

UNIVERSAL SECURITY INSTRUMENTS INC
Form 10-K
July 08, 2008

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended March 31, 2008 or
 Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission file number: 001-31747

UNIVERSAL SECURITY INSTRUMENTS, INC.
(Exact name of registrant as specified in its charter)

MARYLAND
(State or other jurisdiction
of incorporation or organization)

52-0898545
(I.R.S. Employer
Identification No.)

7-A Gwynns Mill Court Owings Mills, Maryland
(Address of principal executive offices)

21117
(Zip Code)

Registrant's telephone number, including area code

(410) 363-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock, \$0.01 par value

Name of Each Exchange on Which Registered
American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None
Title of Class

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Act). Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or other information

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statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company x

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

The aggregate market value of Common Stock, \$.01 par value, held by non-affiliates of the registrant based on the closing sales price of the Common Stock on the American Stock Exchange Stock on September 30, 2007, was \$37,202,394.

The number of shares of common stock outstanding as of June 27, 2008 was 2,487,867.

DOCUMENTS INCORPORATED BY REFERENCE

To the extent specified, Part III of this Form 10-K incorporates information by reference to the Registrant's definitive proxy statement for its 2008 Annual Meeting of Shareholders (to be filed).

UNIVERSAL SECURITY INSTRUMENTS, INC.
2008 ANNUAL REPORT ON FORM 10-K

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PART I

ITEM 1.

BUSINESS

General

Universal Security Instruments, Inc. (“we” or “the Company”) designs and markets a variety of popularly-priced safety products consisting primarily of smoke alarms, carbon monoxide alarms and related products. Most of our products require minimal installation and are designed for easy installation by the consumer without professional assistance, and are sold through retail stores. We also market products to the electrical distribution trade through our wholly-owned subsidiary, USI Electric, Inc. (“USI Electric”). The electrical distribution trade includes electrical and lighting distributors as well as manufactured housing companies. Products sold by USI Electric usually require professional installation.

In 1989 we formed a limited liability company under the laws of Hong Kong, as a joint venture with a Hong Kong-based partner to manufacture various products in the Peoples Republic of China (the “Hong Kong Joint Venture”). We currently own a 50% interest in the Hong Kong Joint Venture and are a significant customer of the Hong Kong Joint Venture (68.9% and 46.4% of its sales during fiscal 2008 and 2007 respectively), with the balance of its sales made to unrelated customers worldwide.

We import all of our products from various foreign suppliers. For the fiscal year ended March 31, 2008, approximately 80.0% of our purchases were imported from the Hong Kong Joint Venture.

Our sales for the year ended March 31, 2008 were \$33,871,362 compared to \$32,934,388 for the year ended March 31, 2007, an increase of approximately 2.8%. We reported income from continuing operations of \$2,824,749 in fiscal 2008 compared to income from continuing operations of \$6,093,366 in fiscal 2007, a decrease of 53.6%.

The Company was incorporated in Maryland in 1969. Our principal executive office is located at 7-A Gwynns Mill Court, Owings Mills, Maryland 21117, and our telephone number is 410-363-3000. Information about us may be obtained from our website www.universalsecurity.com. Copies of our Annual Report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, are available free of charge on our website as soon as they are filed with the Securities and Exchange Commission (SEC) through a link to the SEC’s EDGAR reporting system. Simply select the “Investor Relations” menu item, then click on the “SEC Filings” link. The SEC’s EDGAR reporting system can also be accessed directly at www.sec.gov.

Safety Products

We market a line of residential smoke alarms under the trade names “USI Electric” and “UNIVERSAL” both of which are manufactured by the Hong Kong Joint Venture.

Our line of smoke alarms consists of battery, electrical and electrical with battery backup alarms. Our products contain different types of batteries with different battery lives, and some with alarm silencers. The smoke alarms marketed to the electrical distribution trade also include hearing impaired and heat alarms with a variety of additional features. We also market outdoor floodlights under the name “Lite Aide(TM),” carbon monoxide alarms, door chimes and ground fault circuit interrupter (GFCI) units.

Our wholly-owned subsidiary, USI Electric, Inc., focuses its sales and marketing efforts to maximize safety product sales, especially smoke alarms and carbon monoxide alarms manufactured by our Hong Kong Joint Venture and marketed to the electrical distribution and retail trade.

