UNIVERSAL SECURITY INSTRUMENTS INC
Form 10-Q
December 02, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period ended September 30, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-31747

UNIVERSAL SECURITY INSTRUMENTS, INC.

(Exact name of registrant as specified in its charter)

Maryland	**52-0898545**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11407 Cronhill Drive, Suite A

Owings Mills, Maryland	**21117**
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: **(410) 363-3000**

Inapplicable

(Former name, former address and former fiscal year if changed from last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **x** No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Large accelerated filer ¨ Accelerated filer ¨ Non-Accelerated Filer ¨ Smaller Reporting Company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No **x**

At December 2, 2016, the number of shares outstanding of the registrant’s common stock was 2,312,887.

TABLE OF CONTENTS

		Page
Part I - Financial Information		
Item 1.	Condensed Consolidated Financial Statements:	
	Condensed Consolidated Balance Sheets at September 30, 2016 (unaudited) and March 31, 2016	3
	Condensed Consolidated Statements of Operations for the Three Months Ended September 30, 2016 and 2015 (unaudited)	4
	Condensed Consolidated Statements of Operations for the Six Months Ended September 30, 2016 and 2015 (unaudited)	5
	Condensed Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended September 30, 2016 and 2015 (unaudited)	6
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended September 30, 2016 and 2015 (unaudited)	7
	Notes to Condensed Consolidated Financial Statements (unaudited)	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 4.	Controls and Procedures	16
Part II - Other Information		
Item 1.	Legal Proceedings	17
Item 6.	Exhibits	17
	Signatures	18

PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	(unaudited) September 30, 2016	(audited) March 31, 2016
ASSETS		
CURRENT ASSETS		
Cash	$ 141,792	$ 362,728
Accounts receivable:		
Trade, less allowance for doubtful accounts	25,971	17,389
Receivables from employees	62,322	62,090
Receivable from Hong Kong Joint Venture	175,366	60,506
	263,659	139,985
Amount due from factor	1,628,638	1,789,619
Inventories – finished goods	4,996,042	3,883,247
Prepaid expenses	211,165	410,166
TOTAL CURRENT ASSETS	7,241,296	6,585,745
INVESTMENT IN HONG KONG JOINT VENTURE	11,332,924	11,779,663
PROPERTY AND EQUIPMENT – NET	58,158	71,556
INTANGIBLE ASSET- NET	64,840	67,075
OTHER ASSETS	4,000	6,000
TOTAL ASSETS	$ 18,701,218	$ 18,510,039
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Line of credit - factor	$ 662,991	$ 313,891
Accounts payable - trade	481,627	587,343
Accounts payable - Hong Kong Joint Venture	1,808,531	1,070,103
Accrued liabilities:		
Payroll and employee benefits	89,686	76,480
Commissions and other	25,000	74,327

TOTAL CURRENT LIABILITIES	3,067,835	2,122,144
COMMITMENTS AND CONTINGENCIES	-	-
SHAREHOLDERS’ EQUITY		
Common stock, $.01 par value per share; authorized 20,000,000 shares; 2,312,887 shares issued and outstanding at September 30, 2016 and March 31, 2016	23,129	23,129
Additional paid-in capital	12,885,841	12,885,841
Retained earnings	1,996,795	2,450,540
Accumulated other comprehensive income	727,618	1,028,385
TOTAL SHAREHOLDERS’ EQUITY	15,633,383	16,387,895
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$ 18,701,218	$ 18,510,039

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,	
	2016	2015
Net sales	$ 4,213,705	$ 3,278,225
Cost of goods sold – acquired from Joint Venture	2,905,992	2,519,022
Cost of goods sold – other	61,097	74,546
GROSS PROFIT	1,246,616	684,657
Selling, general and administrative expense	1,154,895	1,153,830
Research and development expense	182,352	147,128
Operating loss	(90,631)	(616,301)
Other income (expense):		
Income from investment in Hong Kong Joint Venture	51,114	209,700
Interest expense	(24,549)	(4,701)
NET LOSS	$ (64,066)	$ (411,302)
Loss per share:		
Basic and diluted	(0.03)	(0.18)
Shares used in computing net loss per share:		
Weighted average basic and diluted shares outstanding	2,312,887	2,312,887

