

NAPCO SECURITY TECHNOLOGIES, INC  
Form 10-K  
September 08, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended June 30, 2016

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 0-10004**

**NAPCO SECURITY TECHNOLOGIES, INC.**

*(Exact name of Registrant as specified in its charter)*

Delaware

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

11-2277818

*(I.R.S. Employer I.D. Number)*

333 Bayview Avenue, Amityville, New York 11701

*(Address of principal executive offices) (Zip Code)*

Registrant's telephone number, including area code: (631) 842-9400

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

Common Stock, par value \$.01 per share The NASDAQ Stock Market LLC  
(Title of Each Class) (Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 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 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 for such shorter period that the registrant was required to submit and post such files). 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 information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No

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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

As of December 31, 2015, the aggregate market value of the common stock of Registrant held by non-affiliates based upon the last sale price of the stock on such date was \$69,768,521.

As of September 06, 2016, 18,786,893 shares of common stock of Registrant were outstanding.

### **Documents Incorporated by Reference**

Part III incorporates information by reference from the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the Registrant's 2016 Annual Meeting of Stockholders.

PART I

**ITEM 1: BUSINESS.**

NAPCO Security Technologies, Inc. ("NAPCO" or the "Company") was incorporated in December 1971 in the State of Delaware. Its executive offices are located at 333 Bayview Ave, Amityville NY 11701. Its telephone number is (631) 842-9400.

The Company is a diversified manufacturer of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products for commercial and residential use. These products are used for commercial, residential, institutional, industrial and governmental applications, and are sold worldwide principally to independent distributors, dealers and installers of security equipment.

Website Access to Company Reports

Copies of our filings under the Securities Exchange Act of 1934 (including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to these reports) are available free of charge on our website ([www.napcosecurity.com](http://www.napcosecurity.com)) on the same day they are electronically filed with the Securities and Exchange Commission.

Products

The Company's products ("Products") are comprised of the following:

Access Control Systems. Access control systems consist of one or more of the following: various types of identification readers (e.g. card readers, hand scanners), a control panel, a PC-based computer and electronically activated door-locking devices. When an identification card or other identifying information is entered into the reader, the information is transmitted to the control panel/PC which then validates the data and determines whether or not to grant access by electronically deactivating the door locking device. An electronic log is kept which records various types of data regarding access activity.

The Company designs, engineers, manufactures and markets the software and control panels discussed above. It also buys and resells various identification readers, PC-based computers and various peripheral equipment for access control systems.

Door Security Products. The Company manufactures a variety of door locking devices including microprocessor-based electronic door locks with push button, card reader and bio-metric operation, door alarms, mechanical door locks and simple dead bolt locks. These devices may control a single door or, in the case of some of the Company's microprocessor-based door locks, may be networked with the Company's access control systems and controlled remotely.

Intrusion and Fire Alarm Systems. Alarm systems usually consist of various detectors, a control panel, a digital keypad and signaling equipment. When a break-in occurs, an intrusion detector senses the intrusion and activates a control panel via hard-wired or wireless transmission that sets off the signaling equipment and, in most cases, causes a bell or siren to sound. Communication equipment such as a digital communicator may be used to transmit the alarm signal to a central station or another person selected by a customer.

The Company manufactures and markets the following products for alarm systems:

Automatic Communicators. When a control panel is activated by a signal from an intrusion detector, it activates a communicator that can automatically dial one or more pre-designated telephone numbers utilizing wired ("landline") or cellular communications systems. If programmed to do so, a digital communicator dials the telephone number of a central monitoring station and communicates in computer language to a digital communicator receiver, which signals an alarm message.

Control Panels. A control panel is the "brain" of an alarm system. When activated by any one of the various types of intrusion detectors, it can activate an audible alarm and/or various types of communication devices.

Combination Control Panels/Digital Communicators and Digital Keypad Systems. A combination control panel, digital communicator and a digital keypad has continued to be the leading configuration in terms of dealer and consumer preference. Benefits of the combination format include the cost efficiency resulting from a single microcomputer function, as well as the reliability and ease of installation gained from the simplicity and sophistication of micro-computer technology.

Fire Alarm Control Panel. Multi-zone fire alarm control panels, which accommodate an optional digital communicator for reporting to a central station, are also manufactured by the Company.

Area Detectors. The Company's area detectors are both passive infrared heat detectors and combination microwave/passive infrared detectors that are linked to alarm control panels. Passive infrared heat detectors respond to the change in heat patterns caused by an intruder moving within a protected area. Combination units respond to both changes in heat patterns and changes in microwave patterns occurring at the same time.

Video Surveillance Systems. Video surveillance systems typically consist of one or more video cameras, a control panel and a video monitor or PC. More advanced systems can also include a recording device and some type of remote communication device such as an internet connection to a PC or browser-enabled cell phone. The system allows the user to monitor various locations at once while recorders save the video images for future use. Remote communication devices can allow the user to view and control the system from a remote location.

The Company designs, engineers, and markets the software and control panels discussed above. It also buys and resells various video cameras, PC-based computers and peripheral equipment for video surveillance systems.

### **Peripheral Equipment**

The Company also markets peripheral and related equipment manufactured by other companies. Revenues from peripheral equipment have not been significant.

## Research and Development

The Company's business involves a high technology element. Research and development costs incurred by the Company are charged to expense as incurred and are included in "Cost of Sales" in the consolidated statements of operations. During the fiscal years ended June 30, 2016 and 2015, the Company expended approximately \$6,169,000 and \$5,382,000, respectively, on Company-sponsored research and development activities conducted primarily by its engineering department to develop and improve the Products. The Company intends to continue to conduct a significant portion of its future research and development activities internally.

## Employees

As of June 30, 2016, the Company had 984 full-time employees.

## Marketing

The Company's staff of 53 sales and marketing support employees located at the Company's Amityville offices sells and markets the Products primarily to independent distributors and wholesalers of security alarm and security hardware equipment. Management estimates that these channels of distribution represented approximately 51% and 53% of the Company's total sales for the fiscal years ended June 30, 2016 and 2015, respectively. The remaining revenues are primarily from installers and governmental institutions. The Company's sales representatives periodically contact existing and potential customers to introduce new products and create demand for those as well as other Company products. These sales representatives, together with the Company's technical personnel, provide training and other services to wholesalers and distributors so that they can better service the needs of their customers. In addition to direct sales efforts, the Company advertises in technical trade publications and participates in trade shows in major United States and European cities.

In the ordinary course of the Company's business the Company grants extended payment terms to certain customers. The Company had one customer with an accounts receivable balance that comprised 22% of the Company's accounts receivable at both June 30, 2016 and 2015. Sales to this customer comprised 13% of net sales in each of the fiscal years ended June 30, 2016 and 2015. For further discussion on Concentration of Credit Risk see disclosures included in Item 1A and Item 7.

## Competition

The security products industry is highly competitive. The Company's primary competitors are comprised of approximately 20 other companies that manufacture and market security equipment to distributors, dealers, central stations and original equipment manufacturers. The Company believes that no one of these competitors is dominant in the industry. Most of these companies have substantially greater financial and other resources than the Company.

The Company competes primarily on the basis of the features, quality, reliability and pricing of, and the incorporation of the latest innovative and technological advances into, its Products. The Company also competes by offering technical support services to its customers. In addition, the Company competes on the basis of its expertise, its proven products, its reputation and its ability to provide Products to customers on a timely basis. The inability of the Company to compete with respect to any one or more of the aforementioned factors could have an adverse impact on the Company's business.

Relatively low-priced "do-it-yourself" alarm system products are available to the public at retail stores. The Company believes that these products compete with the Company only to a limited extent because they appeal primarily to the "do-it-yourself" segment of the market. Purchasers of such systems do not receive professional consultation, installation, service or the sophistication that the Company's Products provide.

