

NAPCO SECURITY TECHNOLOGIES, INC

Form 10-Q

May 13, 2013

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 AND EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2013

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)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes

X No \_\_\_

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Indicate by check mark whether 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 Exchange Act):

Yes \_\_\_ No X

Number of shares outstanding of each of the issuer’s classes of common stock, as of: May 10, 2013

COMMON STOCK, \$.01 PAR VALUE PER SHARE 19,296,335

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NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

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## PART I: FINANCIAL INFORMATION

## Item 1. Financial Statements

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2013 (unaudited)	June 30, 2012 (audited)
	(in thousands, except for share data)	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,856	\$ 2,979
Accounts receivable, net of reserves and allowances	14,532	16,408
Inventories	17,299	19,448
Prepaid expenses and other current assets	949	964
Income tax receivable	33	--
Deferred income taxes	650	650
Total Current Assets	35,319	40,449
Inventories - non-current	5,129	3,834
Deferred income taxes	1,874	1,762
Property, plant and equipment, net	6,793	7,247
Intangible assets, net	10,563	11,251
Other assets	188	207
<b>TOTAL ASSETS</b>	<b>\$ 59,866</b>	<b>\$ 64,750</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Current maturities of long term debt	\$ 1,600	\$ 1,600
Accounts payable	3,224	3,163
Accrued expenses	1,054	1,814
Accrued salaries and wages	1,420	1,589
Accrued income taxes	--	78
Total Current Liabilities	7,298	8,244
Long-term debt, net of current maturities	15,200	18,657
Accrued income taxes	154	126
Total Liabilities	22,652	27,027
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common Stock, par value \$0.01 per share; 40,000,000 shares authorized; 20,796,813 and 20,095,713 shares issued; and 19,296,335 and 19,095,713 shares outstanding, respectively	208	201
Additional paid-in capital	15,444	14,080
Retained earnings	28,869	29,057
	44,521	43,338
Less: Treasury Stock, at cost (1,500,478 and 1,000,000 shares, respectively)	(7,307 )	(5,615 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>37,214</b>	<b>37,723</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 59,866</b>	<b>\$ 64,750</b>

See accompanying notes to condensed consolidated financial statements.



NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Nine months ended March 31,	
	2013	2012
	(In thousands, except share and per share data)	
Net sales	\$ 49,591	\$ 51,056
Cost of sales	36,162	36,941
Gross Profit	13,429	14,115
Selling, general, and administrative expenses	13,216	12,673
Operating Income	213	1,442
Other expense:		
Interest expense, net	440	889
Other, net	10	42
	450	931
(Loss) Income before (Benefit) Provision for Income Taxes	(237 )	511
(Benefit) Provision for income taxes	(49 )	66
Net (Loss) Income	\$ (188 )	\$ 445
Net (Loss) Income per share:		
Basic	\$ (0.01 )	\$ 0.02
Diluted	\$ (0.01 )	\$ 0.02
Weighted average number of shares outstanding:		
Basic	19,181,000	19,096,000
Diluted	19,181,000	19,253,000

See accompanying notes to condensed consolidated financial statements.



NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine months ended March 31,	
	2013	2012
	(in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net (Loss) Income	\$ (188 )	\$ 445
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	1,467	1,638
Provision for doubtful accounts	20	--
Deferred income taxes	(112 )	215
Stock based compensation expense	--	8
Changes in operating assets and liabilities:		
Accounts receivable	1,856	3,903
Inventories	854	(85 )
Prepaid expenses and other current assets	16	159
Income tax receivable	(33 )	(133 )
Other assets	9	(44 )
Accounts payable and accrued expenses	(918 )	(3,077 )
Net Cash Provided by Operating Activities	2,971	3,029
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of property, plant, and equipment	(316 )	(430 )
Net Cash Used in Investing Activities	(316 )	(430 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on long-term debt	(3,457 )	(2,679 )
Tax benefit from stock option exercise	114	--
Cash paid for purchase of treasury stock	(435 )	--
Net Cash Used in Financing Activities	(3,778 )	(2,679 )
Net Decrease in Cash and Cash Equivalents	(1,123 )	(80 )
CASH AND CASH EQUIVALENTS - Beginning	2,979	3,077
CASH AND CASH EQUIVALENTS - Ending	\$ 1,856	\$ 2,997
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Interest paid, net	\$ 353	\$ 938
Income taxes paid	\$ 31	467
<b>NON-CASH FINANCING ACTIVITIES:</b>		
Surrender of shares for common stock options exercised	\$ 1,257	\$ --

See accompanying notes to condensed consolidated financial statements.

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NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)  
MARCH 31, 2013

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

Nature of Business

Napco Security Technologies, Inc. and Subsidiaries (the "Company") is a diversified manufacturer of security products, encompassing electronic door-locking devices, intrusion and fire alarms and building access control systems. 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 the Company'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.

Significant Accounting Policies

The accompanying Condensed Consolidated Financial Statements are unaudited. In management's opinion, all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation have been made. The results of operations for the period ended March 31, 2013 are not necessarily indicative of results that may be expected for any other interim period or for the full year.

The unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended June 30, 2012. The accounting policies used in preparing these unaudited Condensed Consolidated Financial Statements are consistent with those described in the June 30, 2012 Consolidated Financial Statements. In addition, the Condensed Consolidated Balance Sheet as of June 30, 2012 was derived from the audited financial statements but does not include all disclosures required by Generally Accepted Accounting Principles ("GAAP").

Principles of Consolidation

The 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.

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 revenue recognition, reserves for sales returns and allowances, concentration of credit risk, inventories, intangible assets and income taxes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include approximately \$460,000 of short-term time deposits at March 31, 2013 and June 30, 2012. 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 March 31, 2013 and June 30, 2012.