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Six Months Ended September 30, 2016	2015
Net sales	$ 7,392,312	$ 6,214,715
Cost of goods sold - acquired from Joint Venture	4,949,019	4,504,825
Cost of goods sold - other	133,683	142,806
GROSS PROFIT	2,309,610	1,567,084
Selling, general and administrative expense	2,268,615	2,317,616
Research and development expense	319,983	347,431
Operating loss	(278,988)	(1,097,963)
Other expense:		
Loss from investment in Hong Kong Joint Venture	(145,972)	(77,433)
Interest expense	(28,785)	(12,983)
NET LOSS	$ (453,745)	$ (1,188,379)
Loss per share:		
Basic and diluted	(0.20)	(0.51)
Shares used in computing net loss per share:		
Weighted average basic and diluted shares outstanding	2,312,887	2,312,887

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF

COMPREHENSIVE LOSS

(Unaudited)

	Three Months Ended Sept. 30, 2016	2015	Six Months Ended Sept. 30, 2016	2015
NET LOSS	$ (64,066)	$ (411,302)	$ (453,745)	$ (1,188,379)
Other Comprehensive Loss Company's portion of Hong Kong Joint Venture's other comprehensive loss:				
Currency translation	(113,541)	0	(279,844)	0
Unrealized loss on investment securities	(4,341)	(31,945)	(20,921)	(125,460)
Total Other Comprehensive Loss	(117,882)	(31,945)	(300,765)	(125,460)
COMPREHENSIVE LOSS	$ (181,948)	$ (443,247)	$ (754,510)	$ (1,313,839)

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended September 30, 2016	2015
OPERATING ACTIVITIES		
Net loss	$ (453,745)	$ (1,188,379)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	15,633	18,769
Loss from investment in Hong Kong Joint Venture	145,972	77,433
Changes in operating assets and liabilities:		
Decrease (Increase) in accounts receivable and amounts due from factor	37,307	(217,597)
Increase in inventories, prepaid expenses, and other	(911,794)	(535,233)
Increase in accounts payable and accrued expenses	596,591	311,484
NET CASH USED IN OPERATING ACTIVITIES	(570,036)	(1,533,523)
INVESTING ACTIVITIES:		
Decrease in funds held by factor	-	631,906
NET CASH PROVIDED BY INVESTING ACTIVITIES	-	631,906
FINANCING ACTIVITIES:		
Net proceeds from Line of Credit - Factor	349,100	1,001,007
NET CASH PROVIDED BY FINANCING ACTIVITIES	349,100	1,001,007
NET (DECREASE) INCREASE IN CASH	(220,936)	99,390
Cash at beginning of period	362,728	49,427
CASH AT END OF PERIOD	$ 141,792	$ 148,817
SUPPLEMENTAL INFORMATION:		
Interest paid	$ 28,785	$ 12,983
Income taxes paid	-	-

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Statement of Management

The condensed consolidated financial statements include the accounts of Universal Security Instruments, Inc. (USI or the Company) and its wholly-owned subsidiary. Except for the condensed consolidated balance sheet as of March 31, 2016, which was derived from audited financial statements, the accompanying condensed consolidated financial statements are unaudited. Significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim condensed consolidated financial statements include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. The interim condensed consolidated financial statements should be read in conjunction with the Company's March 31, 2016 audited financial statements filed with the Securities and Exchange Commission on Form 10-K filed on September 28, 2016. The interim operating results are not necessarily indicative of the operating results for the full fiscal year.

Management Plans

The Company had net losses of $453,745 for the six months ended September 30, 2016 and $2,137,792 and $3,704,985 for the years ended March 31, 2016 and 2015, respectively. Furthermore, as of September 30, 2016, working capital (computed as the excess of current assets over current liabilities) decreased by $290,140 from $4,463,601 at March 31, 2016, to $4,173,461 at September 30, 2016.