## 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. Deterioration of the current economic conditions may also affect this trend.



## Raw Materials

The Company prepares specifications for component parts used in the Products and purchases the components from outside sources or fabricates the components itself. These components, if standard, are generally readily available; if specially designed for the Company, there is usually more than one alternative source of supply available to the Company on a competitive basis. The Company generally maintains inventories of all critical components. The Company for the most part is not dependent on any one source for its raw materials. The Company believes that any vendor that is currently the sole source of a component can be replaced without a material impact on the Company.

## Sales Backlog

In general, orders for the Products are processed by the Company from inventory. A sales backlog of approximately \$1,592,000 and \$2,044,000 existed as of June 30, 2016 and 2015, respectively. The Company expects to fill the entire backlog that existed as of June 30, 2016 during fiscal 2017.

## Government Regulation

The Company's telephone dialers, microwave transmitting devices utilized in its motion detectors and any new communication equipment that may be introduced from time to time by the Company must comply with standards promulgated by the Federal Communications Commission ("FCC") in the United States and similar agencies in other countries where the Company offers such products, specifying permitted frequency bands of operation, permitted power output and periods of operation, as well as compatibility with telephone lines. Each new Product that is subject to such regulation must be tested for compliance with FCC standards or the standards of such similar governmental agencies. Test reports are submitted to the FCC or such similar agencies for approval. Cost of compliance with these regulations has not been material.

## Patents and Trademarks

The Company has been granted several patents and trademarks relating to the Products. While the Company obtains patents and trademarks as it deems appropriate, the Company does not believe that its current or future success is dependent on its patents or trademarks.

## Foreign Sales

The revenues and identifiable assets attributable to the Company's domestic and foreign operations for its last two fiscal years are summarized in the following table:

|                                 | Financial Information Relating to Domestic and Foreign Operations |           |
|---------------------------------|---|-----------|
|                                 | 2016  | 2015      |
|                                 | (in thousands)  |           |
| Sales to external customers(1): |   |           |
| Domestic                        | \$ 79,931   | \$ 74,736 |
| Foreign                         | 2,582   | 3,026     |
| Total Net Sales                 | \$ 82,513   | \$ 77,762 |
| Identifiable assets:            |   |           |
| United States                   | \$ 51,272   | \$ 50,998 |
| Dominican Republic (2)          | 13,497  | 14,039    |
| Total Identifiable Assets       | \$ 64,769   | \$ 65,037 |

(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 (2016 = \$10,076; 2015 = \$10,546) and fixed assets (2016 = \$3,311; 2015 = \$3,347) located at the Company's principal manufacturing facility in the Dominican Republic.

## ITEM 1A: RISK FACTORS

The risks described below are among those that could materially and adversely affect the Company's business, financial condition or results of operations. These risks could cause actual results to differ materially from historical results and from any results predicted by any forward-looking statements related to conditions or events that may occur in the future.

Our Business Could Be Materially Adversely Affected as a Result of General Economic and Market Conditions

We are subject to the effects of general economic and market conditions. In the event that the U.S. or international economic conditions deteriorate, our revenue, profit and cash-flow levels could be materially adversely affected in future periods. In the event of such deterioration, 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. If such events do occur, they may result in our expenses being too high in relation to our revenues and cash flows.

We Are Dependent Upon the Efforts of Richard L. Soloway, Our Chief Executive Officer and There is No Succession Plan in Place

The success of the Company is largely dependent on the efforts of Richard L. Soloway, Chief Executive Officer. The loss of his services could have a material adverse effect on the Company's business and prospects. There is currently no succession plan to address the loss of Mr. Soloway's services.

Competitors May Develop New Technologies or Products in Advance of Us

Our business may be materially adversely affected by the announcement or introduction of new products and services by our competitors, and the implementation of effective marketing or sales strategies by our competitors. The industry in which the Company operates is characterized by constantly improved products. There can be no assurance that competitors will not develop products that are superior to the Company's products. The Company has historically invested approximately 6% to 8% of annual revenues on Research and Development to mitigate this risk. Future success will depend, in part, on our ability to continue to develop and market products and product enhancements cost-effectively. The Company's research and development expenditures are principally targeted at enhancing existing products, and to a lesser extent at developing new ones. Further, there can be no assurance that the Company will not experience additional price competition, and that such competition may not adversely affect the Company's revenues and results of operations.

Our Business Could Be Materially Adversely Affected by the Inability to Maintain Expense Levels Proportionate to Sales Volume

While expense levels relative to current sales levels result in positive net income and cash flows, if sales levels decrease significantly and we are unable to decrease expenses proportionately, our business may be adversely affected.

Our Business Could Be Materially Adversely Affected as a Result of Housing and Commercial Building Market Conditions

We are subject to the effects of housing and commercial building market conditions. If these conditions deteriorate, resulting in declines in new housing or commercial building starts, existing home or commercial building sales or renovations, our business, results of operations or financial condition could be materially adversely affected, particularly in our intrusion and door locking product lines.

Our Business Could Be Materially Adversely Affected as a Result of Lessening Demand in the Security Market

Our revenue and profitability depend on the overall demand for our products. Delays or reductions in spending, domestically or internationally, for electronic security systems could materially adversely affect demand for our products, which could result in decreased revenues or earnings.

The Markets We Serve Are Highly Competitive and We May Be Unable to Compete Effectively

We compete with approximately 20 other companies that manufacture and market security equipment to distributors, dealers, control stations and original equipment manufacturers. Some of these companies may have substantially greater financial and other resources than the Company. The Company competes primarily on the basis of the features, quality, reliability and pricing of, and the incorporation of the latest innovative and technological advances into, its products. The Company also competes by offering technical support services to its customers. In addition, the Company competes on the basis of its expertise, its proven products, its reputation and its ability to provide products to customers on a timely basis. The inability of the Company to compete with respect to any one or more of the aforementioned factors could have an adverse impact on the Company's business.

Our Business Could be Materially Adversely Affected as a Result of Offering Extended Payment Terms to Customers

We regularly grant credit terms beyond 30 days to certain customers. These terms are offered in an effort to keep a full line of our products in-stock at our customers' locations. The longer the terms that are granted, the more risk is inherent in collection of those receivables. We believe that our Bad Debt reserves are adequate to account for this inherent risk.

We Rely On Distributors To Sell Our Products And Any Adverse Change In Our Relationship With Our Distributors Could Result In A Loss Of Revenue And Harm Our Business.

We distribute our products primarily through independent distributors and wholesalers of security alarm and security hardware equipment. Our distributors and wholesalers also sell our competitors' products, and if they favor our competitors' products for any reason, they may fail to market our products as effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. In addition, the financial health of these distributors and wholesalers and our continuing relationships with them are important to our success. Some of these distributors and wholesalers may be unable to withstand adverse changes in business conditions. Our business could be seriously harmed if the financial condition of some of these distributors and wholesalers substantially weakens.

Members of Management and Certain Directors Beneficially Own a Substantial Portion of the Company's Common Stock and May Be in a Position to Determine the Outcome of Corporate Elections

Richard L. Soloway, our Chief Executive Officer, members of management and the Board of Directors beneficially own approximately 37% of the currently outstanding shares of Common Stock. By virtue of such ownership and their positions with Napco, they may have the practical ability to determine the election of all directors and control the outcome of substantially all matters submitted to Napco's stockholders.

In addition, Napco has a staggered Board of Directors. Such concentration of ownership and the staggered Board could have the effect of making it more difficult for a third party to acquire, or discourage a third party from seeking to acquire, control of Napco.

Our Business Could be Materially Adversely Affected by Adverse Tax Consequences of Offshore Operations

We operate on a global basis, with a portion of our operating income generated outside the United States.