Import Matters

We import all of our products. As an importer, we are subject to numerous tariffs which vary depending on types of products and country of origin, changes in economic and political conditions in the country of manufacture, potential trade restrictions and currency fluctuations. We have attempted to protect ourselves from fluctuations in currency exchange rates to the extent possible by negotiating commitments in U.S. dollars.

Our inventory purchases are also subject to delays in delivery due to problems with shipping and docking facilities, as well as other problems associated with purchasing products abroad. Substantially all of our safety products, including products we purchase from our Hong Kong Joint Venture, are imported from the People's Republic of China.

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Sales and Marketing: Customers

We sell our products to various customers, and our total sales market can be divided generally into two categories; sales by the Company, and sales by our USI Electric subsidiary.

The Company markets our products to retailers, including wholesale distributors, chain, discount, television retailers and home center stores, catalog and mail order companies and to other distributors (“retailers”). Our products have historically been retailed to “do-it-yourself” consumers by these retailers. We do not currently market any significant portion of our products directly to end users.

The Company’s retail sales are made directly by our employees and by approximately 17 independent sales organizations who are compensated by commissions. Our agreements with these sales organizations are generally cancelable by either party upon 30 days notice. We do not believe that the loss of any one of these organizations would have a material adverse effect upon our business. Sales made directly by us are effected by our officers and full-time employees, seven of whom are also engaged in sales, management and training. Sales outside the United States are made by our officers and through exporters, and amounted to less than 0.3% of total sales in the fiscal years ended March 31, 2008 and 2007.

During fiscal 2007, we began selling home safety products to The Home Depot, Inc., a major national home improvement retailer, and total sales to Home Depot for fiscal 2008 and 2007 represented approximately 40.2% and 11% of our revenues, respectively.

Our USI Electric subsidiary markets our products to the electrical distribution trade (primarily electrical and lighting distributors and manufactured housing companies). USI Electric has established a national distribution system with 12 regional stocking warehouses throughout the United States which generally enables customers to receive their orders the next day without paying for overnight freight charges. USI Electric engages sales personnel from the electrical distribution trade and has engaged 27 independent sales organizations which represent approximately 230 sales representatives, some of which have warehouses where USI Electric products are maintained by our sales representatives for sale.

We also market our products through our own sales catalogs and brochures, which are mailed directly to trade customers, and our website. Our customers, in turn, may advertise our products in their own catalogs and brochures and in their ads in newspapers and other media. We also exhibit and sell our products at various trade shows, including the annual National Hardware Show.

Our backlog of orders believed to be firm as of March 31, 2008 was approximately \$1,863,901. Our backlog as of March 31, 2007 was approximately \$2,219,435. This decrease in backlog is primarily due to a reduction in the backlog of orders we had for ground fault circuit interrupters and lower overall sales of our safety products.

Hong Kong Joint Venture

We have a 50% interest in the Hong Kong Joint Venture which has manufacturing facilities in the People’s Republic of China, for the manufacturing of certain of our electronic and electrical products.

We believe that the Hong Kong Joint Venture arrangement will ensure a continuing source of supply for a majority of our safety products at competitive prices. During fiscal year 2008, 80.0% of our total inventory purchases were made from the Hong Kong Joint Venture. The products produced by the Hong Kong Joint Venture include smoke alarms and carbon monoxide alarms. Changes in economic and political conditions in China or any other adversity to the Hong Kong Joint Venture will unfavorably affect the value of our investment in the Hong Kong Joint Venture and would have a material adverse effect on the Company’s ability to purchase products for distribution.

Our purchases from the Hong Kong Joint Venture represented approximately 68.9% of the Hong Kong Joint Venture's total sales during fiscal 2008 and 46% of total sales during fiscal 2007, with the balance of the Hong Kong Joint Venture's sales being primarily made in Europe and Australia, to unrelated customers. The Hong Kong Joint Venture's sales to unrelated customers were \$9,378,242 in fiscal 2008 and \$22,065,702 in fiscal 2007. Please see Note D of the Financial Statements for a comparison of annual sales and earnings of the Hong Kong Joint Venture.