#### Accounts Receivable

Accounts receivable is stated net of the reserves for doubtful accounts of \$220,000 and \$200,000 and for returns and other allowances of \$1,045,000 and \$1,184,000 as of March 31, 2013 and June 30, 2012, respectively. Our reserves for doubtful accounts and for returns and other allowances are subjective critical estimates that have a direct impact on reported net earnings. These reserves are based upon the evaluation of accounts receivable agings, specific exposures, sales levels and historical trends.

## Inventories

Inventories are valued at the lower of cost or fair market 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 amounts of those expenses that are related to procuring and storing raw materials and of those related 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 the difference between the cost of the inventory and 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. There is inherent professional judgment and subjectivity made by both production and engineering members of management in determining the estimated obsolescence percentage. In addition, and as necessary, the Company may establish specific reserves for future known or anticipated events. 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

Certain 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. 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 Marks included intangible assets recorded at fair value on the date of acquisition. The intangible assets are amortized over their estimated useful lives of twenty years (customer relationships) and seven years (non-compete agreement). The Marks USA trade name was deemed to have an indefinite life.

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

	March 31, 2013			June 30, 2012		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value

## Other intangible assets:

Customer relationships	\$9,800	\$ (5,252 )	\$4,548	\$9,800	\$ (4,601 )	\$5,199
Non-compete agreement	340	(225 )	115	340	(188 )	152
Trade name	5,900	--	5,900	5,900	--	5,900
	\$16,040	\$ (5,477 )	\$10,563	\$16,040	\$ (4,789 )	\$11,251

Amortization expense for intangible assets subject to amortization was approximately \$229,000 and \$266,000 for the three months ended March 31, 2013 and 2012, respectively. Amortization expense for intangible assets subject to amortization was approximately \$688,000 and \$799,000 for the nine months ended March 31, 2013 and 2012, respectively. Amortization expense for each of the next five fiscal years is estimated to be as follows: 2013 - \$917,000; 2014 - \$781,000; 2015 - \$667,000; 2016 - \$529,000 and 2017 - \$441,000. The weighted average amortization period for intangible assets was 15.1 years and 15.8 years at March 31, 2013 and June 30, 2012, respectively.

### Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets in question may not be recoverable. Impairment would be recorded in circumstances where undiscounted cash flows expected to be generated by an asset are less than the carrying value of that asset.

### Revenue Recognition

The Company recognizes revenue when the following criteria are met: (i) persuasive evidence of an agreement exists, (ii) there is a fixed and determinable price for the Company's product, (iii) shipment and passage of title occurs, and (iv) collectability is reasonably assured. Revenues from merchandise sales are recorded at the time the product is shipped or delivered to the customer pursuant to the terms of the sale. The Company reports its sales levels on a net sales basis, with net sales being computed by deducting from gross sales the amount of actual sales returns and other allowances and the amount of reserves established for anticipated sales returns and other allowances.

### Sales Returns and Other Allowances

The Company analyzes sales returns and is able to make reasonable and reliable estimates of product returns based on the Company's past history. Estimates for sales returns are based on several factors including actual returns and based on expected return data communicated to it by its customers. Accordingly, the Company believes that its historical returns analysis is an accurate basis for its allowance for sales returns. Actual results could differ from those estimates.

### Advertising and Promotional Costs

Advertising and promotional costs are included in "Selling, General and Administrative" expenses in the consolidated statements of operations and are expensed as incurred. Advertising expense for the three months ended March 31, 2013 and 2012 was \$124,000 and \$388,000, respectively. Advertising expense for the nine months ended March 31, 2013 and 2012 was \$847,000 and \$871,000, respectively. The decrease for the three months resulted primarily from the timing of a major tradeshow. Last year this tradeshow occurred during the quarter ended March 31, 2012 while this year the same tradeshow occurred subsequent to March 31, 2013. For the nine months, this decrease was partially offset by increased expenditures on another major tradeshow and media advertising as compared to the same period a year ago.

### Research and Development Costs

Research and development costs incurred by the Company are charged to expense in the year incurred and are included in "Cost of Sales" in the consolidated statements of operations. Company-sponsored research and development expense for the three months ended March 31, 2013 and 2012 was \$1,187,000 and \$1,094,000, respectively. Company-sponsored research and development expense for the nine months ended March 31, 2013 and 2012 was \$3,842,000 and \$3,134,000, respectively. The increases for the three and nine months was due primarily to expenses relating to development of the Company's iBridge™ tablet computer/touch screen keypad.

### 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. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. 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 (Loss) Per Share

Basic net income (loss) per common share (Basic EPS) is computed by dividing net income (loss) 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 (in thousands, except per share data):

	Three Months Ended March 31,					
	Net Income		Weighted Average		Net Income per Share	
	2013	2012	2013	2012	2013	2012
Basic EPS	\$111	\$303	19,296	19,096	\$0.01	\$0.02
Effect of Dilutive Securities:						
Stock Options	--	--	123	313	--	--
Diluted EPS	\$111	\$303	19,419	19,409	\$0.01	\$0.02

Options to purchase 395,750 shares of common stock for the three months ended March 31, 2013 and 2012 were not included in the computation of Diluted EPS because their inclusion would be anti-dilutive. These options were still outstanding at the end of the respective periods.

	Nine Months Ended March 31,					
	Net (Loss) Income		Weighted Average		Net (Loss) Income per Share	
	2013	2012	2013	2012	2013	2012
Basic EPS	\$(188 )	\$445	19,181	19,096	\$(0.01 )	\$0.02
Effect of Dilutive Securities:						
Stock Options	--	--	--	157	--	--
Diluted EPS	\$(188 )	\$445	19,181	19,253	\$(0.01 )	\$0.02

Options to purchase 672,740 and 733,880 shares of common stock for the nine months ended March 31, 2013 and 2012, respectively, were not included in the computation of Diluted EPS because their inclusion would be anti-dilutive. These options were still outstanding at the end of the respective periods.