We intend to reinvest these earnings in our foreign operations indefinitely, except where we are able to repatriate these earnings to the United States without material incremental tax provision. A significant portion of our assets that result from these earnings remain outside the United States. If these indefinitely reinvested earnings were repatriated into the United States as dividends, we would be subject to additional taxes.

Our Business Could Be Materially Adversely Affected as a Result of the Inability to Maintain Adequate Financing

Our business is dependent on maintaining adequate levels of financing used to fund operations and capital expenditures. The current debt facilities provide for quarterly principal debt repayments of approximately \$75,000 plus interest as well as certain financial covenants relating to ratios affected by profit, asset and debt levels. If the Company's profits, asset or cash-flow levels decline below the minimums required to meet these covenants or to make the minimum debt payments, the Company may be materially adversely affected. Effects on the Company could include higher interest costs, reduction in borrowing availability or revocation of these credit facilities.

Our Business Could Be Materially Adversely Affected by a weakening of the US Dollar against the Dominican Peso

We are exposed to foreign currency risks due to our operations in the Dominican Republic. We have significant operations in the Dominican Republic which are denominated in Dominican pesos. We are subject to the risk that currency exchange rates between the United States and the Dominican Republic will fluctuate significantly, potentially resulting in an increase in some of our expenses when US dollars are transferred to Dominican pesos to pay these expenses.

**ITEM 1B: UNRESOLVED STAFF COMMENTS.**

Not applicable.

**ITEM 2: PROPERTIES.**

The Company owns executive offices and production and warehousing facilities at 333 Bayview Avenue, Amityville, New York. This facility consists of a fully-utilized 90,000 square foot building on a six acre plot. This six-acre plot provides the Company with space for expansion of office, manufacturing and storage capacities. These facilities are pledged as security in the Company's credit facilities with its primary bank.

The Company's foreign subsidiary located in the Dominican Republic, Napco DR, S.A. (formerly known as NAPCO/Alarm Lock Grupo International, S.A.), owns a building of approximately 167,000 square feet of production and warehousing space in the Dominican Republic. That subsidiary also leases the land associated with this building under a 99-year lease expiring in the year 2092 at an annual cost of approximately \$288,000. As of June 30, 2016, a majority of the Company's products were manufactured at this facility, utilizing U.S. quality control standards.

Management believes that these facilities are more than adequate to meet the needs of the Company in the foreseeable future.

**ITEM 3: LEGAL PROCEEDINGS.**

There are no pending or threatened material legal proceedings to which NAPCO or its subsidiaries or any of their property is subject.

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.

**ITEM 4: MINE SAFETY DISCLOSURE.**

Not Applicable.



PART II**ITEM 5: MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

## Principal Market

NAPCO's Common Stock is traded on the NASDAQ Stock Market, Global Market System, under the symbol NSSC.

The tables set forth below reflect the range of high and low sales of the Common Stock in each quarter of the past two fiscal years as reported by the NASDAQ Global Market System.

| Common Stock | Quarter Ended Fiscal 2016 |         |          |         |
|--------------|---------------------------|---------|----------|---------|
|              | Sept. 30                  | Dec. 31 | March 31 | June 30 |
| High         | \$6.09                    | \$ 7.33 | \$ 6.32  | \$ 6.64 |
| Low          | \$5.47                    | \$ 5.41 | \$ 5.18  | \$ 5.57 |

| Common Stock | Quarter Ended Fiscal 2015 |         |          |         |
|--------------|---------------------------|---------|----------|---------|
|              | Sept. 30                  | Dec. 31 | March 31 | June 30 |
| High         | \$5.43                    | \$ 4.78 | \$ 5.82  | \$ 6.09 |
| Low          | \$4.33                    | \$ 4.07 | \$ 4.63  | \$ 5.03 |

## Approximate Number of Security Holders

The number of holders of record of NAPCO's Common Stock as of September 06, 2016 was 96 (such number does not include beneficial owners of stock held in nominee name).

## Dividend Information

NAPCO has declared no cash dividends during the past two years with respect to its Common Stock. Any cash dividends must be approved by the Company's lenders.

## Equity Compensation Plan Information as of June 30, 2016

| PLAN CATEGORY   | NUMBER OF<br>SECURITIES<br>TO BE ISSUED<br>UPON<br>EXERCISE OF<br>OUTSTANDING<br>OPTIONS<br>(a) | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE OF<br>OUTSTANDING<br>OPTIONS<br>(b) | NUMBER OF<br>SECURITIES<br>REMAINING<br>AVAILABLE FOR<br>FUTURE ISSUANCE<br>(EXCLUDING<br>SECURITIES<br>REFLECTED IN<br>COLUMN (a)<br>(c) |
|---|---|--|---|
| Equity compensation plans approved by security holders:     | 250,000   | (1) \$ 5.76  | 852,500 (2)   |
| Equity compensation plans not approved by security holders: | —   | —  | —   |
| Total   | 250,000   | (1) \$ 5.76  | 852,500 (2)   |

(1) The 2002 Employee Stock Option Plan expired in 2012. 102,500 options are outstanding under the 2002 Plan. No further options may be granted under this plan.

In December 2012, the stockholders approved the 2012 Employee Stock Option Plan which authorizes the granting of awards, the exercise of which would allow up to an aggregate of 950,000 shares of the Company's common (2) stock to be acquired by the holders of such awards. In December 2012, the stockholders also approved the 2012 Non-Employee Stock Option Plan which 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.

**ITEM 6: SELECTED FINANCIAL DATA.**

The table below summarizes selected financial information. For further information, refer to the audited consolidated financial statements and the notes thereto beginning on page FS-1 of this report.

Fiscal Year Ended and at June 30  
(In thousands, except share and per share data)

|   | 2016       | 2015       | 2014       | 2013       | 2012       |
|---|------------|------------|------------|------------|------------|
| Statement of earnings data:                     |            |            |            |            |            |
| Net Sales                                       | \$82,513   | \$77,762   | \$74,382   | \$71,386   | \$70,928   |
| Gross Profit                                    | 27,584     | 26,047     | 23,713     | 21,724     | 21,152     |
| Income from Operations                          | 6,323      | 5,281      | 4,316      | 3,717      | 3,761      |
| Net Income                                      | 5,773      | 4,845      | 3,476      | 3,021      | 2,286      |
| Cash Flow Data:                                 |            |            |            |            |            |
| Net cash flows provided by operating activities | 9,160      | 3,887      | 4,743      | 4,899      | 4,096      |
| Net cash flows used in investing activities     | (693 )     | (730 )     | (753 )     | (383 )     | (606 )     |
| Net cash flows used in financing activities     | (7,008 )   | (3,294 )   | (4,736 )   | (4,266 )   | (3,588 )   |
| Per Share Data:                                 |            |            |            |            |            |
| Net earnings per common share:                  |            |            |            |            |            |
| Basic   | \$0.31     | \$0.25     | \$0.18     | \$0.16     | \$0.12     |
| Diluted   | \$0.31     | \$0.25     | \$0.18     | \$0.16     | \$0.12     |
| Weighted average common shares outstanding:     |            |            |            |            |            |
| Basic   | 18,874,000 | 19,164,000 | 19,392,000 | 19,210,000 | 19,096,000 |
| Diluted   | 18,894,000 | 19,169,000 | 19,428,000 | 19,362,000 | 19,303,000 |
| Cash Dividends declared per common share (1)    | \$0.00     | \$0.00     | \$0.00     | \$0.00     | \$0.00     |
| Balance sheet data:                             |            |            |            |            |            |
| Working capital (2)                             | \$36,888   | \$35,590   | \$33,436   | \$33,221   | \$32,205   |
| Total assets                                    | 64,769     | 65,037     | 63,364     | 63,903     | 64,750     |

|                      |        |        |        |        |        |
|----------------------|--------|--------|--------|--------|--------|
| Long-term debt       | 4,500  | 9,100  | 10,200 | 14,800 | 18,657 |
| Stockholders' equity | 51,273 | 46,504 | 43,752 | 40,335 | 37,723 |

(1) The Company has never paid a dividend on its common stock.

