

NAPCO SECURITY TECHNOLOGIES, INC
Form 10-Q
February 08, 2019

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, 2018**
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
(State or other jurisdiction of
incorporation of organization)

11-2277818
(IRS Employer Identification
Number)

333 Bayview Avenue
Amityville, New York
(Address of principal executive offices)

11701
(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)

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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 every Interactive Data File required to be submitted 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 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 the definitions 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 x Emerging growth company "

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

Number of shares outstanding of each of the issuer's classes of common stock, as of: February 7, 2019

COMMON STOCK, \$.01 PAR VALUE PER SHARE 18,470,032

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, 2018 (unaudited) (in thousands, except share data)	June 30, 2018
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,921	\$ 5,308
Accounts receivable, net of allowance for doubtful accounts of \$182 and \$195 at December 31, 2018 and June 30, 2018, respectively	19,845	22,738
Inventories, net	27,116	24,533
Prepaid expenses and other current assets	1,634	1,124
Total Current Assets	56,516	53,703
Inventories - non-current, net	6,067	4,401
Deferred income taxes	655	564
Property, plant and equipment, net	7,405	6,791
Intangible assets, net	7,388	7,545
Other assets	270	265
TOTAL ASSETS	\$ 78,301	\$ 73,269
CURRENT LIABILITIES		
Accounts payable	\$ 4,994	\$ 4,807
Accrued expenses	5,481	2,112
Accrued salaries and wages	2,166	2,190
Accrued income taxes	601	293
Total Current Liabilities	13,242	9,402
Accrued income taxes	414	414
Total Liabilities	13,656	9,816
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common Stock, par value \$0.01 per share; 40,000,000 shares authorized; 21,219,342 and 21,204,327 shares issued; and 18,557,704 and 18,729,082 shares outstanding, respectively	212	212
Additional paid-in capital	17,066	16,890
Retained earnings	63,074	59,420
Less: Treasury Stock, at cost (2,661,638 and 2,475,245 shares, respectively)	(15,707)	(13,069)
TOTAL STOCKHOLDERS' EQUITY	64,645	63,453

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 78,301	\$ 73,269
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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,	
	2018	2017
	(in thousands, except for share and per share data)	
Net sales:		
Equipment revenues	\$ 20,685	\$ 18,269
Service revenues	4,144	2,843
	24,829	21,112
Cost of sales:		
Equipment related expenses	13,203	11,933
Service related expenses	955	700
	14,158	12,633
Gross Profit	10,671	8,479
Research and development	1,762	1,639
Selling, general, and administrative expenses	5,615	5,674
Operating Income	3,294	1,166
Other expense:		
Interest expense, net	6	22
Income before Provision for Income Taxes	3,288	1,144
Provision (benefit) for Income Taxes	419	(89
Net Income	\$ 2,869	\$ 1,233
Income per share:		
Basic	\$ 0.15	\$ 0.07
Diluted	\$ 0.15	\$ 0.07
Weighted average number of shares outstanding:		
Basic	18,603,000	18,849,000
Diluted	18,649,000	18,883,000

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,	
	2018	2017
	(in thousands, except for share and per share data)	
Net sales:		
Equipment revenues	\$ 40,275	\$ 36,855
Service revenues	7,930	5,431
	48,205	42,286
Cost of sales:		
Equipment related expenses	26,210	24,024
Service related expenses	1,765	1,297
	27,975	25,321
Gross Profit	20,230	16,965
Research and development	3,507	3,246
Selling, general, and administrative expenses	11,670	11,494
Operating Income	5,053	2,225
Other expense:		
Interest expense, net	13	48
Income before Provision for Income Taxes	5,040	2,177
Provision for Income Taxes	667	54
Net Income	\$ 4,373	\$ 2,123
Income per share:		
Basic	\$ 0.23	\$ 0.11
Diluted	\$ 0.23	\$ 0.11
Weighted average number of shares outstanding:		
Basic	18,665,000	18,848,000
Diluted	18,713,000	18,881,000