#### Stock-Based Compensation

The Company has established two share incentive programs as discussed in Note 8.

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the vesting period. Determining the fair value of share-based awards at the grant date requires assumptions and judgments about expected volatility and forfeiture rates, among other factors.

There were no stock-based compensation costs for the three months ended March 31, 2013 and 2012. Stock-based compensation costs of \$0 and \$8,000 were recognized for the nine months ended March 31, 2013 and 2012, respectively.

#### Foreign Currency

All assets and liabilities of foreign subsidiaries are translated into U.S. Dollars at fiscal period-end exchange rates. Income and expense items are translated at average exchange rates prevailing during the fiscal year. The realized and unrealized gains and losses associated with foreign currency translation, as well as related other comprehensive income, were not material for the three and nine months ended March 31, 2013 and 2012.



### Comprehensive Income

For the three and nine months ended March 31, 2013 and 2012, the Company's operations did not give rise to material items includable in comprehensive income, which were not already included in net income. Accordingly, the Company's comprehensive income approximates its net income for all periods presented.

### Segment Reporting

The Company's reportable operating segments are determined based on the Company's management approach. The management approach is based on the way that the chief operating decision maker organizes the segments within an enterprise for making operating decisions and assessing performance. The Company's results of operations are reviewed by the chief operating decision maker on a consolidated basis and the Company operates in only one segment. The Company has presented required geographical data in Note 11, and no additional segment data has been presented.

### Shipping and Handling Revenues and Costs

The Company records the amount billed to customers in net sales (\$118,000 and \$159,000 for the three months ended March 31, 2013 and 2012, respectively, and \$367,000 and \$434,000 for the nine months ended March 31, 2013 and 2012, respectively) and classifies the costs associated with these revenues in cost of sales (\$266,000 and \$267,000 for the three months ended March 31, 2013 and 2012, respectively, and \$748,000 and \$824,000 for the nine months ended March 31, 2013 and 2012, respectively).

### Recently Issued Accounting Standards

In July 2012, the FASB amended its authoritative guidance related to testing indefinite-lived intangible assets for impairment. Under the revised guidance, entities testing their indefinite-lived intangible assets for impairment have the option of performing a qualitative assessment before performing further impairment testing. If entities determine, on the basis of qualitative factors, that it is more-likely-than-not that the asset is impaired, a quantitative test is required. The guidance becomes effective in the beginning of the Company's fiscal 2014, with early adoption permitted. The Company is currently evaluating the timing of adopting this guidance which is not expected to have an impact on the Company's consolidated financial statements.

In September 2011, the FASB amended its authoritative guidance related to testing goodwill for impairment. Under the revised guidance, entities testing goodwill for impairment have the option of performing a qualitative assessment before performing Step 1 of the goodwill impairment test. If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more-likely-than-not less than the carrying amount, the two-step impairment test would be required. This guidance becomes effective in the beginning of the Company's fiscal 2013, with early adoption permitted. The Company is not adopting this guidance early, and it does not expect the guidance to have an impact on the Company's consolidated financial statements.

### NOTE 2 - Business and Credit Concentrations

The Company had one customer with an accounts receivable balance equal to 11% of the Company's accounts receivable at March 31, 2013 and 15% at June 30, 2012. Sales to any one customer did not exceed 10% of net sales in any of the past three fiscal years.

### NOTE 3 - Inventories

Inventories, net of reserves are valued at lower of cost (first-in, first-out method) or market. The Company regularly reviews parts and finished goods inventories on hand and, when necessary, records a provision for excess or obsolete inventories. The Company also regularly reviews the period over which its inventories will be converted to sales. Any inventories expected to convert to sales beyond 12 months from the balance sheet date are classified as non-current.

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

	March 31, 2013	June 30, 2012
Component parts	\$ 12,696	\$ 13,155
Work-in-process	3,074	3,199
Finished product	6,658	6,928
	\$ 22,428	\$ 23,282

## Classification of inventories, net of reserves:

	March 31, 2013	June 30, 2012
Current	\$ 17,299	\$ 19,448
Non-current	5,129	3,834
	\$ 22,428	\$ 23,282

## NOTE 4 - Property, Plant, and Equipment

Property, plant and equipment consist of the following:

	March 31, 2013	June 30, 2012	Useful Life in Years
	(in thousands)		
Land	\$ 904	\$ 904	--
Buildings	8,911	8,911	30 to 40
Molds and dies	6,783	6,748	3 to 5
Furniture and fixtures	2,324	2,317	5 to 10
Machinery and equipment	19,380	19,107	7 to 10
Leasehold improvements	372	372	Shorter of the lease term or life of asset
	38,674	38,359	
Less: accumulated depreciation and amortization	31,881	31,112	
	\$ 6,793	\$ 7,247	

Depreciation and amortization expense on property, plant, and equipment was approximately \$262,000 and \$278,000 for the three months ended March 31, 2013 and 2012, respectively and \$769,000 and \$797,000 for the nine months ended March 31, 2013 and 2012, respectively.