(2) Working capital is calculated by deducting Current Liabilities from Current Assets.

## **ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

### **Overview**

The Company is a diversified manufacturer of security products, encompassing access control systems, door security products, intrusion and fire alarm systems and video surveillance products for commercial and residential use. These products are used for commercial, residential, institutional, industrial and governmental applications, and are sold worldwide principally to independent distributors, dealers and installers of security equipment. International sales accounted for approximately 3% and 4% of our revenues for the fiscal years ended June 30, 2016 and 2015, respectively.

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 may contribute to increasing profit margins. Conversely, when production levels decline our fixed costs are spread over reduced levels, which may contribute to 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 2016 to contribute materially to revenue during fiscal 2016, 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. In the event that the U.S. or international economic conditions deteriorate, our revenue, profit and cash-flow levels could be materially adversely affected in future periods. In the event of such deterioration, 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. If such events do occur, they may result in our expenses being too high in relation to our revenues and cash flows.

## **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. 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 2016 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 or service, (iii) shipment and passage of title occurs or service has been provided, 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. Revenues for services are recorded at the time the service is provided to the customer pursuant to the terms of 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.

#### Concentration of Credit Risk

An entity is more vulnerable to concentrations of credit risk if it is exposed to risk of loss greater than it would have had if it mitigated its risk through diversification of customers. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance. The Company had one customer with an accounts receivable balance that comprised 22% of the Company's accounts receivable at both June 30, 2016 and 2015. Sales to this customer comprised 13% of net sales in each of the fiscal years ended June 30, 2016 and 2015.

In the ordinary course of business, we have established a reserve for doubtful accounts and customer deductions in the amount of \$145,000 and \$175,000 as of June 30, 2016 and 2015, respectively. Our reserve for doubtful accounts is a subjective critical estimate that has a direct impact on reported net earnings. This reserve is based upon the evaluation of accounts receivable agings, specific exposures and historical or anticipated events.

## 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.

## Intangible Assets

The Company evaluates its Intangible Assets for impairment at least on an annual basis and will evaluate them earlier if there are indicators of a potential impairment. Those intangible assets that are classified as goodwill or as other intangibles with indefinite lives are not amortized. Impairment testing is performed in two steps: (i) the Company determines if there is impairment by comparing the fair value of a reporting unit with its carrying value, and (ii) if there is impairment, the Company measures the amount of impairment loss by comparing the implied fair value of intangible assets with the carrying amount of the intangible assets.

## Income Taxes

The Company has identified the United States and New York State as its major tax jurisdictions. The fiscal 2012 and forward years are still open for examination.



For the year ended June 30, 2016, the Company recognized a net income tax expense of \$371,000. During the year ending June 30, 2016 the Company increased its reserve for uncertain income tax positions by \$46,000. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense and accrued income taxes. As of June 30, 2016, the Company had accrued interest totaling \$0 and \$148,000 of unrecognized net tax benefits that, if recognized, would favorably affect the Company's effective income tax rate in any future period. The Company uses the flow through method to account for investment tax credits earned on eligible research and development expenditures. Under this method, the investment tax credits are recognized as a reduction to income tax expense.

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.

## Liquidity and Capital Resources

The Company's cash on hand as of June 30, 2015 combined with proceeds from operating activities during fiscal 2016 were adequate to meet the Company's capital expenditure needs and debt obligations during fiscal 2016. The Company's primary internal source of liquidity is the cash flow generated from operations. The primary source of external financing is a revolving credit facility of \$11,000,000 (the "Revolving Credit Facility") which expires in June 2021. As of June 30, 2016, \$2,000,000 was outstanding under this revolving line of credit. As of June 30, 2016, the Company's unused sources of funds consisted principally of \$3,805,000 in cash and \$9,000,000 unused balance available under its revolving line of credit.

During the year ended June 30, 2016 the Company utilized its cash on hand at June 30, 2015 (\$2,346,000) and a portion of its cash from operations (\$5,355,000 of \$9,160,000) to repay outstanding debt (\$5,900,000), purchase treasury stock (\$1,108,000) and purchase property, plant and equipment (\$693,000).

As of June 30, 2016, long-term debt consisted of a revolving credit facility of \$11,000,000 (the "Revolving Credit Facility") which expires in June 2021 and one term loan for \$6,000,000 which expires in June 2019 (the "Term Loan"). The Revolving Credit Facility had an expiration date of June 2017 which was extended to June 2021 at the end of fiscal 2016. Repayment of the Term Loan commenced on September 30, 2012. The Term Loan is being repaid with 28 equal, quarterly payments of \$75,000 and the remaining balance of \$1,900,000 due on or before the expiration date. As of June 30, 2016, the Company had \$2,000,000 in outstanding borrowings and \$9,000,000 in availability under the Revolving Credit Facility and \$2,800,000 outstanding under the Term Loan. The Company's long-term debt is described more fully in Note 6 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.

Outstanding balances and interest rates as of June 30, 2016 and June 30, 2015 are as follows:

|                          | June 30, 2016 |               | June 30, 2015 |               |   |  |
|--------------------------|---------------|---------------|---------------|---------------|---|--|
|                          | Outstanding   | Interest Rate | Outstanding   | Interest Rate |   |  |
| Revolving line of credit | \$ 2,000      | 1.6           | % \$ 3,000    | 1.7           | % |  |
| Term loans               | 2,800         | 1.6           | % 7,700       | 1.7           | % |  |

|            |         |     |            |     |   |
|------------|---------|-----|------------|-----|---|
| Total debt | \$4,800 | 1.6 | % \$10,700 | 1.7 | % |
|------------|---------|-----|------------|-----|---|

The Company believes its current working capital, anticipated cash flows from operations and its revolving credit agreement will be sufficient to fund the Company's operations through at least the next twelve months.

The Company takes into consideration several factors in measuring its liquidity, including the ratios set forth below:

|                      | As of June 30, |          |
|----------------------|----------------|----------|
|                      | 2016           | 2015     |
| Current Ratio        | 5.1 to 1       | 4.8 to 1 |
| Sales to Receivables | 4.3 to 1       | 4.3 to 1 |
| Total debt to equity | .09 to 1       | .23 to 1 |

As of June 30, 2016, the Company had no material commitments for capital expenditures or inventory purchases other than purchase orders issued in the normal course of business. On April 26, 1993, the Company's foreign subsidiary entered into a 99-year land lease of approximately 4 acres of land in the Dominican Republic, on which the Company's principle manufacturing facility is located, at an annual cost of approximately \$288,000.

*Working Capital.* Working capital increased by \$1,298,000 to \$36,888,000 at June 30, 2016 from \$35,590,000 at June 30, 2015. Working capital is calculated by deducting Current Liabilities from Current Assets.

*Accounts Receivable.* Accounts Receivable increased by \$1,018,000 to \$19,012,000 at June 30, 2016 as compared to \$17,994,000 at June 30, 2015. The increase in Accounts Receivable was due primarily to an increase in sales for the quarter ended June 30, 2016 as compared to the same quarter a year ago.

*Inventories.* Inventories, which include both current and non-current portions, decreased by \$1,533,000 to \$25,337,000 at June 30, 2016 as compared to \$26,870,000 at June 30, 2015. The decrease was due primarily to the Company increasing stock of several of its new products at the end of fiscal 2015. The initial rollout of these new products and the fulfillment of these orders were completed during fiscal 2016, allowing the Company to reduce its inventory.