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,	
	2018	2017
	(in thousands, except share data)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 4,373	\$ 2,123
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	668	672
(Recovery of) provision for doubtful accounts	(13)	20
Deferred income taxes	100	(817)
Non-cash stock based compensation expense	152	136
Changes in operating assets and liabilities:		
Accounts receivable	4,671	2,894
Inventories	(4,608)	(1,287)
Prepaid expenses and other current assets	565	190
Other assets	(11)	(151)
Accounts payable, accrued expenses, accrued salaries and wages, accrued income taxes	449	(956)
Net Cash Provided by Operating Activities	6,346	2,824
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant, and equipment	(1,119)	(651)
Net Cash Used in Investing Activities	(1,119)	(651)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	—	(1,500)
Proceeds from stock option exercises	24	16
Cash paid for purchase of treasury stock	(2,638)	(194)
Net Cash Used in Financing Activities	(2,614)	(1,678)
Net Change in Cash and Cash Equivalents	2,613	495
CASH AND CASH EQUIVALENTS - Beginning	5,308	3,454
CASH AND CASH EQUIVALENTS - Ending	\$ 7,921	\$ 3,949
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest paid, net	\$ 17	\$ 45
Income taxes paid	\$ 258	\$ 184
Surrender of Common Shares	5	3

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2018

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 security products, intrusion and fire alarm systems, alarm communication services, 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, 2018 and the notes thereto included in the Company's Annual Report on Form 10-K filed with the SEC on September 13, 2018. 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 include the accounts of Napco Security Technologies, Inc. and all of its wholly-owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

Reclassification

Amounts previously recorded in cost of sales totaling \$1,639,000 and 3,246,000 for the three and six months ending December 31, 2017, respectively, have been reclassified to research and development from cost of sales to conform with the current period presentation.

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 and cash equivalents, certificates of deposits, current receivables and payables and certain other short-term financial instruments approximate their fair value as of December 31, 2018 due to their short-term maturities.

Cash and Cash Equivalents

Cash and cash equivalents include approximately \$460,000 of short-term time deposits at December 31, 2018 and June 30, 2018. 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, 2018 and June 30, 2018. 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 \$182,000 and \$195,000 as of December 31, 2018 and June 30, 2018, respectively. Our reserves for doubtful accounts 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 but are tested for impairment at least annually. Intangible assets with definite lives are amortized over their useful lives. Infinite-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 customer relationships are amortized over their estimated useful lives of twenty years. The Marks trade name was deemed to have an indefinite life.

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

	December 31, 2018			June 30, 2018		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Customer relationships	\$9,800	\$ (8,312)	\$ 1,488	\$9,800	\$ (8,155)	\$ 1,645
Trade name	5,900	—	5,900	5,900	—	5,900
	\$15,700	\$ (8,312)	\$ 7,388	\$15,700	\$ (8,155)	\$ 7,545

Amortization expense for intangible assets subject to amortization was approximately \$79,000 and \$92,000 for the three months ended December 31, 2018 and 2017, respectively. Amortization expense for intangible assets subject to amortization was approximately \$157,000 and \$185,000 for the six months ended December 31, 2018 and 2017, respectively. Amortization expense for each of the next five fiscal years is estimated to be as follows: 2019 - \$313,000; 2020 - \$264,000; 2021 - \$223,000; 2022 - \$188,000; and 2023 - \$159,000. The weighted average amortization period for intangible assets was 9.6 years and 10.6 years at December 31, 2018 and 2017, 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 in accordance with Accounting Standards Codification (“ASC”), Topic 606, *Revenue from Contracts with Customers*, which the Company adopted effective July 1, 2018. Accordingly, the Company recognizes revenue when its customers obtain control of its products or services, in an amount that reflects the consideration that the Company expects to receive in exchange for those goods and services. See Note 2 – Revenue Recognition for additional accounting policies and transition disclosures.

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, 2018 and 2017 was \$435,000 and \$462,000, respectively. Advertising expense for the six months ended December 31, 2018 and 2017 was \$1,085,000 and \$1,103,000, respectively.

Research and Development Costs

Research and development costs incurred by the Company are charged to expense as incurred and are included in "Operating expenses" in the consolidated statements of operations. Company-sponsored research and development expense for the three months ended December 31, 2018 and 2017 was \$1,762,000 and \$1,639,000, respectively. Company-sponsored research and development expense for the six months ended December 31, 2018 and 2017 was \$3,507,000 and \$3,246,000, respectively. These amounts, previously recorded in cost of sales have been reclassified to research and development to conform with the current period presentation.

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. 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	
	2018	2017	2018	2017	2018	2017
Basic EPS	\$2,869	\$1,233	18,603	18,849	\$ 0.15	\$ 0.07
Effect of Dilutive Securities:						
Stock Options						