## NOTE 5 - Income Taxes

The provision for income taxes represents Federal, foreign, and state and local income taxes. The effective rate differs from statutory rates due to the effect of state and local income taxes, tax rates in foreign jurisdictions, tax benefit of R&D credits and certain nondeductible expenses. Our effective tax rate will change from quarter to quarter based on recurring and non-recurring factors including, but not limited to, the geographical mix of earnings, enacted tax legislation, and state and local income taxes. In addition, changes in judgment from the evaluation of new information resulting in the recognition, de-recognition or re-measurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

The Company does not expect that our unrecognized tax benefits will significantly change within the next twelve months. We file a consolidated U.S. income tax return and tax returns in certain state and local and foreign jurisdictions. As of March 31, 2013 we remain subject to examination in all tax jurisdictions for all relevant jurisdictional statutes for fiscal years 2008 and thereafter.

The Company has identified its U.S. Federal income tax return and its State return in New York as its major tax jurisdictions. During the three and nine months ended March 31, 2013 the Company increased its reserve for uncertain income tax positions by \$28,000. As a result, as of March 31, 2013 and June 30, 2012 the Company has a long-term accrued income tax liability of \$154,000 and \$126,000, respectively.



## NOTE 6 - Long-Term Debt

As of March 31, 2013, long-term debt consisted of a revolving credit facility of \$11,000,000 (the "Revolving Credit Facility") which expires in June 2017 and two term loans, one for \$6,000,000 which expires in June 2019, and one for \$6,500,000 which expires in June 2017 (the "Term Loans"). Repayment of the Terms Loans commenced on September 30, 2012. The \$6,000,000 Term Loan is being repaid with 28 equal, quarterly payments of \$75,000 and the remaining balance of \$3,900,000 due on or before the expiration date. The \$6,500,000 Term Loan is being repaid in 20 equal, quarterly payments of \$325,000.

Outstanding balances and interest rates as of March 31, 2013 and June 30, 2012 are as follows (dollars in thousands):

	March 31, 2013			June 30, 2012		
	Outstanding	Interest Rate		Outstanding	Interest Rate	
Revolving line of credit	\$ 5,500	2.5 %	\$	7,757	3.1 %	
Term loans	11,300	2.5 %		12,500	3.1 %	
Total debt	\$ 16,800	2.5 %	\$	20,257	3.1 %	

On June 29, 2012, the Company entered into a Third Amended and Restated Credit Agreement with the Company, as the Borrower, and HSBC Bank USA, National Association as Lender, Administrative Agent and Collateral Agent (the "Agreement"). The Agreement amended and restated the previous revolving credit facility and term loan as described above. The Agreement also provides for a LIBOR-based interest rate option of LIBOR plus 2.0% to 2.75%, depending on the ratio of outstanding debt to EBITDA, which is to be measured and adjusted quarterly, a prime rate-based option of the prime rate plus 0.25% and other terms and conditions as more fully described in the Agreement. In addition, the Agreement provides for availability under the Revolving Credit Facility to be limited to the lesser of \$11,000,000 or the result of a borrowing base formula based upon the Company's Accounts Receivables and Inventory values net of certain deductions. The Company's obligations under the Agreement continue to be secured by all of its assets, including but not limited to, deposit accounts, accounts receivable, inventory, the Company's corporate headquarters in Amityville, N.Y., equipment and fixtures and intangible assets. In addition, the Company's wholly-owned subsidiaries, with the exception of the Company's foreign subsidiaries, have issued guarantees and pledges of all of their assets to secure the Company's obligations under the Agreement. All of the outstanding common stock of the Company's domestic subsidiaries and 65% of the common stock of the Company's foreign subsidiaries has been pledged to secure the Company's obligations under the Agreement.

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

## NOTE 7 - Stock Options

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

Under the 2012 Plan, stock options may be granted to valued employees with a term of up to 10 years at an exercise price equal to or greater than the fair market value on the date of grant and are exercisable in whole or in part at 20%

per year beginning on the date of grant. An option granted under the 2012 Plan shall vest in full upon a “change in control” as defined in the 2012 Plan. At March 31, 2013, no stock options were granted or exercisable and 950,000 stock options were available for grant under this plan.

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

Under the 2012 Non-Employee Plan, stock options may be granted with a term of up to 10 years at an exercise price equal to or greater than the fair market value on the date of grant and are exercisable in whole or in part at 20% per year beginning on the date of grant. An option granted under the 2012 Non-Employee Plan shall vest in full upon a “change in control” as defined in the 2012 Non-Employee Plan. At March 31, 2013, no stock options were granted or exercisable and 50,000 stock options were available for grant under this plan.



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

Under the 2002 Plan, stock options have been granted to key employees with a term of 10 years at an exercise price equal to the fair market value on the date of grant and are exercisable in whole or in part at 20% per year from the date of grant. At December 31, 2012, 1,471,480 stock options were granted, 651,140 stock options were exercisable and no stock options were available for grant under this plan.

No options were granted under the 2002 Plan during the three or nine months ended March 31, 2013 or 2012.

The following table reflects activity under the 2002 Plan for the nine months ended March 31,

	2013		2012	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of period	1,380,140	\$2.95	1,380,140	\$2.95
Granted	--	--	--	--
Terminated	--	--	--	--
Exercised	729,000	1.85	--	--
Outstanding, end of period	651,140	\$4.18	1,380,140	\$2.95
Exercisable, end of period	651,140	\$4.18	1,380,140	\$2.95
Weighted average fair value at grant date of options granted	n/a		n/a	
Total intrinsic value of options exercised	\$1,301,000		n/a	
Total intrinsic value of options outstanding	\$578,000		\$1,259,000	
Total intrinsic value of options exercisable	\$578,000		\$1,259,000	

729,000 options were exercised during the nine months ended March 31, 2013 and no options were exercised during the nine months ended March 31, 2012. These exercises were paid for with 399,790 shares of the Company's common stock, 27,900 of which were retired upon receipt. Cash received from option exercises for each of the nine months ended March 31, 2013 and 2012 was \$0 and the actual tax benefit realized for the tax deductions from option exercises totaled \$114,000 and \$0 for these periods, respectively.