*Accounts Payable and Accrued Expenses.* Accounts payable and accrued expenses increased by \$860,000 to \$8,688,000 as of June 30, 2016 as compared to \$7,828,000 at June 30, 2015. This increase is primarily due to the higher sales volume in the fourth quarter of fiscal 2016 as compared to fiscal 2015. This increase resulted in the Company increasing purchases of raw materials at the end of fiscal 2016 in order to restock its finished goods inventory.

### **Off-Balance Sheet Arrangements**

The Company does not maintain any off-balance sheet arrangements.

### **Contractual Obligations**

The following table summarizes the Company's contractual obligations by fiscal year:

| Contractual obligations | Payments due by period: |                  |           |           |                   |
|-------------------------|-------------------------|------------------|-----------|-----------|-------------------|
|                         | Total                   | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
|                         |                         |                  |           |           |                   |

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|   |              |             |             |             |              |
|---|--------------|-------------|-------------|-------------|--------------|
| Long-term debt obligations                              | \$4,800,000  | \$300,000   | \$2,500,000 | \$2,000,000 | \$—          |
| Land lease (76 years remaining) (1)                     | 21,888,000   | 288,000     | 576,000     | 576,000     | 20,448,000   |
| Operating lease obligations                             | 59,000       | 23,000      | 36,000      | —           | —            |
| Other long-term obligations (employment agreements) (1) | 2,092,000    | 1,311,000   | 781,000     | —           | —            |
| Total   | \$28,839,000 | \$1,922,000 | \$3,893,000 | \$2,576,000 | \$20,448,000 |

(1) See footnote 10 to the accompanying consolidated financial statements.

**Results of Operations****Fiscal 2016 Compared to Fiscal 2015**

|   | Fiscal year ended June 30, |           | % Increase/<br>(decrease) |    |
|---|----------------------------|-----------|---------------------------|----|
|   | 2016                       | 2015      |                           |    |
| Net sales   | \$ 82,513                  | \$ 77,762 | 6.1                       | %  |
| Gross profit  | 27,584                     | 26,047    | 5.9                       | %  |
| Gross profit as a % of net sales                        | 33.4                       | % 33.5    | (0.3)                     | )% |
| Selling, general and administrative                     | 21,261                     | 20,766    | 2.4                       | %  |
| Selling, general and administrative as a % of net sales | 25.8                       | % 26.7    | (3.4)                     | )% |
| Income from operations                                  | 6,323                      | 5,281     | 19.7                      | %  |
| Interest expense, net                                   | 179                        | 215       | (16.7)                    | )% |
| Other expense, net                                      | —                          | 5         | (100.0)                   | )% |
| Provision for income taxes                              | 371                        | 216       | 71.8                      | %  |
| Net income  | 5,773                      | 4,845     | 19.2                      | %  |

Net sales in fiscal 2016 increased by \$4,751,000 to \$82,513,000 as compared to \$77,762,000 in fiscal 2015. The increase in net sales was primarily due to increased sales of the Company's Napco brand intrusion products (\$2,676,000), Alarm Lock brand door-locking products (\$253,000), and Marks brand door-locking products (\$2,947,000) and was partially offset by decreases in the Company's Continental brand access control products (\$1,125,000).

The Company's gross profit increased by \$1,537,000 to \$27,584,000 or 33.4% of net sales in fiscal 2016 as compared to \$26,047,000 or 33.5% of net sales in fiscal 2015. Gross profit was primarily affected by the increase in net sales as discussed above as partially offset by increased Research and Development expenditures which are included in Cost of Sales.

Selling, general and administrative expenses for fiscal 2016 increased by \$495,000 to \$21,261,000 as compared to \$20,766,000 in fiscal 2015. Selling, general and administrative expenses as a percentage of net sales decreased to 25.8% in fiscal 2016 from 26.7% in fiscal 2015. The increases in dollars resulted primarily from increases in selling wages and commissions as well as increased advertising and tradeshow expenditures. The Company increased expenditures in these areas in order to generate higher sales. The decrease as a percentage of net sales was due primarily to Net sales increasing at a higher rate than Selling, general and administrative expenses.

Interest expense for fiscal 2016 decreased by \$36,000 to \$179,000 from \$215,000 for the same period a year ago. The decrease in interest expense is primarily the result of the Company's reduction of its outstanding borrowings under its revolving line of credit and its term loan.

Other expenses remained relatively constant at \$0 and \$5,000 for fiscal 2016 and 2015, respectively.

The Company's provision for income taxes for fiscal 2016 increased by \$155,000 to \$371,000 as compared to \$216,000 for the same period a year ago. The increase in income taxes from fiscal 2015 to fiscal 2016 resulted primarily from the higher pre-tax income in fiscal 2016 as compared to fiscal 2015 as well as a benefit recognized in fiscal 2015 resulting from R&D Credits and a decrease in certain of the Company's income tax reserves.

Net income for fiscal 2016 increased by \$928,000 to \$5,773,000 as compared to \$4,845,000 in fiscal 2015. This resulted primarily from the items discussed above.

## **Forward-looking Information**

This Annual Report on Form 10-K 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, uncertain economic, military and political conditions in the world, our ability to maintain and develop competitive products, adverse tax consequences of offshore operations, the ability to maintain adequate financing and significant fluctuations in the exchange rate between the Dominican Peso and the U.S. Dollar. The Company's Risk Factors are discussed in more detail in Item 1A.

## **ITEM 7A: 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 loan) 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 June 30, 2016, an aggregate principal amount of approximately \$4,800,000 was outstanding under the Company's credit facilities with a weighted average interest rate of approximately 1.6%. 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 \$48,000 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 or weakening in the U.S. dollar to the RD\$ would result in an annual increase or decrease in income from operations of approximately \$630,000.





**ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

a. Financial Statements: Financial statements required pursuant to this Item are presented on pages FS-1 through FS-25 of this report as follows:

**NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES**

|  | <u>Page</u> |
|--|-------------|
| <u>Report of Independent Registered Public Accounting Firm</u>   | FS-1        |
| Consolidated Financial Statements:   |             |
| <u>Consolidated Balance Sheets as of June 30, 2016 and 2015</u>  | FS-2        |
| <u>Consolidated Statements of Income for the Fiscal Years Ended June 30, 2016 and 2015</u>               | FS-4        |
| <u>Consolidated Statements of Stockholders' Equity for the Fiscal Years Ended June 30, 2016 and 2015</u> | FS-5        |
| <u>Consolidated Statements of Cash Flows for the Fiscal Years Ended June 30, 2016 and 2015</u>           | FS-6        |
| <u>Notes to Consolidated Financial Statements</u>  | FS-7        |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders, Audit Committee and Board of Directors

Napco Security Technologies, Inc. and Subsidiaries

Amityville, New York

We have audited the accompanying consolidated balance sheets of Napco Security Technologies, Inc. and Subsidiaries (the "Company") as of June 30, 2016 and 2015, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of its internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Napco Security Technologies, Inc. and Subsidiaries as of June 30, 2016 and 2015 and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ BAKER TILLY VIRCHOW KRAUSE, LLP

New York, New York

September 8, 2016

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## NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

June 30, 2016 and 2015

(In Thousands)

## ASSETS

|   | 2016            | 2015            |
|---|-----------------|-----------------|
| <b>CURRENT ASSETS</b>                               |                 |                 |
| Cash and cash equivalents                           | \$3,805         | \$2,346         |
| Accounts receivable, net of reserves and allowances | 19,012          | 17,994          |
| Inventories   | 21,428          | 22,757          |
| Prepaid expenses and other current assets           | 936             | 1,046           |
| Deferred income taxes                               | 703             | 880             |
| <b>Total Current Assets</b>                         | <b>45,884</b>   | <b>45,023</b>   |
| Inventories - non-current                           | 3,909           | 4,113           |
| Deferred income taxes                               | 436             | 634             |
| Property, plant and equipment, net                  | 6,049           | 6,234           |
| Intangible assets, net                              | 8,357           | 8,886           |
| Other assets  | 134             | 147             |
| <b>TOTAL ASSETS</b>                                 | <b>\$64,769</b> | <b>\$65,037</b> |

See accompanying notes to consolidated financial statements.