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Discontinued Operations

In October 2006, we formed 2113824 Ontario, Inc., an Ontario corporation, as a wholly-owned subsidiary of the Company for the purpose of acquiring a two-thirds interest in two Canadian corporations, International Conduits, Ltd. (Icon) and Intube, Inc. (Intube). Icon and Intube are based in Toronto, Canada and manufacture and distribute electrical mechanical tubing (EMT) steel conduit. Icon also sells home safety products, primarily purchased from the Company, in the Canadian market. The primary purpose of the Icon and Intube acquisition was to expand our product offerings to include EMT steel conduit, and to provide this product and service to the commercial construction market. On April 2, 2007, Icon and Intube were merged under the laws of Ontario to form one corporation.

At the time of our investment in Icon, we projected that our established U.S. sales network would allow us to increase sales of EMT to U.S. customers. Despite our efforts, Icon suffered continuing losses, and we were not successful in increasing Icon's sales in the face of competition and a downturn in the housing market. On January 29, 2008, Icon received notice from CIT Financial, Ltd. (CIT Canada), Icon's principal and secured lender, that Icon was in default under the terms of the Credit Agreement dated June 22, 2007 between Icon and CIT Canada and demanding immediate payment of all of Icon's obligations to CIT Canada under the Credit Agreement. On February 11, 2008, the assets of Icon were placed under the direction of a court appointed receiver.

The assets held for sale related to the discontinued Canadian operations were adjusted to net realizable value based on management's estimates. The process of completing the liquidation of Icon's assets is continuing and the Company believes the process will continue into the second quarter of our 2009 fiscal year. Accordingly, the actual impairment charges actually incurred could differ based on the actual results of the liquidation process.

The results of Icon for the fiscal year ended March 31, 2008 and for the six month period from the date of acquisition (October 1, 2006) to March 31, 2007 have been restated and are presented in our financial statements as the results of discontinued operations, and certain prior year amounts have been restated in order to conform with the current year's presentation.

Other Suppliers

Certain private label products not manufactured for us by the Hong Kong Joint Venture are manufactured by other foreign suppliers. We believe that our relationships with our suppliers are good. We believe that the loss of our ability to purchase products from the Hong Kong Joint Venture would have a material adverse effect on the Company. The loss of any of our other suppliers would have a short-term adverse effect on our operations, but replacement sources for these other suppliers could be developed.

Competition

In fiscal year 2008, sales of safety products accounted for substantially all of our total sales. In the sale of smoke alarms, we compete in all of our markets with First Alert and Walter Kidde Portable Equipment, Inc. In the sale of GFCI units, we compete in all our markets with Leviton Manufacturing Co., Inc., Pass & Seymour, Inc., Cooper Wiring Devices and Hubbell, Inc. All of these companies have greater financial resources and financial strength than we have. We believe that our safety products compete favorably in the market primarily on the basis of styling, features and pricing.

The safety industry in general involves changing technology. The success of our products may depend on our ability to improve and update our products in a timely manner and to adapt to new technological advances.

Employees

As of March 31, 2008, we had 19 employees, 14 of whom are engaged in administration and sales, and the balance of whom are engaged in product development, manufacturing and servicing. Our employees are not unionized, and we believe that our relations with our employees are satisfactory.

ITEM 1A.

RISK FACTORS

An investment in our Common Stock is subject to risks inherent to our business. The material risks and uncertainties that management believes affect the Company are described below. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company's business operations.

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Risk Factors Relating To Our Business Generally

Our success depends to a very large degree on our relationship with and the success of our Hong Kong Joint Venture.

During fiscal year 2008, 80.0% of our total inventory purchases were made from the Hong Kong Joint Venture. The products produced by the Hong Kong Joint Venture include smoke alarms and carbon monoxide alarms, and we are currently pursuing the development of additional products to be manufactured by the Hong Kong Joint Venture. Our purchases from the Hong Kong Joint Venture represented approximately 68.9% of the Hong Kong Joint Venture's total sales during fiscal 2008, with the balance of the Hong Kong Joint Venture's sales being primarily made in Europe and Australia to unrelated customers. If the Hong Kong Joint Venture does not maintain profitability, our profitability will be adversely affected.

In addition, adverse changes in our relationship with our Hong Kong Joint Venture partners would unfavorably affect the value of our investment in the Hong Kong Joint Venture and could have a material adverse effect on our ability to purchase products for distribution.