The following table summarizes information about stock options outstanding under the 2002 Plan at March 31, 2013:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding at March 31, 2013	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at March 31, 2013	Weighted average exercise price
\$1.62 - \$4.00	285,390	0.8	\$ 1.97	285,390	\$ 1.97

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\$4.01 -					
\$7.50	328,250	3.8	5.29	328,250	5.29
\$7.51 -					
\$11.16	37,500	3.0	11.16	37,500	11.16
	651,140	2.4	\$ 4.18	651,140	\$ 4.18

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As of March 31, 2013, there was no unearned stock-based compensation cost related to non-vested share-based compensation arrangements granted under the 2002 Plan. All options outstanding under the 2002 Plan were vested as of the beginning of the current period; therefore, the total fair value of the options vested during the nine months ended March 31, 2013 under the 2002 Plan was \$0.

In September 2000, the stockholders approved a 10 year extension of the already existing 1990 non-employee stock option plan (the 2000 Plan) to encourage non-employee directors and consultants of the Company to invest in the Company's stock. This plan expired in September 2010. No further options may be granted under the 2000 Plan. The 2000 Plan provided for the granting of non-qualified stock options, the exercise of which would allow up to an aggregate of 270,000 shares of the Company's common stock to be acquired by the holders of the stock options. The 2000 Plan provided that the option price will not be less than 100% of the fair market value of the stock at the date of grant. Outstanding options are exercisable at 20% per year and expire five years after the date of grant. Compensation cost was recognized for the fair value of the options granted to non-employee directors and consultants as of the date of grant.

The following table reflects activity under the 2000 Plan for the nine months ended March 31,

	2013		2012	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of period	30,000	\$5.03	30,000	\$5.03
Granted	--	--	--	--
Terminated	--	--	--	--
Exercised	--	--	--	--
Outstanding, end of period	30,000	\$5.03	30,000	\$5.03
Exercisable, end of period	30,000	\$5.03	30,000	\$5.03
Weighted average fair value at grant date of options granted	n/a		n/a	
Total intrinsic value of options exercised	n/a		n/a	
Total intrinsic value of options outstanding	\$0		\$0	
Total intrinsic value of options exercisable	\$0		\$0	

As of March 31, 2013, there was no unearned stock-based compensation cost related to non-vested share-based compensation arrangements granted under the 2000 Plan. All options outstanding under the 2000 Plan were vested as of the beginning of the current period; therefore, the total fair value of the options vested during the nine months ended March 31, 2013 under the 2000 Plan was \$0.

#### NOTE 8 – Stockholders' Equity Transactions

During the first nine months of fiscal 2013 certain employees exercised incentive stock options under the Company's 2002 Plan totaling 729,000 shares. No incentive stock options were exercised during the three months ended March 31, 2013. The exercises were completed as cashless exercises as allowed for under the 2002 Plan, where the exercise shares are issued by the Company in exchange for shares of the Company's common stock that are owned by the optionees. The number of shares surrendered by the optionees are based upon the per share price on the effective date of the option exercise. In addition, the Company repurchased 128,588 shares of its Common Stock from its Chief Executive Officer, Richard Soloway. The purchase price was \$3.38 per share, the previous business day's closing price on NASDAQ, for an aggregate purchase price of \$434,627. The repurchase was to fund Mr. Soloway's tax liability associated with the exercise of 675,000 options granted to him under the 2002 Plan. The repurchase was approved by

the Board of Directors of the Company, including all of the independent directors. Mr. Soloway's exercises resulted in a tax benefit to the Company of \$114,000 which is included in Additional Paid-in Capital.

The following table reflects the activity of these equity transactions for the nine months ended March 31, 2013 (dollars in thousands):

	Common Stock			Treasury Stock	
	Number of Shares Issued	Amount	Additional Paid-in Capital	Number of Shares	Amount
BALANCE June 30, 2012	20,095,713	\$201	\$14,080	(1,000,000)	\$(5,615 )
Options exercised	729,000	7	1,364	--	--
Shares surrendered and cancelled under option exercise	(27,900 )	--	--	--	--
Shares surrendered and held in Treasury under option exercise	--	--	--	(371,890 )	(1,257 )
Shares repurchased and held in Treasury	--	--	--	(128,588 )	(435 )
BALANCE March 31, 2013	20,796,813	\$208	\$15,444	(1,500,478)	\$(7,307 )

#### NOTE 9 - 401(k) Plan

The Company maintains a 401(k) plan (“the Plan”) that covers all U.S. non-union employees with one or more years of service and is qualified under Sections 401(a) and 401(k) of the Internal Revenue Code. Company contributions to this plan are discretionary and totaled \$27,000 and \$19,000 and \$73,000 and \$19,000 for the three and nine months ended March 31, 2013 and 2012, respectively.

#### NOTE 10 - Commitments and Contingencies

##### Leases

The Company is committed under various operating leases. Rent expense, with the exception of the land lease referred to below, totaled approximately \$14,000 and \$12,000 for the three months ended March 31, 2013 and 2012, respectively and \$37,000 and \$38,000 for the nine months ended March 31, 2013 and 2012, respectively.

##### Land Lease

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

##### Litigation

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

##### Employment Agreements

As of March 31, 2013, the Company was obligated under two employment agreements and one severance agreement. The employment agreements are with the Company's Chief Executive Officer (“the CEO”) and Senior Vice President of Sales and Marketing (“the SVP”). The employment agreement with the CEO provides for an annual salary of \$587,000, as adjusted for inflation; incentive compensation as may be approved by the Board of Directors from

time to time and a termination payment in an amount up to 299% of the average of the prior five calendar year's compensation, subject to certain limitations, as defined in the agreement. The employment agreement renews annually in August unless either party gives the other notice of non-renewal at least six months prior to the end of the applicable term. The employment agreement with the SVP provides for an annual salary of \$274,400 and, if terminated by the Company without cause, severance of nine months' salary and continued company-sponsored health insurance for six months from the date of termination.