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## NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

June 30, 2016 and 2015

(In Thousands, Except Share Data)

## LIABILITIES AND STOCKHOLDERS' EQUITY

|   | 2016            | 2015            |
|---|-----------------|-----------------|
| <b>CURRENT LIABILITIES</b>  |                 |                 |
| Current maturities of long term debt  | \$300           | \$1,600         |
| Accounts payable  | 4,328           | 3,954           |
| Accrued expenses  | 1,893           | 1,624           |
| Accrued salaries and wages  | 2,467           | 2,250           |
| Accrued income taxes  | 8               | 5               |
| Total Current Liabilities   | 8,996           | 9,433           |
| Long-term debt, net of current maturities   | 4,500           | 9,100           |
| Total Liabilities   | 13,496          | 18,533          |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                 |                 |
| <b>STOCKHOLDERS' EQUITY</b>   |                 |                 |
| Common Stock, par value \$0.01 per share; 40,000,000 shares authorized; 21,116,743 and 21,049,243 shares issued; and 18,786,893 and 18,966,028 shares outstanding, respectively | 211             | 210             |
| Additional paid-in capital  | 16,622          | 16,133          |
| Retained earnings   | 46,172          | 40,399          |
|   | 63,005          | 56,742          |
| Less: Treasury Stock, at cost (2,329,850 and 2,083,215 shares, respectively)  | (11,732)        | (10,238)        |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>51,273</b>   | <b>46,504</b>   |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$64,769</b> | <b>\$65,037</b> |

See accompanying notes to consolidated financial statements.

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## NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

Years Ended June 30, 2016 and 2015

(In Thousands, Except Share and Per Share Data)

|  | 2016       | 2015       |
|--|------------|------------|
| Net sales                                      | \$82,513   | \$77,762   |
| Cost of sales                                  | 54,929     | 51,715     |
| Gross Profit                                   | 27,584     | 26,047     |
| Selling, general, and administrative expenses  | 21,261     | 20,766     |
| Operating Income                               | 6,323      | 5,281      |
| Other expense:                                 |            |            |
| Interest expense, net                          | 179        | 215        |
| Other, net                                     | —          | 5          |
|  | 179        | 220        |
| Income before Provision for Income Taxes       | 6,144      | 5,061      |
| Provision for Income Taxes                     | 371        | 216        |
| Net Income                                     | \$5,773    | \$4,845    |
| Income per share:                              |            |            |
| Basic  | \$0.31     | \$0.25     |
| Diluted  | \$0.31     | \$0.25     |
| Weighted average number of shares outstanding: |            |            |
| Basic  | 18,874,000 | 19,164,000 |
| Diluted  | 18,894,000 | 19,169,000 |

See accompanying notes to consolidated financial statements.

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## NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended June 30, 2016 and 2015

(In Thousands, Except Share Data)

|                                  | Common Stock            |        |                            | Treasury Stock   |            | Retained Earnings | Total     |
|----------------------------------|-------------------------|--------|----------------------------|------------------|------------|-------------------|-----------|
|                                  | Number of Shares Issued | Amount | Additional Paid-in Capital | Number of Shares | Amount     |                   |           |
| BALANCE June 30, 2014            | 21,049,243              | \$ 210 | \$ 16,032                  | (1,630,167)      | \$(8,044 ) | \$ 35,554         | \$ 43,752 |
| Repurchase of Treasury Shares    | —                       | —      | —                          | (453,048 )       | (2,194 )   | —                 | (2,194 )  |
| Stock-based compensation expense | —                       | —      | 101                        | —                | —          | —                 | 101       |
| Net income                       | —                       | —      | —                          | —                | —          | 4,845             | 4,845     |
| BALANCE June 30, 2015            | 21,049,243              | \$ 210 | \$ 16,133                  | (2,083,215)      | \$(10,238) | \$ 40,399         | \$ 46,504 |
| Repurchase of Treasury Shares    | —                       | —      | —                          | (192,767 )       | (1,108 )   | —                 | (1,108 )  |
| Stock Options Exercised          | 67,500                  | 1      | 386                        | (53,868 )        | (386 )     | —                 | 1         |
| Stock-based compensation expense | —                       | —      | 103                        | —                | —          | —                 | 103       |
| Net income                       | —                       | —      | —                          | —                | —          | 5,773             | 5,773     |
| BALANCE June 30, 2016            | 21,116,743              | \$ 211 | \$ 16,622                  | (2,329,850)      | \$(11,732) | \$ 46,172         | \$ 51,273 |

See accompanying notes to consolidated financial statements.

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## NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended June 30, 2016 and 2015 (In Thousands)

|  | 2016           | 2015           |
|--|----------------|----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                |                |
| Net income   | \$5,773        | \$4,845        |
| Adjustments to reconcile net income to net cash provided by operating activities:    |                |                |
| Depreciation and amortization  | 1,420          | 1,570          |
| Charge to obsolescence reserve   | (455 )         | (472 )         |
| Provision for doubtful accounts  | (30 )          | 66             |
| Deferred income taxes  | 375            | 230            |
| Non-cash stock based compensation expense  | 103            | 101            |
| Changes in operating assets and liabilities:   |                |                |
| Accounts receivable  | (988 )         | (1,156)        |
| Inventories  | 1,988          | (1,388)        |
| Prepaid expenses and other current assets  | 110            | (57 )          |
| Income tax receivable  | —              | 121            |
| Other assets   | —              | 6              |
| Accounts payable, accrued expenses, accrued salaries and wages, accrued income taxes | 864            | 21             |
| <b>Net Cash Provided by Operating Activities</b>                                     | <b>9,160</b>   | <b>3,887</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                |                |
| Purchases of property, plant, and equipment  | (693 )         | (730 )         |
| <b>Net Cash Used in Investing Activities</b>   | <b>(693 )</b>  | <b>(730 )</b>  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                |                |
| Principal payments on long-term debt   | (5,900)        | (1,600)        |
| Proceeds from long-term debt   | —              | 500            |
| Cash paid for purchase of treasury stock   | (1,108)        | (2,194)        |
| <b>Net Cash Used in Financing Activities</b>   | <b>(7,008)</b> | <b>(3,294)</b> |
| <b>Net Change in Cash and Cash Equivalents</b>                                       | <b>1,459</b>   | <b>(137 )</b>  |
| <b>CASH AND CASH EQUIVALENTS - Beginning</b>   | <b>2,346</b>   | <b>2,483</b>   |
| <b>CASH AND CASH EQUIVALENTS - Ending</b>  | <b>\$3,805</b> | <b>\$2,346</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>  |                |                |
| Interest paid, net   | \$184          | \$215          |
| Income taxes paid  | \$—            | \$29           |
| Surrender of Common Shares   | \$54           | \$—            |

See accompanying notes to consolidated financial statements.

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NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products for commercial and residential use. These products are used for commercial, residential, institutional, industrial and governmental applications, and are sold worldwide principally to independent distributors, dealers and installers of security equipment.

The Company's fiscal year begins on July 1 and ends on June 30. Historically, the end users of 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:

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

#### Fair Value of Financial Instruments

The methods and assumptions used to estimate the fair value of the following classes of financial instruments were: Current Assets and Current Liabilities - The carrying amount of cash, certificates of deposits, current receivables and payables and certain other short-term financial instruments approximate their fair value as of June 30, 2016 due to their short-term maturities; Long-Term Debt - The carrying amount of the Company's long-term debt, including the current portion, at June 30, 2016 in the amount of \$4,800,000 approximates fair value.

