08
Diluted	\$ 0.11	\$ 0.08
Weighted average number of shares outstanding:		
Basic	18,848,000	18,792,000
Diluted	18,881,000	18,844,000

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Six months ended December 31,	
	2017	2016
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 2,123	\$ 1,425
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	672	649
Provision for doubtful accounts	20	—
Deferred income taxes	(817)	184
Stock based compensation expense	136	98
Changes in operating assets and liabilities:		
Accounts receivable	2,894	2,745
Inventories	(1,287)	(2,369)
Prepaid expenses and other current assets	190	80
Other assets	(151)	—
Accounts payable, accrued expenses and accrued income taxes	(956)	148
Net Cash Provided by Operating Activities	2,824	2,960
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant, and equipment	(651)	(580)
Net Cash Used in Investing Activities	(651)	(580)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	(1,500)	(2,450)
Proceeds from stock option exercise	16	49
Cash paid for purchase of treasury stock	(194)	—
Net Cash Used in Financing Activities	(1,678)	(2,401)
Net Increase (Decrease) in Cash and Cash Equivalents	495	(21)
CASH AND CASH EQUIVALENTS - Beginning	3,454	3,805
CASH AND CASH EQUIVALENTS - Ending	\$ 3,949	\$ 3,784
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest paid, net	\$ 45	\$ 49
Income taxes paid	\$ 184	\$ 53
Surrender of common shares	3	\$ 44

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2017

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

Nature of Business:

Napco Security Technologies, Inc. and Subsidiaries (the "Company" or "Napco") 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 Napco'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. Deterioration of the current economic conditions may also affect this trend.

Significant Accounting Policies:

Principles of Consolidation

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, 2017 and the notes thereto included in the Company's Annual Report on Form 10-K filed with the SEC on September 13, 2017. 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 significant inter-company accounts and transactions have been eliminated.

Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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, allowance for doubtful accounts, 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, short-term certificates of deposit, current receivables and payables and certain other short-term financial instruments approximate their fair value as of December 31, 2017 due to their short-term maturities; Long-Term Debt - The carrying amounts of the Company's long-term debt at December 31, 2017 in the amount of \$2,000,000 and at June 30, 2017 in the amount of \$3,500,000 approximates fair value.

Cash and Cash Equivalents

Cash and cash equivalents include approximately \$460,000 of short-term certificates of deposit at December 31, 2017 and June 30, 2017. 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 December 31, 2017 and June 30, 2017. The Company has historically not experienced any credit losses with balances in excess of FDIC limits

Accounts Receivable

Accounts receivable is stated net of the reserves for doubtful accounts of \$175,000 as of December 31, 2017 and \$155,000 as of June 30, 2017 and for returns and other allowances of \$1,145,000 as of December 31, 2017 and \$1,250,000 as of June 30, 2017. 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 our accounts receivable aging, specific exposures, sales levels and historical trends.

Inventories

Inventories are valued at the lower of cost or net realizable 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. Intangible assets with definite lives are amortized over their useful lives. Indefinite-lived 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). The Marks trade name was deemed to have an indefinite life.

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

	December 31, 2017			June 30, 2017		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Customer relationships	\$9,800	\$ (7,969)	) \$ 1,831	\$9,800	\$ (7,784)	) \$ 2,016
Trade name	5,900	—	) 5,900	5,900	—	) 5,900
	\$15,700	\$ (7,969)	) \$ 7,731	\$15,700	\$ (7,784)	) \$ 7,916

Amortization expense for intangible assets subject to amortization was approximately \$92,000 and \$110,000 for the three months ended December 31, 2017 and 2016, respectively. Amortization expense for intangible assets subject to amortization was approximately \$185,000 and \$220,000 for the six months ended December 31, 2017 and 2016, respectively. Amortization expense for each of the next five fiscal years is estimated to be as follows: 2018 - \$371,000; 2019 - \$313,000; 2020 - \$264,000; 2021 - \$223,000; and 2022 - \$188,000. The weighted average amortization period for intangible assets was 10.6 years and 11.6 years at December 31, 2017 and 2016, 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 8% for the each of the six months ended December 30, 2017 and 2016, respectively.