## NOTE 11 - Geographical Data

The Company is engaged in one major line of business: the development, manufacture, and distribution of security alarm products and door security devices for commercial and residential use. Sales to unaffiliated customers are primarily shipped from the United States. The Company has customers worldwide with major concentrations in North America, Europe, and South America.

The following represents selected consolidated geographical data:

	Three Months ended		Nine Months ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Sales to external customers(1):				
Domestic	\$16,174	\$16,423	\$46,543	\$48,330
Foreign	989	813	3,048	2,726
Total Net Sales	\$17,163	\$17,236	\$49,591	\$51,056
	As of			
	March 31,	June 30,		
	2013	2012		
Identifiable assets:				
United States	\$47,105	\$50,838		
Dominican Republic (2)	12,761	13,912		
Total Identifiable Assets	\$59,866	\$64,750		

(1) All of the Company's sales originate in the United States and are shipped primarily from the Company's facilities in the United States. There were no sales into any one foreign country in excess of 10% of total Net Sales.

(2) Consists primarily of inventories (March 31, 2013 = \$8,962,000; June 30, 2012 = \$9,866,000) and fixed assets (March 31, 2013 = \$3,675,000; June 30, 2012 = \$3,936,000) located at the Company's principal manufacturing facility in the Dominican Republic.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

## Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q and the information incorporated by reference may include "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act of 1934. The Company intends the Forward-Looking Statements to be covered by the Safe Harbor Provisions for Forward-Looking Statements. All statements regarding the Company's expected financial position and operating results, its business strategy, its financing plans and the outcome of any contingencies are Forward-Looking Statements. The Forward-Looking Statements are based on current estimates and projections about our industry and our business. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," or variations of such words and similar expressions are intended to identify such Forward-Looking Statements. The Forward-Looking Statements are subject to risks and uncertainties that could cause actual results to differ materially from those set forth or implied by any Forward-Looking Statements. For example, the Company is highly dependent on its Chief Executive Officer for strategic planning. If he is unable to perform his services for any significant period of time, the Company's ability to grow could be adversely affected. In addition, factors that could cause actual results to differ materially from the Forward-Looking Statements include, but are not limited to, the uncertain economic, military and political conditions in the world, the ability to maintain adequate financing, our ability to maintain and

develop competitive products, adverse tax consequences of offshore operations, significant fluctuations in the exchange rate between the Dominican Peso and the U.S. Dollar, distribution problems, unforeseen environmental liabilities, and the successful integration of Marks into our existing operations.

#### Overview

The Company is a diversified manufacturer of security products, encompassing electronic locking devices, intrusion and fire alarms and building access control systems. 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. International sales accounted for approximately 6% of our revenues for both of the nine month periods ended March 31, 2013 and 2012.



The Company owns and operates manufacturing facilities in Amityville, New York and the Dominican Republic. A significant portion of our operating costs are fixed, and do not fluctuate with changes in production levels or utilization of our manufacturing capacity. As production levels rise and factory utilization increases, the fixed costs are spread over increased output, which should improve profit margins. Conversely, when production levels decline our fixed costs are spread over reduced levels, thereby decreasing margins.

The security products market is characterized by constant incremental innovation in product design and manufacturing technologies. Generally, the Company devotes 6-8% of revenues to research and development (R&D) on an annual basis. The Company does not expect products resulting from our R&D investments in fiscal 2013 to contribute materially to revenue during this fiscal year, but should benefit the Company over future years. In general, the new products introduced by the Company are initially shipped in limited quantities, and increase over time. Prices and manufacturing costs tend to decline over time as products and technologies mature.

#### Economic and Other Factors

We are subject to the effects of general economic and market conditions. Since October 2008, the U.S. and international economies have experienced a significant downturn and continue to be at depressed levels. In the event that the U.S. or international financial markets erode further, our revenue, profit and cash-flow levels could be materially adversely affected in future periods. If the worldwide economic downturn worsens, many of our current or potential future customers may experience serious cash flow problems and as a result may, modify, delay or cancel purchases of our products. Additionally, customers may not be able to pay, or may delay payment of, accounts receivable that are owed to us. Furthermore, the ongoing downturn and economic uncertainty makes it difficult for us to forecast our revenues.

#### Seasonality

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. Further deterioration of the current economic conditions may also affect this trend.

#### Critical Accounting Policies and Estimates

The Company's significant accounting policies are fully described in Note 1 to the Company's consolidated financial statements included in its 2012 Annual Report on Form 10-K. Management believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

#### Revenue Recognition

The Company recognizes revenue when the following criteria are met: (i) persuasive evidence of an agreement exists, (ii) there is a fixed and determinable price for the Company's product, (iii) shipment and passage of title occurs, and (iv) collectability is reasonably assured. Revenues from product sales are recorded at the time the product is shipped or delivered to the customer pursuant to the terms of the sale. The Company reports its sales on a net sales basis, with net sales being computed by deducting from gross sales the amount of actual sales returns and other allowances and the amount of reserves established for anticipated sales returns and other allowances.

The Company analyzes sales returns and is able to make reasonable and reliable estimates of product returns based on the Company's past history. Estimates for sales returns are based on several factors including actual returns and based on expected return data communicated to it by its customers. Accordingly, the Company believes that its historical returns analysis is an accurate basis for its allowance for sales returns. Actual results could differ from those estimates.

