UNIVERSAL SECURITY INSTRUMENTS INC
Form 10-Q
August 20, 2018

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 June 30, 2018

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, 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 ¨ Non-Accelerated Filer ¨ Smaller Reporting Company x 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

At August 20, 2018, the number of shares outstanding of the registrant's common stock was 2,312,887.

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	(unaudited) June 30, 2018	(audited) March 31, 2018
CURRENT ASSETS		
Cash	$77,072	$128,161
Accounts receivable:		
Trade, less allowance for doubtful accounts	138,861	418,550
Receivables from employees	55,496	55,568
Receivable from Hong Kong Joint Venture	378,674	-
	573,031	474,118
Amount due from factor	1,978,763	2,410,680
Inventories – finished goods	5,863,773	5,491,892
Prepaid expenses	223,856	278,100
TOTAL CURRENT ASSETS	8,716,495	8,782,951
INVESTMENT IN HONG KONG JOINT VENTURE	9,390,105	10,023,275
INTANGIBLE ASSET - NET	57,014	58,132
PROPERTY AND EQUIPMENT – NET	29,611	35,585
OTHER ASSETS	4,000	4,000
TOTAL ASSETS	$18,197,225	$18,903,943
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Line of credit - factor	$1,204,399	$1,611,154
Accounts payable - Hong Kong Joint Venture	4,333,195	3,838,627
Accounts payable - trade	613,196	494,253
Accrued liabilities:		
Accrued payroll and employee benefits	58,932	51,066
Accrued commissions and other	61,770	155,507

TOTAL CURRENT LIABILITIES	6,271,492	6,150,607
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 June 30, 2018 and March 31, 2018	23,129	23,129
Additional paid-in capital	12,885,841	12,885,841
Accumulated Deficit	(1,737,713)	(1,298,880)
Accumulated other comprehensive income	754,476	1,143,246
TOTAL SHAREHOLDERS' EQUITY	11,925,733	12,753,336
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$18,197,225	$18,903,943

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

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UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30, 2018	2017
Net sales	$4,045,996	$3,318,237
Cost of goods sold – acquired from Joint Venture	2,618,867	2,252,427
Cost of goods sold – other	186,985	84,277
GROSS PROFIT	1,240,144	981,533
Selling, general and administrative expense	1,197,771	1,143,920
Research and development expense	153,387	174,723
Operating loss	(111,014)	(337,110)
Other expense:		
Loss from investment in Hong Kong Joint Venture	244,400	188,110
Interest expense	83,419	18,443
NET LOSS	$(438,833)	$(543,663)
Loss per share:		
Basic and diluted	$(0.19)	$(0.24)
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 June 30,	
	2018	2017
NET LOSS	$(438,833)	$(543,663)
Other Comprehensive (Loss) Income		
Company's portion of Hong Kong Joint Venture's other Comprehensive (loss) income:		
Currency translation	(379,479)	132,544
Unrealized (loss) income on investment securities	(9,291)	19,523
Total Other Comprehensive (Loss) Income	(388,770)	152,067
COMPREHENSIVE LOSS	$(827,603)	$(391,596)

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

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UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended June 30,	
	2018	2017
OPERATING ACTIVITIES		
Net loss	$(438,833)	$(543,663)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,092	10,029
Loss from investment in Hong Kong Joint Venture	244,400	188,110
Changes in operating assets and liabilities:		
Decrease (Increase) in accounts receivable and amounts due from factor	333,004	(315,244)
(Increase) Decrease in inventories, prepaid expenses, and other	(317,637)	247,957
Increase in accounts payable and accrued expenses	527,640	949,359
NET CASH PROVIDED BY OPERATING ACTIVITIES	355,666	536,548
INVESTING ACTIVITIES:		
Purchase of equipment	-	(16,106)
NET CASH USED IN INVESTING ACTIVITIES	-	(16,106)
FINANCING ACTIVITIES:		
Net repayment of Line of Credit - Factor	(406,755)	(536,289)
NET CASH USED IN FINANCING ACTIVITIES	(406,755)	(536,289)
NET DECREASE IN CASH	(51,089)	(15,847)
Cash at beginning of period	128,161	262,355
CASH AT END OF PERIOD	$77,072	$246,508
SUPPLEMENTAL INFORMATION:		
Interest paid	$96,367	$18,443
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, 2018, 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 accounting principles generally accepted in the United States of America (US-GAAP) have been condensed or omitted. The interim condensed consolidated financial statements should be read in conjunction with the Company's March 31, 2018 audited financial statements filed with the Securities and Exchange Commission on Form 10-K on July 16, 2018. 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 $438,833 for the three months ended June 30, 2018 and $2,262,310 and $2,058,902 for the years ended March 31, 2018 and 2017, respectively. Furthermore, as of June 30, 2018, working capital (computed as the excess of current assets over current liabilities) decreased by $187,341 from $2,632,344 at March 31, 2018, to $2,445,003 at June 30, 2018.

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 (Agreement) with Merchant Factor Corporation (Merchant or Factor). 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. At June 30, 2018, the Company had approximately $913,000 of availability on the facility with Merchant.

In addition, we have secured extended payment terms for purchases up to $4,000,000 from Eyston Company Limited, our Hong Kong Joint Venture for the purchase of the sealed battery products. These amounts are unsecured and have repayment terms of one hundred-twenty days for each advance thereunder. The interest rate on amounts due to the Hong Kong Joint Venture was 4.5% through June 1, 2018 when this was increased to 5.5%. At June 30, 2018, the balance of accounts payable due to the Hong Kong Joint Venture was $4,333,195.