Our short-term borrowings to finance operating losses, trade accounts receivable, and foreign inventory purchases are provided pursuant to the terms of our Factoring Agreement with Merchant. Advances from the Company's factor, are at the sole discretion of Merchant based on their assessment of the Company's receivables, inventory and financial condition at the time of each request for an advance. In addition, we have secured extended payment terms for purchases up to $2,000,000 from our Hong Kong Joint Venture for the purchase of the new sealed battery products. These amounts are unsecured, bear interest at 3.25%, and have repayment terms of ninety days for each advance thereunder. The combined availability of these facilities totaled approximately $2,091,000 at September 30, 2016.

The Company has a history of sales that are insufficient to generate profitable operations and has limited sources of financing. Management's plan in response to these conditions includes increasing sales of the Company's new line of sealed battery safety alarms, decreasing payroll expenses, and seeking additional financing on our existing credit facility. The Company has seen positive results on this plan during the fiscal year ended March 31, 2016 and through September 30, 2016 due to the increased sales of certain of its sealed battery products and reductions in payroll expense. Management expects sales growth to continue going forward. Though no assurances can be given, if management's plan is successful over the next twelve months, the Company anticipates that it should be able to meet its cash needs. Cash flows and credit availability is expected to be adequate to fund operations for one year from the issuance date of these condensed consolidated financial statements.

Line of Credit – Factor

On January 15, 2015, the Company entered into a Factoring Agreement (Agreement) with Merchant Factors Corporation (Merchant or Factor) for the purpose of factoring the Company's trade accounts receivable and to provide financing secured by finished goods inventory. The Agreement for the assignment of accounts receivable expires on January 6, 2018 and provides for continuation of the program on successive two year periods until terminated by one of the parties to the Agreement. In accordance with the provisions of the Agreement, the Company may take advances equal to eighty percent (80%) of the uncollected non-recourse factored trade accounts receivable balance less applicable factoring commissions and may borrow up to fifty percent (50%) of eligible inventories subject to a borrowing limitation on inventory of $1,000,000. As of September 30, 2016, the Company had borrowings of $662,991 under the Agreement with Merchant, and the Company had remaining availability under the discount factoring agreement of approximately $1,931,000. Advances on factored trade accounts receivable and borrowing on inventories are secured by all of the Company's trade accounts receivable and inventories, are repaid periodically as collections are made by Merchant but are otherwise due upon demand, and bear interest at the prime commercial rate of interest, as published, plus two percent (Effective rate 5.50% at September 30, 2016). Advances under the factoring agreement are made at the sole discretion of Merchant, based on their assessment of the receivables, inventory and our financial condition at the time of each request for an advance.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with US-GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

Revenue Recognition

The Company recognizes sales upon shipment of products, when title has passed to the buyer, net of applicable provisions for any discounts or allowances. We recognize revenue when the following criteria are met: evidence of an arrangement exists; fixed and determinable fee; delivery has taken place; and collectability is reasonably assured. Customers may not return, exchange or refuse acceptance of goods without our approval. However, the Company has entered into an agreement with a customer to grant pre-approved rights of return of up to fifty percent of products sold on certain invoices to provide for and gain acceptance within certain markets. When a pre-approved right of return is granted, revenue recognition is deferred until the right of return expires. We have established allowances to cover anticipated doubtful accounts based upon historical experience.

Joint Venture

The Company and its joint venture partner, a Hong Kong corporation, each owns a 50% interest in a Hong Kong joint venture, Eyston Company Limited (the “Hong Kong Joint Venture”), that manufactures security products in its facilities located in the People’s Republic of China. There are no material differences between US-GAAP and those used by the Honk Kong Joint Venture when compared to US-GAAP. The following represents summarized balance sheet and income statement information of the Hong Kong Joint Venture as of and for the six months ended September 30, 2016 and 2015:

	2016 (Unaudited)	2015 (Unaudited)
Net sales	$8,273,094	$10,236,562
Gross profit	2,208,510	2,214,351
Net income (loss)	206,428	(23,079)

Total current assets	13,042,873	11,705,386
Total assets	28,010,955	31,239,508
Total current liabilities	4,359,497	5,494,185
Total liabilities	4,833,183	5,494,185

During the six months ended September 30, 2016 and 2015 the Company purchased $5,726,467 and $4,853,808, respectively, of products directly from the Hong Kong Joint Venture for resale. For the six month period ended September 30, 2016 the Company has reduced its equity in the earnings of the Joint Venture to reflect an increase of $249,186 in inter-Company profit on purchases held by the Company in inventory. For the six month period ended September 30, 2015 the Company has reduced its equity in the earnings of the Joint Venture to reflect an increase of $65,893 in inter-Company profit on purchases held by the Company in inventory.