Advertising and Promotional Costs

Advertising and promotional costs are included in "Selling, General and Administrative" expenses in the consolidated statements of income and are expensed as incurred. Advertising expense for the three months ended December 31, 2017 and 2016 was \$462,000 and \$498,000, respectively. Advertising expense for the six months ended December 31, 2017 and 2016 was \$1,103,000 and \$1,172,000, 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 income. Company-sponsored research and development expense for the three months ended December 31, 2017 and 2016 was \$1,639,000 and \$1,609,000, respectively. Company-sponsored research and development expense for the six months ended December 31, 2017 and 2016 was \$3,246,000 and \$3,237,000, 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 enactment of H. R. 1, Tax Cuts and Jobs Act on December 22, 2017 reduced the U. S. Corporate income tax rate to 21% and had a favorable impact on the Company's net deferred tax liabilities. The effect on the deferred tax assets and liabilities for the change in tax rate is recognized in income in the three and six month periods ending December 31, 2017 which includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. 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 December 31 (in thousands, except per share data):

	Net Income		Weighted Average Shares		Net Income per Share	
	2017	2016	2017	2016	2017	2016
Basic EPS	\$ 1,233	\$ 857	18,849	18,798	\$ 0.07	\$ 0.05
Effect of Dilutive Securities:						
Stock Options	—	—	34	53	—	—
Diluted EPS	\$ 1,233	\$ 857	18,883	18,851	\$ 0.07	\$ 0.05

Options to purchase 870 and 5,000 shares of common stock for the three months ended December 31, 2017 and 2016, 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.

The following provides a reconciliation of information used in calculating the per share amounts for the six months ended December 31 (in thousands, except per share data):

	Net Income		Weighted Average Shares		Net Income per Share	
	2017	2016	2017	2016	2017	2016
Basic EPS	\$ 2,123	\$ 1,425	18,848	18,792	\$ 0.11	\$ 0.08
Effect of Dilutive Securities:						
Stock Options	—	—	33	52	—	—
Diluted EPS	\$ 2,123	\$ 1,425	18,881	18,844	\$ 0.11	\$ 0.08

Options to purchase 435 and 5,000 shares of common stock for the six months ended December 31, 2017 and 2016, 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 \$103,000 and \$65,000 were recognized for three months ended December 31, 2017 and 2016, respectively. Stock-based compensation costs of \$136,000 and \$98,000 were recognized for six months ended December 31, 2017 and 2016, respectively. The effect on both Basic and Diluted Earnings per share was \$0.00 for the three and six months ended December 31, 2017 and 2016.

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 period. The realized and unrealized gains and losses associated with foreign currency translation, as well as related other comprehensive income, were not significant for the either of the three and six months ended December 31, 2017 and 2016.

Comprehensive Income

For the three and six months ended December 31, 2017 and 2016, the Company's operations did not give rise to significant 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.

Shipping and Handling Revenues and Costs

The Company records the amount billed to customers for shipping and handling in net sales (\$125,000 and \$105,000 in the three months ended December 31, 2017 and 2016, respectively and \$247,000 and \$245,000 in the six months ended December 31, 2017 and 2016, respectively) and classifies the costs associated with these revenues in cost of sales (\$252,000 and \$217,000 in the three months ended December 31, 2017 and 2016, respectively and \$459,000 and \$433,000 in the six months ended December 31, 2017 and 2016, respectively).