#### Cash and Cash Equivalents

Cash and cash equivalents include approximately \$460,000 of short-term time deposits at June 30, 2016 and June 30, 2015. 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 June 30, 2016 and June 30, 2015. The Company has historically not experienced any credit losses with balances in excess of FDIC limits

#### Accounts Receivable

Accounts receivable is stated net of the reserves for doubtful accounts of \$145,000 and \$175,000 and for returns and other allowances of \$1,255,000 and \$1,260,000 as of June 30, 2016 and June 30, 2015, 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 our accounts receivable aging, 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 proportion of those expenses that are related to procuring and storing raw materials as compared to the manufacture and assembly of finished products. These proportions, the method of their application, and the resulting overhead included in ending inventory, are based in part on subjective estimates and actual results could differ from those estimates.

In addition, the Company records an inventory obsolescence reserve, which represents any excess of the cost of the inventory over its estimated market value, based on various product sales projections. This reserve is calculated using an estimated obsolescence percentage applied to the inventory based on age, historical trends, requirements to support forecasted sales, and the ability to find alternate applications of its raw materials and to convert finished product into alternate versions of the same product to better match customer demand. In addition, and as necessary, the Company may establish specific reserves for future known or anticipated events. There is inherent professional judgment and subjectivity made by both production and engineering members of management in determining the estimated obsolescence percentage.

The Company also regularly reviews the period over which its inventories will be converted to sales. Any inventories expected to convert to sales beyond 12 months from the balance sheet date are classified as non-current.

## Property, Plant, and Equipment

Property, plant, and equipment are carried at cost less accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred; costs of major renewals and improvements are capitalized. At the time property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation are eliminated from the asset and accumulated depreciation accounts and the profit or loss on such disposition is reflected in income.

Depreciation is recorded over the estimated service lives of the related assets using primarily the straight-line method. Amortization of leasehold improvements is calculated by using the straight-line method over the estimated useful life of the asset or lease term, whichever is shorter.

## Intangible Assets

Intangible assets determined to have indefinite lives are not amortized but are tested for impairment at least annually. Intangible assets with definite lives are amortized over their useful lives. Intangible assets are reviewed for impairment at least annually at the Company's fiscal year end of June 30 or more often whenever there is an indication that the carrying amount may not be recovered.

The Company's acquisition of substantially all of the assets and certain liabilities of G. Marks Hardware, Inc. ("Marks") in August 2008 included intangible assets recorded at fair value on the date of acquisition. The intangible assets are amortized over their estimated useful lives of twenty years (customer relationships) and seven years (non-compete agreement). The Marks trade name was deemed to have an indefinite life.

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

|                        | June 30, 2016 |                          |                | June 30, 2015 |                          |                |
|------------------------|---------------|--------------------------|----------------|---------------|--------------------------|----------------|
|                        | Cost          | Accumulated amortization | Net book value | Cost          | Accumulated amortization | Net book value |
| Customer relationships | \$9,800       | \$ (7,343 )              | \$ 2,457       | \$9,800       | \$ (6,820 )              | \$ 2,980       |
| Non-compete agreement  | 340           | (340 )                   | —              | 340           | (334 )                   | 6              |
| Trade name             | 5,900         | —                        | 5,900          | 5,900         | —                        | 5,900          |
|                        | \$16,040      | \$ (7,683 )              | \$ 8,357       | \$16,040      | \$ (7,154 )              | \$ 8,886       |

Amortization expense for intangible assets subject to amortization was approximately \$529,000 and \$667,000 for the fiscal years ended June 30, 2016 and 2015, respectively. Amortization expense for each of the next five fiscal years is estimated to be as follows: 2017 - \$441,000; 2018 - \$371,000; 2019 - \$313,000 and 2020 - \$264,000 and 2021 - \$223,000. The weighted average amortization period for intangible assets was 12.1 years and 13.1 years at June 30, 2016 and 2015, 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 or service, (iii) shipment and passage of title occurs or service has been provided, 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. Revenues for services are recorded at the time the service is provided to the customer pursuant to the terms of 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.

#### 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. As a percentage of gross sales, sales returns, rebates and allowances were 7% and 8% for the fiscal years ended June 30, 2016 and 2015, respectively.

#### 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 fiscal years ended June 30, 2016 and 2015 was \$2,132,000 and \$1,671,000, respectively.

#### Research and Development Costs

Research and development costs incurred by the Company are charged to expense as incurred and are included in "Cost of Sales" in the consolidated statements of operations. Company-sponsored research and development expense for the fiscal years ended June 30, 2016 and 2015 was \$6,169,000 and \$5,382,000, respectively.

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## 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 Per Share

Basic net income per common share (Basic EPS) is computed by dividing net income by the weighted average number of common shares outstanding. Diluted net income per common share (Diluted EPS) is computed by dividing net income by the weighted average number of common shares and dilutive common share equivalents and convertible securities then outstanding.

The following provides a reconciliation of information used in calculating the per share amounts for the fiscal years ended June 30 (in thousands, except per share data):

|                                | Net Income |         | Weighted Average Shares |        | Net Income per Share |         |
|--------------------------------|------------|---------|-------------------------|--------|----------------------|---------|
|                                | 2016       | 2015    | 2016                    | 2015   | 2016                 | 2015    |
| Basic EPS                      | \$5,773    | \$4,845 | 18,874                  | 19,164 | \$ 0.31              | \$ 0.25 |
| Effect of Dilutive Securities: |            |         |                         |        |                      |         |
| Stock Options                  | —          | —       | 20                      | 5      | —                    | —       |
| Diluted EPS                    | \$5,773    | \$4,845 | 18,894                  | 19,169 | \$ 0.31              | \$ 0.25 |

Options to purchase 127,404 and 255,688 shares of common stock for the fiscal years ended June 30, 2016 and 2015, 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 7.

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.

Stock-based compensation costs of \$103,000 and \$101,000 were recognized for fiscal years ended June 30, 2016 and 2015, respectively. The effect on both Basic and Diluted Earnings per share was \$0.01 for each of the fiscal years ended June 30, 2016 and 2015.

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### 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 fiscal years ended June 30, 2016 and 2015.

### Comprehensive Income

For the fiscal years ended June 30, 2016 and 2015, 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 for shipping and handling in net sales (\$492,000 and \$515,000 in the fiscal years ended June 30, 2016 and 2015, respectively) and classifies the costs associated with these revenues in cost of sales (\$918,000 and \$945,000 in fiscal years ended June 30, 2016 and 2015).

### Recently Issued Accounting Standards

In March 2016, the Financial Accounting Standards Board (“FASB”) issued authoritative guidance that changes the way companies account for certain aspects of share-based payments to employees. The most significant impact relates to the accounting for income tax effects of share-based compensation awards. This new guidance is part of the FASB’s simplification initiative and requires that all excess tax benefits and tax deficiencies be recorded as income tax expense or benefit in the income statement. In addition, companies are required to treat the tax effects of exercised or vested awards as discrete items in the period that they occur. Other updates include changing the threshold on tax withholding requirements. Under this guidance, an employer can withhold up to the maximum statutory withholding rates in a jurisdiction without tainting the award classification. Additionally, this guidance allows companies to elect a forfeiture recognition method whereby they account for forfeitures as they occur (actual) or they estimate the number of awards expected to be forfeited (current GAAP). Lastly, as it relates to public entities, this guidance also provides requirements for the cash flow classification of cash paid by an employer when directly withholding shares for tax-withholding purposes and excess tax benefits. This guidance becomes effective for the Company’s fiscal 2018 first quarter, with early adoption permitted, and the guidance prescribes different transition methods for the various provisions (i.e., retrospective, modified retrospective, or prospective). The Company is currently evaluating the impact of applying this guidance on its consolidated financial statements.