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 resulting from the delivery of the Company's line of sealed battery ionization smoke alarms and carbon monoxide products, and obtaining additional financing on its credit facility. The Company has seen positive results on this plan during the fiscal years ended March 31, 2018 and 2017 and through June 30, 2018 due to sales of its sealed battery products and management expects this growth to continue going forward. Though no assurances can be given, if management's plan continues to be successful over the next twelve months, the Company anticipates that it should be able to meet its cash needs for the next twelve months following the issuance date of this report.

Cash flows and credit availability is expected to be adequate to fund operations for one year from the issuance date of this report.

Line of Credit – Factor

On January 15, 2015, the Company entered into the Agreement with Merchant for the purpose of factoring the Company's trade accounts receivable and to provide financing secured by finished goods inventory. Under the Agreement the Company may borrow eighty percent (80%) of eligible accounts receivable. Additional funding, characterized by Merchant as an over advance, may be provided up to one hundred percent (100%) of eligible accounts receivable. The over advance portion, if any, may not exceed fifty percent (50%) of eligible inventory up to a maximum of $500,000. The Agreement which expires on January 6, 2020, and provides for continuation of the program for successive two year periods until terminated by one of the parties to the Agreement. As of June 30, 2018, the Company had borrowings of $1,204,399 under the Agreement, and the Company had remaining availability under the Agreement of approximately $913,000. Advances on factored trade accounts receivable 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 7.00% at June 30, 2018). 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

Adoption of ASC Topic 606, *Revenue from Contracts with Customers*

On April 1, 2018, the Company adopted ASC Topic 606 using the modified retrospective method. Results for reporting periods beginning after April 1, 2018 are presented under ASC Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with ASC Topic 605, “Revenue Recognition”. The adoption of ASC Topic 606 had no material impact on our current or previously recorded results of operations.

Revenue Recognition

The Company’s primary source of revenue is the sale of safety and security products based upon purchase orders or contracts with customers. Revenue is recognized at a point in time once the Company has determined that the customer has obtained control over the product. Control is typically deemed to have been transferred to the customer when the product is shipped or delivered to the customer. Customers may not return, exchange or refuse acceptance of goods without our approval. Generally, the Company does not grant extended payment terms. Shipping and handling costs associated with outbound freight, after control over a product has transferred to a customer, are accounted for as a fulfillment cost and are recorded in selling, general and administrative expense.

The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for products sold. Revenue is recorded at the transaction price net of estimates of variable consideration. The Company uses the expected value method based on historical data in considering the impact of estimates of variable consideration, which may include trade discounts, allowances, product returns (including rights of return) or warranty replacements. Estimates of variable consideration are included in revenue to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur.

The Company has entered into an agreement with a single customer to grant pre-approved rights of return of up to twenty-five percent of products sold on certain invoices to provide for and gain acceptance within certain markets. This customer has been provided extended payment terms to provide for a portion of the payment to be made within 120 days.

Disaggregation of Revenue

The Company presents revenue associated with sales of products acquired from our Hong Kong Joint Venture separately from revenue associated with sales of ground fault circuit interrupters (GFCI's) and ventilation fans. The Company believes this disaggregation best depicts how our various product lines perform and are affected by economic factors. Revenue recognized by these categories for the fiscal quarters ended June 30, 2018 and 2017 are as follows:

	Three months ended	
	June 30, 2018	June 30, 2017
Sales of products acquired from our HKJV	$3,764,416	$3,156,044
Sales of GFCI's and ventilation fans	281,580	162,193
	$4,045,996	$3,318,237

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Receivables

Receivables are recorded when the Company has an unconditional right to consideration. We have established allowances to cover anticipated doubtful accounts based upon historical experience.

Remaining Performance Obligations

Remaining performance obligations represent the transaction price of firm orders for satisfied or partially satisfied performance obligations on contracts with an original expected duration of one year or more. The Company's contracts are predominantly short-term in nature with a contract term of one year or less. For those contracts, the Company has utilized the practical expedient in ASC Topic 606 exempting the Company from disclosure of the transaction price allocated to remaining performance obligations if the performance obligation is part of a contract that has an original expected duration of one year or less.

Joint Venture

The Company and its joint venture partner, a Hong Kong corporation, each owns a 50% interest in 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 the basis of accounting used by the Hong Kong Joint Venture. The following represents summarized balance sheet and income statement information of the Hong Kong Joint Venture as of and for the three months ended June 30, 2018 and 2017:

	2018	2017
	(Unaudited)	(Unaudited)
Net sales	$3,266,557	$3,165,980
Gross profit	346,111	454,631
Net loss	(546,959)	(527,061)
Total current assets	13,189,847	12,665,252
Total assets	22,082,883	24,241,558
Total current liabilities	2,990,291	2,548,771
Total liabilities	3,378,728	2,939,357

During the three months ended June 30, 2018 and 2017 the Company purchased $2,804,372 and $1,891,141, respectively, of products directly from the Hong Kong Joint Venture for resale. For the three months ended June 30, 2018 the Company has decreased its equity in the net loss of the Joint Venture to reflect a decrease of $29,079 in inter-Company profit on purchases held by the Company in inventory. For the three months ended June 30, 2017 the Company has decreased its equity in the net loss of the Joint Venture to reflect a decrease of $75,421 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. 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.

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.