Recently Issued Accounting Standards

In March 2016, the Financial Accounting Standards Board ("FASB") issued authoritative guidance that changes the way companies account for certain aspects of share-based payments to employees. The most significant impact relates to the accounting for income tax effects of share-based compensation awards. This new guidance is part of the FASB's simplification initiative and requires that all excess tax benefits and tax deficiencies be recorded as income tax expense or benefit in the income statement. In addition, companies are required to treat the tax effects of exercised or vested awards as discrete items in the period that they occur. Other updates include changing the threshold on tax withholding requirements. Under this guidance, an employer can withhold up to the maximum statutory withholding rates in a jurisdiction without tainting the award classification. Additionally, this guidance allows companies to elect a forfeiture recognition method whereby they account for forfeitures as they occur (actual) or they estimate the number of awards expected to be forfeited (current GAAP). Lastly, as it relates to public entities, this guidance also provides requirements for the cash flow classification of cash paid by an employer when directly withholding shares for tax-withholding purposes and excess tax benefits. This guidance became effective for the Company's fiscal 2018 first quarter and the guidance prescribes different transition methods for the various provisions (i.e., retrospective, modified retrospective or prospective). The adoption of this standard did not have a material effect on our consolidated results of operations and financial condition.

In February 2016, the FASB issued authoritative guidance that requires lessees to account for most leases on their balance sheets with the liability being equal to the present value of the lease payments. The right-of-use asset will be based on the lease liability adjusted for certain costs such as direct costs. Lease expense will be recognized similar to current accounting guidance with operating leases resulting in a straight-line expense and financing leases resulting in a front-loaded expense similar to the current accounting for capital leases. This guidance becomes effective for the Company's fiscal 2020 first quarter, with early adoption permitted. This guidance must be adopted using a modified retrospective transition approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, and provides for certain practical expedients. The Company is currently evaluating the timing, impact and method of applying this guidance on its consolidated financial statements.

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 ("NRV"). ASU 2015-11 was effective for the Company's quarter ended September 30, 2017. The adoption of this standard did not 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 two customers, both of which are nationwide distributors of the Company's products, with accounts receivable balances that comprised 15% and 14% of the Company's accounts receivable at December 31, 2017 and 24% and 10% at June 30, 2017. Sales to neither of these customers exceeded 10% of net sales in either of the three or six months ended December 31, 2017. Sales to one of these customers comprised 13% and 14% of net sales for the three and six months ended December 2016, respectively.

NOTE 3 - Inventories

Inventories, net of reserves are valued at lower of cost (first-in, first-out method) or NRV. The Company regularly reviews parts and finished goods inventories on hand and, when necessary, records a provision for excess or obsolete inventories. 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.

Inventories, net of reserves consist of the following (in thousands):

	December 31, 2017	June 30, 2017
Component parts	\$ 17,310	\$ 16,638
Work-in-process	4,610	4,415
Finished product	9,946	9,526
	\$ 31,866	\$ 30,579
Classification of inventories, net of reserves:		
Current	\$ 26,687	\$ 26,212
Non-current	5,179	4,367
	\$ 31,866	\$ 30,579

NOTE 4 – Property, Plant and Equipment

Property, plant and equipment consist of the following (in thousands):

	December 31, 2017	June 30, 2017	Useful Life in Years
Land	\$904	\$904	—
Buildings	8,911	8,911	30 to 40
Molds and dies	7,171	7,058	3 to 5
Furniture and fixtures	2,599	2,570	5 to 10
Machinery and equipment	22,544	22,183	7 to 10
Leasehold improvements	633	485	Shorter of the lease term or life of asset
	42,762	42,111	
Less: accumulated depreciation and amortization	(36,052)	(35,568)	
	\$6,710	\$6,543	

Depreciation and amortization expense on property, plant, and equipment was \$248,000 and \$213,000 for the three months ended December 31, 2017 and 2016, respectively. Depreciation and amortization expense on property, plant, and equipment was \$484,000 and \$422,000 for the six months ended December 31, 2017 and 2016, respectively.