Our reliance on the Hong Kong Joint Venture exposes us to uncertainties and risks from abroad which could negatively affect our operations and sales.

Our relationship with the Hong Kong Joint Venture and our and the Hong Kong Joint Venture's sales in other countries expose us to particular risks. The following are among the risks that could negatively affect our imports and our and the Hong Kong Joint Venture's sales in foreign markets:

new restrictions on access to markets,
currency devaluation,
new tariffs,
adverse changes in monetary and/or tax policies,
inflation, and
governmental instability.

Should any of these risks occur, the value of our investment in the Hong Kong Joint Venture could be reduced and our results of operations could be negatively impacted.

The lack of availability of inventory could adversely affect our financial results.

We source inventory primarily from our Hong Kong Joint Venture, which has manufacturing facilities in the People's Republic of China. Our purchases of inventory are subject to being affected by a number of factors, namely, production capacity, labor unrest and untimely deliveries. Changes in economic and political conditions in China or any other adversity to the Hong Kong Joint Venture will unfavorably affect the value of our investment in the Hong Kong Joint Venture and could have a material adverse effect on the our ability to purchase products for distribution.

Our Hong Kong Joint Venture is subject to political and economic factors unique to China.

The Chinese government has been reforming the Chinese economic system. In recent years, the government has also begun reforming the government structure. These reforms have resulted in significant economic growth and social progress. Although the majority of the production assets in China are still state-owned, economic reform policies have emphasized autonomous enterprises and the utilization of market mechanisms. Our Hong Kong Joint Venture currently expects that the Chinese government will continue its reform by further reducing governmental intervention in business enterprises and allowing market mechanisms to allocate resources. Any adverse changes in political,

economic or social conditions in China could have a material adverse effect on the Hong Kong Joint Venture's operations and our financial results, as well as our ability to purchase products manufactured by the Hong Kong Joint Venture.

We are subject to risks in connection with the importation of our products from foreign countries.

We import all of our products. As an importer, we are subject to numerous tariffs which vary depending on types of products and country of origin, changes in economic and political conditions in the country of manufacture, potential trade restrictions and currency fluctuations. We have attempted to protect ourselves from fluctuations in currency exchange rates to the extent possible by negotiating commitments in U.S. dollars. We are also subject to strikes or other labor unrest at points of origin and destination, as well as delays and restrictions which impact shipping and shipping routes.

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We rely on our key personnel and the loss of one or more of those personnel could have a material adverse effect on our business, financial condition and results of operations.

Our operations and prospects depend in large part on the performance of our senior management team. There can be no assurance that we would be able to find qualified replacements for any of these individuals if their services were no longer available. The loss of the services of one or more members of our senior management team could have a material adverse effect on our business, financial condition, and results of operations.

Our competition is both intense and varied and our failure to effectively compete could adversely affect our prospects.

In fiscal year 2008, our sales of safety products accounted for substantially all of our sales. Many of our competitors have greater financial resources and financial strength than we have. Some of our competitors may be willing to reduce prices and accept lower profit margins to compete with us. While we believe that our safety products compete favorably with other such products in the market, primarily on the basis of styling, features, and pricing, the safety industry in general involves changing technology. The success of our products may depend on our ability to improve and update our products in a timely manner and to adapt to new technological advances. As a result of this competition, we could lose market share and suffer losses, which could have a material adverse effect on our future financial performance.

The security products marketplace is dynamic and challenging because of the introduction of new products and services.

We must constantly introduce new products, services, and product features to meet competitive pressures. We may be unable to timely change our existing merchandise sales mix in order to meet these competitive pressures, which may result in increased inventory costs or loss of market share.

Adverse changes in national or regional U.S. economic conditions could adversely affect our financial results.

We market our products nationally to retailers, including wholesale distributors, chain, discount, and home center stores, catalog and mail order companies and to other distributors. Overall consumer confidence, consumer credit availability, recessionary trends, housing starts and prices, mortgage rates, and consumers' disposable income and spending levels directly impact our sales. Negative trends, whether national or regional in nature, in any of these economic conditions could adversely affect our financial results.

Our products must meet specified quality and safety standards to enter and stay on the market.