Income Taxes

We calculate our interim tax provision in accordance with the guidance for accounting for income taxes in interim periods. At the end of each interim period, we estimate the annual effective tax rate and apply that tax rate to our ordinary quarterly pre-tax income. The tax expense or benefit related to discrete events during the interim period is recognized in the interim period in which those events occurred. In addition, the effect of changes in enacted tax laws or rates or tax status is recognized in the interim period in which the change occurs.

The Company recognizes a liability or asset for the deferred tax consequences of temporary differences between the tax basis of assets or liabilities and their reported amounts in the financial statements. These temporary differences may result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. The deferred tax assets are reviewed periodically for recoverability and a valuation allowance is provided whenever it is more likely than not that a deferred tax asset will not be realized. The Company established a full valuation allowance on its deferred tax assets to recognize that net operating losses, and research and foreign tax credits expiring in future periods will likely not be realized. This determination was made based on continued taxable losses which cause uncertainty as to whether the Company will generate sufficient taxable income to use the deferred tax assets prior to expiration. Our ability to realize the tax benefits associated with the deferred tax assets depends primarily upon the timing of future taxable income and the expiration dates of the components of the deferred tax assets. If sufficient future taxable income is generated, we may be able to offset a portion of future tax expenses.

Accounts Receivable and Amount Due From Factor

The Company assigns the majority of its short-term receivables arising in the ordinary course of business to our factor. At the time a receivable is assigned to our factor the credit risk associated with the credit worthiness of the debtor is assumed by the factor. The Company continues to bear any credit risk associated with delivery or warranty issues related to the products sold.

Management assesses the credit risk of both its trade accounts receivable and its financing receivables based on the specific identification of accounts that have exceeded credit terms. An allowance for uncollectible receivables is provided based on that assessment. Changes in the allowance account are charged to operations in the period the change is determined. Amounts ultimately determined to be uncollectible are eliminated from the receivable accounts and from the allowance account in the period that the receivables' status is determined to be uncollectible.

Based on the nature of the factoring agreement and prior experience, no allowance related to Amounts Due from Factor has been provided. At September 30, 2016 and 2015, an allowance of approximately $57,000 has been provided for uncollectible trade accounts receivable.

Net Loss per Common Share

Basic net loss 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. There were no potentially dilutive common stock equivalents outstanding during the three or six month periods ended September 30, 2016 or 2015. As a result, basic and diluted weighted average common shares outstanding are identical for the three month and six month periods ended September 30, 2016 and 2015.

Contingencies

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

Recent Accounting Pronouncements Not Yet Adopted

Changes to US-GAAP are established by the Financial Accounting Standards Board (FASB) in the form of Accounting Standards Updates (ASU's) to the FASB's Accounting Standards Codification. The Company considers the applicability and impact of all ASU's.

In June 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers: Topic 606.* ASU 2014-09 affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, *Revenue Recognition,* and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, *Revenue Recognition—Construction-Type and Production-Type Contracts.* In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, *Property, Plant, and Equipment,* and intangible assets within the scope of Topic 350, *Intangibles—Goodwill and Other)* are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this ASU.

The core principle of the guidance is that an entity should 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. To achieve that core principle, an entity should apply the following steps: Step 1: Identify the contract(s) with a customer. Step 2: Identify the performance obligations in the contract. Step 3: Determine the transaction price. Step 4: Allocate the transaction price to the performance obligations in the contract. Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation. This guidance is effective for annual periods beginning on or after December 15, 2017, including interim reporting periods within that reporting period and should be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized at the date of initial application. The Company is currently assessing the impact that adopting this new accounting standard will have on the condensed consolidated financial statements and footnote disclosures.

In August 2016, the FASB issued ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments,” which clarifies and provides guidance on eight cash flow classification issues and is intended to reduce existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This standard is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures.

Other recently issued ASU’s were evaluated and determined to be either not applicable or are not expected to have a material impact on our condensed consolidated financial statements.

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 con