NOTE 5 - Income Taxes

The provision for income taxes represents Federal, foreign, and state and local income taxes. The effective rate differs from statutory rates due to the effect of state and local income taxes, tax rates in foreign jurisdictions, tax benefit of R&D credits and certain nondeductible expenses. Our effective tax rate will change from quarter to quarter based on recurring and non-recurring factors including, but not limited to, the geographical mix of earnings, enacted tax legislation, and state and local income taxes. For the three and six months ended December 31, 2017 the effective tax rate was favorably impacted by the enactment of H.R. 1, Tax Cuts and Jobs Act (the “Act”) on December 22, 2017. The Act reduced the U.S. Corporate income tax rate to 21% and resulted in a \$286,000 reduction in the Company’s net deferred tax liabilities. As the Company has a June 30 fiscal year-end, the lower corporate income tax rate will be phased in, resulting in a U.S. federal statutory rate of approximately 27.55% for fiscal 2018 and a 21% U.S. federal statutory rate for subsequent fiscal years. The Company reported \$208,000 of provisional expense on its unremitted foreign earnings. Accounting Standard Codification (“ASC”) 740 requires filers to record the effects of tax law changes in the period enacted. However, the SEC issued Staff Accounting Bulletin No. 118 (“SAB 118”), that permits filers to record provisional amounts during a measurement period ending no later than one year from the date of the Act’s enactment. As of December 31, 2017, the Company has not completed accounting for the tax effects of enactment of the Act; however, the Company has made a reasonable estimate of the effects on the existing deferred balances as well as the computation of the one-time transition tax. In addition, changes in judgment from the evaluation of new information resulting in the recognition de-recognition or re-measurement of a tax position taken in a prior annual period is recognized separately in the quarter of the change.

The Company does not expect that our unrecognized tax benefits will significantly change within the next twelve months. We file a consolidated U.S. income tax return and tax returns in certain state and local and foreign jurisdictions. As of December 31, 2017 we remain subject to examination in all tax jurisdictions for all relevant jurisdictional statutes for fiscal years 2014 and thereafter.

The Company has identified its U.S. Federal income tax return and its State return in New York as its major tax jurisdictions.

NOTE 6 - Long-Term Debt

As of December 31, 2017, long-term debt consisted of a revolving credit facility of \$11,000,000 (the “Revolving Credit Facility”) which expires in June 2021.

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Outstanding balances and interest rates as of December 31, 2017 and June 30, 2017 are as follows (dollars in thousands):

	December 31, 2017		June 30, 2017	
	Outstanding	Interest Rate	Outstanding	Interest Rate
Revolving line of credit	\$ 2,000	2.5	% \$ 3,500	2.2 %

The Revolving Credit Facility (the “Agreement”) also provides for a LIBOR-based interest rate option of LIBOR plus 1.15% to 2.00%, depending on the ratio of outstanding debt to EBITDA, which is to be measured and adjusted quarterly, a prime rate-based option of the prime rate plus 0.25% and other terms and conditions as more fully described in the Agreement. In addition, the Agreement provides for availability under the Revolving Credit Facility to be limited to the lesser of \$11,000,000 or the result of a borrowing base formula based upon the Company’s Accounts Receivables and Inventory values net of certain deductions. The Company’s obligations under the Agreement continue to be secured by all of its assets, including but not limited to, deposit accounts, accounts receivable, inventory, and the Company’s corporate headquarters in Amityville, NY, equipment and fixtures and intangible assets. In addition, the Company’s wholly-owned subsidiaries, with the exception of the Company’s foreign subsidiaries, have issued guarantees and pledges of all of their assets to secure the Company’s obligations under the Agreement. All of the outstanding common stock of the Company’s domestic subsidiaries and 65% of the common stock of the Company’s foreign subsidiaries has been pledged to secure the Company’s obligations under the Agreement.

The Agreement contains various restrictions and covenants including, among others, restrictions on payment of dividends, restrictions on borrowings and compliance with certain financial ratios, as defined in the Agreement.

NOTE 7 - Stock Options

The Company follows ASC 718 “Share-Based Payment”, which requires that all share based payments to employees, including stock options, be recognized as compensation expense in the consolidated financial statements based on their fair values and over the requisite service period. The Company recorded non-cash compensation expense relating to stock-based compensation of \$103,000 and \$65,000 for the three months ended December 31, 2017 and 2016, respectively (\$0.00 per basic and diluted share for each period). The Company recorded non-cash compensation expense relating to stock-based compensation of \$136,000 and \$98,000 for the six months ended December 31, 2017 and 2016, respectively (\$0.00 per basic and diluted share for each period).