#### Inventories

Inventories are valued at the lower of cost or fair market 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 the difference between the cost of the inventory and 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. There is inherent professional judgment and subjectivity made by both production and engineering members of management in determining the estimated obsolescence percentage. In addition, and as necessary, the Company may establish specific reserves for future known or anticipated events. 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.

## 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. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. 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.

## Results of Operations

	Three months ended March 31, (dollars in thousands)			Nine months ended March 31, (dollars in thousands)		
	2013	2012	% Increase/ (decrease)	2013	2012	% Increase/ (decrease)
Net sales	\$ 17,163	\$ 17,236	(0.4 )%	\$ 49,591	\$ 51,056	(2.9 )%
Gross profit	4,652	5,064	(8.1 )%	13,429	14,115	(4.9 )%
Gross profit as a % of net sales	27.1 %	29.4 %	(2.3 )%	27.1 %	27.6 %	(0.5 )%
Selling, general and administrative	4,394	4,375	0.4 %	13,216	12,673	4.3 %
Selling, general and administrative as a percentage of net sales	25.6 %	25.4 %	0.2 %	26.6 %	24.8 %	1.8 %
Operating income	258	689	(62.6 )%	213	1,442	(85.2 )%
Interest expense, net	122	287	(57.5 )%	440	889	(50.5 )%
Other expense	3	15	(80.0 )%	10	42	(76.2 )%
Provision (benefit) for income taxes	22	84	(73.8 )%	(49 )	66	(174.2 )%
Net income (loss)	111	303	(63.4 )%	(188 )	445	(142.2 )%

Sales for the three months ended March 31, 2013 remained relatively constant at \$17,163,000 as compared to \$17,236,000 for the same period a year ago. Sales for the nine months ended March 31, 2013 decreased by 3% to \$49,591,000 as compared to \$51,056,000 for the same period a year ago. Sales for the three months reflected decreased sales in the Company's intrusion (\$1,164,000) and access control (\$177,000) products as partially offset by an increase in the Company's door-locking products (\$1,268,000). The decrease in sales for the nine months was primarily due to decreased sales in the Company's intrusion (\$2,888,000) and access control (\$368,000) products as partially offset by an increase in the Company's door-locking products (\$1,791,000). The decrease in sales of intrusion products for the three and nine months was due primarily to several intrusion customers reducing their inventory levels as well as decreased demand from one of the Company's large intrusion dealers. Sales for the nine months and to a lesser extent the three months were also negatively impacted by the storm known as Superstorm Sandy, which devastated portions of the Caribbean and the Mid-Atlantic and Northeastern United States with lesser impacts in the Southeastern and Midwestern states and Eastern Canada.

Gross profit for the three months ended March 31, 2013 decreased to \$4,652,000 or 27.1% of sales as compared to \$5,064,000 or 29.4% of sales for the same period a year ago. Gross profit for the nine months ended March 31, 2013 decreased to \$13,429,000 or 27.1% of sales as compared to \$14,115,000 or 27.6% of sales for the same period a year ago. The decrease in gross profit for the three and nine months was primarily due to increased expenditures on Research and Development primarily relating to the Company's iBridge tablet-style keypad and related applications as well as a one-time payment by the Company of \$175,000 as settlement of a product licensing dispute. The increases in Research and Development were \$93,000 and \$708,000 for the three and nine months ended March 31, 2013, respectively, as compared to the same periods a year ago. The decrease in gross profit for the nine months was also due to the decrease in sales for the nine months ended March 31, 2013 as compared to the same period a year ago.

Selling, general and administrative expenses for the three months ended March 31, 2013 remained relatively constant at \$4,394,000, or 25.6% of sales, as compared to \$4,375,000, or 25.4% of sales a year ago. Selling, general and administrative expenses for the nine months ended March 31, 2013 increased by \$543,000 to \$13,216,000, or 26.6% of sales, as compared to \$12,673,000, or 24.8% of sales a year ago.

Selling, general and administrative expenses for the three months reflected increased expenses relating to additional sales personnel and advertising and were offset by the timing of a major tradeshow. Last year this tradeshow occurred during the quarter ended March 31, 2012 while this year the same tradeshow occurred subsequent to March 31, 2013. In addition, the increase in Selling, general and administrative expenses for the nine months was due primarily to these factors as well as to increased expenditures relating to a tradeshow that occurred in the first six months of fiscal years 2013 and 2012.

Interest expense, net for the three months ended March 31, 2013 decreased by \$165,000 to \$122,000 as compared to \$287,000 for the same period a year ago. Interest expense, net for the nine months ended March 31, 2013 decreased by \$449,000 to \$440,000 as compared to \$889,000 for the same period a year ago. The decrease in interest expense for the three and nine months ended March 31, 2013 resulted from lower interest rates charged by the Company's bank as well as lower outstanding debt in the current period.

The Company's provision for income taxes for the three months ended March 31, 2013 decreased by \$62,000 to \$22,000 as compared to \$84,000 for the same period a year ago. The Company's provision for income taxes for the nine months ended March 31, 2013 decreased by \$115,000 to a benefit of \$(49,000) as compared to a provision of \$66,000 for the same period a year ago. The change in the provision (benefit) for income taxes was caused primarily by the changes in consolidated net income as well as the change in the proportion of the income before income taxes being generated by the Company's U.S. operations to the loss being generated by non-taxable foreign operations for the three and nine months ended March 31, 2013 as compared to the same periods a year ago. As a result, the Company's effective rate for income tax was 17% and 22% for the three months ended March 31, 2013 and 2012, respectively, and 21% and 13% for the nine months ended March 31, 2013 and 2012, respectively.