Our products must meet US. and various international standards before they are sold. For example, in the United States, our products must be certified by Underwriters Laboratories (UL) and similar certifications must be obtained in each country where we compete for market share. If our manufacturers' products or manufacturing facilities (including those of the Hong Kong Joint Venture) fail to pass periodic inspections, the approval certificates for the relevant products may be suspended until corrections are made. Loss of UL or other independent certifications could have a material adverse affect on our sales and financial results.

Our products expose us to the potential of product liability claims.

All of our products are manufactured by the Hong Kong Joint Venture or others. Nevertheless, we could be named as a defendant in an action arising from damages suffered as a result of one of our products. While we carry products liability insurance, to the extent we are found liable for damages for which we are uninsured, our profitability may be adversely affected. Any suit, even if not meritorious or if covered by an indemnification obligation, could result in the

expenditure of a significant amount of our financial and managerial resources and could create significant negative publicity for us and our products.

We may be unable to successfully execute our merchandising and marketing strategic initiatives.

Our wholly-owned subsidiary, USI Electric focuses its sales and marketing efforts and initiatives to maximize safety product sales, especially smoke alarms and carbon monoxide alarms manufactured by our Hong Kong Joint Venture and marketed to the electrical distribution and retail trade. If we fail to successfully execute these initiatives, our business could be adversely affected.

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We are and could become subject to litigation regarding intellectual property rights, which could seriously harm our business.

We design most of our security products and contract with suppliers to manufacture those products and deliver them to us. We have been the subject of lawsuits by third parties which assert against us infringement claims or claims that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. If such infringement by our suppliers or us were found to exist, we could be subject to monetary damages and an injunction preventing the use of their intellectual property. If one of our products were found to infringe, we may attempt to acquire a license or right to use such technology or intellectual property, which could result in higher manufacturing costs. Any infringement claim, even if not meritorious and/or covered by an indemnification obligation, could result in the expenditure of a significant amount of our financial and managerial resources.

If governmental regulations change or are applied differently, our business could suffer.

The sales of our smoke and carbon monoxide alarms are impacted by local laws and regulations mandating the installation of these security devices in new and sometimes existing homes and buildings. Changes in these consumer safety regulations, both in the United States and abroad, could impact our business.

Risk Factors Relating to our Articles of Incorporation and our Stock

The liability of our directors is limited.

Our Articles of Incorporation limit the liability of directors to the maximum extent permitted by Maryland law.

It is unlikely that we will issue dividends on our common stock in the foreseeable future.

We have not declared or paid cash dividends on our common stock in over 22 years and do not intend to pay cash dividends in the foreseeable future. The payment of dividends in the future will be at the discretion of our board of directors.

The exercise of outstanding options will dilute the percentage ownership of our stockholders, and any sales in the public market of shares of our common stock underlying such options may adversely affect prevailing market prices for our common stock.

As of March 31, 2008, there are outstanding options to purchase an aggregate of 88,921 shares of our common stock at per share exercise prices ranging from \$7.68 to \$16.09. The exercise of such outstanding options would dilute the percentage ownership of our existing stockholders, and any sales in the public market of shares of our common stock underlying such options may adversely affect prevailing market prices for our common stock.

It may be difficult for a third party to acquire us, which could affect our stock price.

Our charter and Bylaws contain certain anti-takeover provisions pursuant to the Maryland General Corporation Law. This means that we may be a less attractive target to a potential acquirer who otherwise may be willing to pay a premium for our common stock above its market price.

ITEM 1B.

UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2.

PROPERTIES

Effective December 1999, we entered into an operating lease for a 9,000 square foot office and warehouse located in Baltimore County, Maryland. This lease is due to expire October 2008, and we are in discussions with our landlord for an extension of the lease or the Company will relocate locally. The Company is currently evaluating if our lease will be renewed on substantially the same terms as our current lease. The current rental, with common area maintenance, approximates \$5,835 per month during the current fiscal year, with increasing rentals at 3% per year.

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Effective March 2003, we entered into an operating lease for an approximately 2,600 square foot office in Naperville, Illinois. This lease expires in February 2012 and is subject to increasing rentals at 3% per year. The monthly rental, with common area maintenance, approximates \$3,089 per month during the current fiscal year.

The Hong Kong Joint Venture currently operates an approximately 100,000 square foot manufacturing facility i