2012 Employee Stock Option Plan

In December 2012, the stockholders approved the 2012 Employee Stock Option Plan (the “2012 Employee Plan”). The 2012 Employee Plan authorizes the granting of awards, the exercise of which would allow up to an aggregate of 950,000 shares of the Company's common stock to be acquired by the holders of such awards. Under this plan, the Company may grant stock options, which are intended to qualify as incentive stock options (“ISOs”), to valued employees. Any plan participant who is granted ISOs and possesses more than 10% of the voting rights of the Company's outstanding common stock must be granted an option with a price of at least 110% of the fair market value on the date of grant.

Under the 2012 Employee Plan, stock options may be granted to valued employees with a term of up to 10 years at an exercise price equal to or greater than the fair market value on the date of grant and are exercisable, in whole or in part, at 20% per year beginning on the date of grant. An option granted under this plan shall vest in full upon a “change in control” as defined in the plan. At December 31, 2017, 88,100 stock options were granted, 60,300 stock options were exercisable and 823,900 stock options were available for grant under this plan.

The following table reflects activity under the 2012 Plan for the six months ended December 31,:

	2017	Weighted average exercise price	2016	Weighted average exercise price
	Options		Options	
Outstanding, beginning of year	70,600	\$ 5.84	112,500	\$ 5.54
Granted	20,000	8.97	5,000	8.15
Terminated/Lapsed	—	—	(400)	6.31
Exercised	(2,500)	6.31	(1,500)	6.31
Outstanding, end of period	88,100	\$ 6.53	115,600	\$ 5.64
Exercisable, end of period	60,300	\$ 6.03	74,500	\$ 5.57
Weighted average fair value at grant date of options granted	\$111,000		\$26,000	
Total intrinsic value of options exercised	\$7,000		\$9,000	
Total intrinsic value of options outstanding	\$279,000		\$331,000	
Total intrinsic value of options exercisable	\$221,000		\$218,000	

500 and 1,500 stock options were exercised during the three months ended December 31, 2017 and 2016, respectively. \$3,000 and \$9,000 was received from option exercises during the three months ended December 31, 2017 and 2016, respectively, and the actual tax benefit realized for the tax deductions from option exercises was \$0 for each of these periods. 2,500 and 1,500 stock options were exercised during the six months ended December 31, 2017 and 2016, respectively. \$16,000 and \$9,000 was received from option exercises during the six months ended December 31, 2017 and 2016, respectively, and the actual tax benefit realized for the tax deductions from option exercises was \$0 for each of these periods.

The following table summarizes information about stock options outstanding under the 2012 Employee Plan at December 31, 2017:

Range of exercise prices	Options outstanding		Weighted average exercise price	Options exercisable	
	Number outstanding	Weighted average remaining contractual life		Number exercisable	Weighted average exercise price
\$4.29-\$9.63	88,100	7.3	\$ 6.53	60,300	\$ 6.03
	88,100	7.3	\$ 6.53	60,300	\$ 6.03

As of December 31, 2017, there was \$132,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2012 Employee Plan. 20,000 and 5,000 options were granted during the three and six months ended December 31, 2017 and 2016, respectively. The total fair value of the options vesting during the three months ended December 31, 2017 and 2016 under this plan was \$80,000 and \$59,000, respectively. The total fair value of the options vesting during the six months ended December 31, 2017 and 2016 under this plan was \$96,000 and \$75,000, respectively.

2012 Non-Employee Stock Option Plan

In December 2012, the stockholders approved the 2012 Non-Employee Stock Option Plan (the “2012 Non-Employee Plan”). This plan authorizes the granting of awards, the exercise of which would allow up to an aggregate of 50,000 shares of the Company's common stock to be acquired by the holders of such awards. Under this plan, the Company may grant stock options to non-employee directors and consultants to the Company and its subsidiaries.