Net income decreased by \$192,000 to \$111,000 or \$0.01 per diluted share for the three months ended March 31, 2013 as compared to \$303,000 or \$0.02 per diluted share for the same period a year ago. Net income decreased by \$633,000 to a loss of \$(188,000) or \$(0.01) per diluted share for the nine months ended March 31, 2013 as compared to \$445,000 or \$0.02 per diluted share for the same period a year ago. The changes for the three and nine months ended March 31, 2013 were primarily due to the items as described above.

#### Liquidity and Capital Resources

During the nine months ended March 31, 2013 the Company utilized all of its cash from operations (\$2,971,000) and a portion of its cash on hand at June 30, 2012 (\$1,237,000 of \$2,979,000) to repay outstanding debt (\$3,457,000), purchase treasury stock (\$435,000) and purchase property, plant and equipment (\$316,000). The Company believes its current working capital, cash flows from operations and its revolving credit agreement will be sufficient to fund the Company's operations through the next twelve months.

Accounts Receivable at March 31, 2013 decreased \$1,876,000 to \$14,532,000 as compared to \$16,408,000 at June 30, 2012. This decrease is primarily the result of the lower sales volume during the quarter ended March 31, 2013 as compared to the quarter ended June 30, 2012, which is typically the Company's highest.

Inventories at March 31, 2013 decreased \$854,000 to \$22,428,000 as compared to \$23,282,000 at June 30, 2012. This decrease is primarily the result of earlier and more accurate forecasting of product demand from the Company's customers. Non-current inventories increased by \$1,295,000 to \$5,129,000 at March 31, 2013 from \$3,834,000 at June

30, 2012. This increase was due to shifts made in the Company's forecast of demand by product line.

Accounts payable and accrued expenses decreased \$868,000 to \$5,698,000 as of March 31, 2013 as compared to \$6,566,000 at June 30, 2012. This decrease is due primarily to the reduction in inventory discussed above.

As of March 31, 2013, long-term debt consisted of a revolving credit facility of \$11,000,000 (the "Revolving Credit Facility") which expires in June 2017 and two term loans, one for \$6,000,000 which expires in June 2019, and one for \$6,500,000 which expires in June 2017 (the "Term Loans"). Repayment of the Terms Loans commenced on September 30, 2012. The \$6,000,000 Term Loan is being repaid with 28 equal, quarterly payments of \$75,000 and the remaining balance of \$3,900,000 due on or before the expiration date. The \$6,500,000 Term Loan is being repaid in 20 equal, quarterly payments of \$325,000. The Company's long-term debt is described more fully in Note 7 to the condensed consolidated financial statements.

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

As of March 31, 2013 the Company had no material commitments for capital expenditures or inventory purchases other than purchase orders issued in the normal course of business.

### ITEM 3: Quantitative and Qualitative Disclosures About Market Risk

The Company's principal financial instrument is long-term debt (consisting of a revolving credit facility and term loans) that provides for interest based on the prime rate or LIBOR as described in the agreement. The Company is affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable by the Company under these credit facilities. At March 31, 2013, an aggregate principal amount of approximately \$16,800,000 was outstanding under the Company's credit facilities with a weighted average interest rate of approximately 2.5%. If principal amounts outstanding under the Company's credit facilities remained at this level for an entire year and the interest rate increased or decreased, respectively, by 1% the Company would pay or save, respectively, an additional \$168,000 in interest that year.

All foreign sales transactions by the Company are denominated in U.S. dollars. As such, the Company has shifted foreign currency exposure onto its foreign customers. As a result, if exchange rates move against foreign customers, the Company could experience difficulty collecting unsecured accounts receivable, the cancellation of existing orders or the loss of future orders. The foregoing could materially adversely affect the Company's business, financial condition and results of operations. We are also exposed to foreign currency risk relative to expenses incurred in Dominican Pesos ("RD\$"), the local currency of the Company's production facility in the Dominican Republic. The result of a 10% strengthening in the U.S. dollar to our RD\$ expenses would result in an annual decrease in income from operations of approximately \$600,000.

### ITEM 4: Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives.

At the conclusion of the period ended March 31, 2013, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at March 31, 2013.

During the third quarter of fiscal 2013, there were no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II: OTHER INFORMATION

Item 1A. Risk Factors

Information regarding the Company's Risk Factors are set forth in the Company's Annual Report on Form 10-K for the year ended June 30, 2012. There have been no material changes in the risk factors previously disclosed in the Company's Form 10-K for the year ended June 30, 2012 during the three months ended March 31, 2013.

Item 6. Exhibits

31.1	Certification Pursuant to Rule 13a-14(a)/15d-14(a) of Richard L. Soloway, Chairman of the Board and President
31.2	Certification Pursuant to Rule 13a-14(a)/15d-14(a) of Kevin S. Buchel, Senior Vice President of Operations and Finance
32.1	Section 1350 Certifications
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*

\* Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for the purposes of section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

May 13, 2013

NAPCO SECURITY TECHNOLOGIES, INC.  
(Registrant)

By: /s/ RICHARD L. SOLOWAY  
Richard L. Soloway  
Chairman of the Board of Directors,  
President and Secretary  
(Chief Executive Officer)

By: /s/ KEVIN S. BUCHEL  
Kevin S. Buchel  
Senior Vice President of Operations  
and Finance and Treasurer  
(Principal Financial and Accounting  
Officer)

Exhibit No.	Title
Ex-31.1	Certification Pursuant to Rule 13a-14(a)/15d-14(a) of Richard L. Soloway, Chairman of the Board and President
Ex-31.2	Certification Pursuant to Rule 13a-14(a)/15d-14(a) of Kevin S. Buchel, Senior Vice President of Operations and Finance
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