Under the 2012 Non-Employee Plan, stock options may be granted with a term of up to 10 years at an exercise price equal to or greater than the fair market value on the date of grant and are exercisable in whole or in part at 20% per year beginning on the date of grant. An option granted under this plan shall vest in full upon a “change in control” as defined in the plan. At December 31, 2017, 29,200 stock options were granted, 15,200 stock options were exercisable and no stock options were available for grant under this plan.

The following table reflects activity under the 2012 Non-Employee Plan for the six months ended December 31,:

	2017		2016	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	14,200	\$ 4.69	35,000	\$ 4.73
Granted	15,000	8.70	—	—
Terminated/Lapsed	—	—	—	—
Exercised	—	—	(5,200)	4.76
Outstanding, end of period	29,200	\$ 6.75	29,800	\$ 4.73
Exercisable, end of period	15,200	\$ 5.53	20,800	\$ 4.76
Weighted average fair value at grant date of options granted	\$83,000		n/a	
Total intrinsic value of options exercised	n/a		\$25,000	
Total intrinsic value of options outstanding	\$86,000		\$112,000	
Total intrinsic value of options exercisable	\$63,000		\$78,000	

No stock options were exercised during the three or six months ended December 31, 2017. No cash was received from option exercises during the three or six months ended December 31, 2017 and the actual tax benefit realized for the

tax deductions from option exercises was \$0 for each of these periods. 5,200 options were exercised during the three and six months ended December 31, 2016. All of the 5,200 exercises were settled by exchanging 3,056 shares of the Company's common stock which were retired and returned to authorized. No cash was received from option exercises during the three and six months ended December 31, 2016 and the actual tax benefit realized for the tax deductions from option exercises was \$0 for each of these periods.

The following table summarizes information about stock options outstanding under the 2012 Non-Employee Plan at December 31, 2017:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$4.37 - \$8.70	29,200	8.1	\$ 6.75	15,200	\$ 5.53
	29,200	8.1	\$ 6.75	15,200	\$ 5.53

As of December 31, 2017, there was \$72,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2012 Non-Employee Plan. 15,000 options were granted during the three and six months ended December 31, 2017. No options were granted during the three or six months ended December 31, 2016. The total fair value of the options vesting during the three months ended December 31, 2017 and 2016 under this plan was \$22,000 and \$6,000, respectively. The total fair value of the options vesting during the six months ended December 31, 2017 and 2016 under this plan was \$39,000 and \$22,000, respectively.

2002 Employee Stock Option Plan

In December 2002, the stockholders approved the 2002 Employee Stock Option Plan (the “2002 Employee Plan”). This plan expired in October 2012. This plan authorized the granting of awards, the exercise of which would allow up to an aggregate of 1,836,000 shares of the Company's common stock to be acquired by the holders of such awards. Under this plan, the Company may have granted stock options, which were intended to qualify as incentive stock options (ISOs), to key employees. Any plan participant who was granted ISOs and possessed more than 10% of the voting rights of the Company's outstanding common stock must have been granted an option with a price of at least 110% of the fair market value on the date of grant.

Under the 2002 Employee Plan, stock options have been granted to key employees with a term of 10 years at an exercise price equal to the fair market value on the date of grant and are exercisable in whole or in part at 20% per year from the date of grant. At December 31, 2017, 1,471,480 stock options had been granted and no stock options were exercisable. No further stock options were available for grant under this plan after the plan's expiration in October 2012.

The following table reflects activity under the 2002 Employee plan for the three months ended December 31,:

	2017	Weighted average exercise price	2016	Weighted average exercise price
	Options		Options	
Outstanding, beginning of year	5,000	\$ 5.35	102,500	\$ 6.04
Granted	—	—	—	—
Terminated/Lapsed	—	—	(10,500)	6.02
Exercised	(5,000)	5.35	(52,000)	6.31
Outstanding, end of period	—	\$ —	40,000	\$ 5.69
Exercisable, end of period	—	\$ —	40,000	\$ 5.69
Weighted average fair value at grant date of options granted	n/a		n/a	
Total intrinsic value of options exercised	\$20,000		\$114,000	
Total intrinsic value of options outstanding	n/a		\$113,000	
Total intrinsic value of options exercisable	n/a		\$113,000	

0 and 5,000 stock options were exercised during the three and six months ended December 31, 2017, respectively. The 5,000 exercises were settled in cashless exercises by exchanging 2,815 shares of the Company's common stock which were retired and returned to unissued status. No cash was received from option exercises during either of the three or six months ended December 31, 2017 and the actual tax benefit realized for the tax deductions from option exercises was \$0 for each of these periods. 52,000 stock options were exercised during the three and six months ended December 31, 2016. 45,500 of the 52,000 exercises were settled by exchanging 40,655 shares of the Company's common stock which were retired and returned to authorized. The remaining 6,500 exercises were paid for in cash. \$40,000 was received from option exercises during the three and six months ended December 31, 2016 and the actual tax benefit realized for the tax deductions from option exercises was \$0 for each of these periods.

NOTE 8 – Stockholders' Equity Transactions

On September 16, 2014 the Company's board of directors authorized the repurchase of up to 1 million of the approximately 19.4 million shares of the Company's common stock outstanding. The repurchase will be made from time to time in the open market or in privately negotiated transactions subject to market conditions and the market price of the common stock. Relative to the Loan Agreement described in Note 6, the Company's lender gave its consent to this stock repurchase plan. 22,600 shares were purchased under this plan during the three and six months ended December 31, 2017.

NOTE 9 - 401(k) Plan

The Company maintains a 401(k) plan ("the Plan") that covers all U.S. non-union employees with one or more years of service and is qualified under Sections 401(a) and 401(k) of the Internal Revenue Code. Company contributions to this plan are discretionary and totaled \$33,000 and \$27,000 for the three months ended December 31, 2017 and 2016, respectively and \$64,000 and \$55,000 for the six months ended December 31, 2017 and 2016, respectively

NOTE 10 - Commitments and Contingencies

Leases

The Company is committed under various operating leases, not including the land lease discussed below, which do not extend beyond fiscal 2023.

Rent expense, with the exception of the land lease referred to below, totaled approximately \$7,000 and \$6,000 for the three months ended December 31, 2017 and 2016, respectively and \$13,000 and \$12,000 for the six months ended December 31, 2017 and 2016, respectively.

Land Lease

On April 26, 1993, one of the Company's foreign subsidiaries entered into a 99 year lease, expiring in 2092, for approximately four acres of land in the Dominican Republic at an annual cost of \$288,000, on which the Company's principal production facility is located.

Litigation

In the normal course of business, the Company is a party to claims and/or litigation. Management believes that the settlement of such claims and/or litigation, considered in the aggregate, will not have a material adverse effect on the Company's financial position and results of operations.

Employment Agreements

As of December 31, 2017, the Company was obligated under three employment agreements and one severance agreement. The employment agreements are with the Company's CEO, Senior Vice President of Sales and Marketing ("the SVP of Sales") and the Senior Vice President of Engineering ("the SVP of Engineering"). The employment agreement with the CEO provides for an annual salary of \$730,000, as adjusted for inflation; incentive compensation

as may be approved by the Board of Directors from time to time and a termination payment in an amount up to 299% of the average of the prior five calendar year's compensation, subject to certain limitations, as defined in the agreement. The employment agreement renews annually in August unless either party gives the other notice of non-renewal at least six months prior to the end of the applicable term. The employment agreement with the SVP of Sales expires in October 2018 and provides for an annual salary of \$334,000, a bonus arrangement for fiscal 2018 and, if terminated by the Company without cause, severance of nine months' salary and continued company-sponsored health insurance for six months from the date of termination. The employment agreement with the SVP of Engineering expires in August 2018 and provides for an annual salary of \$302,000, a bonus arrangement for fiscal 2018 and, if terminated by the Company without cause, severance of nine month's salary and continued company-sponsored health insurance for six months from the date of termination.