In February 2016, the FASB issued authoritative guidance that requires lessees to account for most leases on their balance sheets with the liability being equal to the present value of the lease payments. The right-of-use asset will be based on the lease liability adjusted for certain costs such as direct costs. Lease expense will be recognized similar to current accounting guidance with operating leases resulting in a straight-line expense and financing leases resulting in a front-loaded expense similar to the current accounting for capital leases. This guidance becomes effective for the Company’s fiscal 2020 first quarter, with early adoption permitted. This guidance must be adopted using a modified retrospective transition approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, and provides for certain practical expedients. The Company is currently evaluating the timing, impact and method of applying this guidance on its consolidated financial statements.

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In November 2015, the FASB issued ASU 2015-17 “Balance Sheet Classification of Deferred Taxes”. The amendments require deferred tax assets and liabilities, along with related valuation allowances, to be classified as noncurrent on the balance sheet. As a result, each tax jurisdiction will now only have one net noncurrent deferred tax asset or liability. The new guidance does not change the existing requirement that prohibits offsetting deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction. ASU 2015-17 is effective for the Company’s quarter ended September 30, 2016. Early application is permitted. We have not early adopted ASU 2015-17. The new guidance must be applied prospectively after the date of adoption. We have evaluated the adoption of this ASU, and do not expect this to have a material effect on our consolidated results of operations and financial condition.

In July 2015, the FASB issued ASU 2015-11 “Inventory (Topic 330): Simplifying the Measurement of Inventory” (ASU 2015-11). The amendments in ASU 2015-11 simplify the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. ASU 2015-11 is effective for the Company’s quarter ended September 30, 2017. Early application is permitted. We have not early adopted ASU 2015-11. The new guidance must be applied prospectively after the date of adoption. We are in the process of evaluating the adoption of this ASU, and do not expect this to have a material effect on our consolidated results of operations and financial condition.

In May 2014, the FASB issued authoritative guidance that defines how companies should report revenues from contracts with customers. The standard requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It provides companies with a single comprehensive five-step principles-based model to use in accounting for revenue and supersedes current revenue recognition requirements, including most industry-specific and transaction-specific revenue guidance. In August 2015, the FASB deferred the effective date of the new revenue standard by one year. As a result, the new standard would not be effective for the Company until fiscal 2019. In addition, the FASB is allowing companies to early adopt this guidance for the Company’s fiscal 2018. The guidance permits an entity to apply the standard retrospectively to all prior periods presented, with certain practical expedients, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company will apply this new guidance when it becomes effective and has not yet selected a transition method. The Company is currently evaluating the impact of adoption on its consolidated financial statements.

#### NOTE 2 - Business and Credit Concentrations

An entity is more vulnerable to concentrations of credit risk if it is exposed to risk of loss greater than it would have had if it mitigated its risk through diversification of customers. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance. The Company had one customer with an accounts receivable balance that comprised 22% of the Company’s accounts receivable at both June 30, 2016 and 2015. Sales to this customer comprised 13% of net sales in each of the fiscal years ended June 30, 2016 and 2015.

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.

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

|   | June 30, |          |
|---|----------|----------|
|   | 2016     | 2015     |
| Component parts                                 | \$14,021 | \$15,037 |
| Work-in-process                                 | 3,758    | 4,136    |
| Finished product                                | 7,558    | 7,697    |
|   | \$25,337 | \$26,870 |
| Classification of inventories, net of reserves: |          |          |
| Current   | \$21,428 | \$22,757 |
| Non-current                                     | 3,909    | 4,113    |
|   | \$25,337 | \$26,870 |

#### NOTE 4 - Property, Plant, and Equipment

Property, plant and equipment consist of the following (in thousands):

|   | June 30, |         | Useful Life in Years                       |
|---|----------|---------|--|
|   | 2016     | 2015    |  |
| Land  | \$904    | \$904   | —  |
| Buildings                                       | 8,911    | 8,911   | 30 to 40                                   |
| Molds and dies                                  | 7,036    | 7,002   | 3 to 5                                     |
| Furniture and fixtures                          | 2,531    | 2,478   | 5 to 10                                    |
| Machinery and equipment                         | 21,035   | 20,429  | 7 to 10                                    |
| Leasehold improvements                          | 294      | 294     | Shorter of the lease term or life of asset |
|   | 40,711   | 40,018  |  |
| Less: accumulated depreciation and amortization | 34,662   | 33,784  |  |
|   | \$6,049  | \$6,234 |  |

Depreciation and amortization expense on property, plant, and equipment was approximately \$878,000 and \$890,000 in fiscal 2016 and 2015, respectively.

#### NOTE 5 - Income Taxes



The provision for income taxes is comprised of the following (in thousands):

|                               | For the Years Ended June 30, |          |
|-------------------------------|------------------------------|----------|
|                               | 2016                         | 2015     |
| Current income taxes:         |                              |          |
| Federal                       | \$ (31 )                     | \$ (49 ) |
| State                         | 27                           | 35       |
|                               | (4 )                         | (14 )    |
| Deferred income tax provision | 375                          | 230      |
| Provision for income taxes    | \$ 371                       | \$ 216   |

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A reconciliation of the U.S. Federal statutory income tax rate to our actual effective tax rate on earnings before income taxes is as follows for the years ended June 30, (dollars in thousands):

|   | 2016    |                           | 2015    |                           |
|---|---------|---------------------------|---------|---------------------------|
|   | Amount  | % of<br>Pre-tax<br>Income | Amount  | % of<br>Pre-tax<br>Income |
| Tax at Federal statutory rate                         | \$2,089 | 34.0 %                    | \$1,721 | 34.0 %                    |
| Increases (decreases) in taxes resulting from:        |         |                           |         |                           |
| Meals and entertainment                               | 61      | 1.0 %                     | 66      | 1.3 %                     |
| State income taxes, net of Federal income tax benefit | 20      | 0.3 %                     | 21      | 0.4 %                     |
| Foreign source income not subject to tax              | (1,278) | (20.8 )%                  | (1,069) | (21.1 )%                  |
| R&D Credit refund                                     | (415 )  | (6.8 )%                   | (328 )  | (6.5 )%                   |
| Undistributed foreign earnings                        | (90 )   | (1.4 )%                   | (93 )   | (1.8 )%                   |
| Other, net  | (16 )   | (0.3 )%                   | (102 )  | (2.0 )%                   |
| Effective tax rate                                    | \$371   | 6.0 %                     | \$216   | 4.3 %                     |

Deferred tax assets and deferred tax liabilities at June 30, 2016 and 2015 are as follows (in thousands):

|                                  | Current Deferred Tax Assets<br>(Liabilities) |        | Long-term Deferred Tax<br>Assets (Liabilities) |        |
|----------------------------------|--|--------|--|--------|
|                                  | 2016   | 2015   | 2016   | 2015   |
| Accounts receivable              | \$ 26  | \$ 36  | \$ —   | \$ —   |
| Inventories                      | 364  | 533    | 200  | 261    |
| Accrued Liabilities              | 313  | 311    | 87   | 86     |
| Stock based compensation expense | —  | —      | 154  | 147    |
| Goodwill                         | —  | —      | (14 )  | 214    |
| R&D credit                       | —  | —      | 1,214  | 804    |
| Property, plant and equipment    | —  | —      | (503 )   | (512 ) |
| Other deferred tax liabilities   | —  | —      | (702 )   | (366 ) |
|                                  | 703  | 880    | 436  | 634    |
| Valuation allowance              | —  | —      | —  | —      |
| Net deferred tax assets          | \$ 703                                       | \$ 880 | \$ 436   | \$ 634 |

The Company has identified the United States and New York State as its major tax jurisdictions. The fiscal 2012 and forward years are still open for examination.

During the year ending June 30, 2016 the Company increased its reserve for uncertain income tax positions by \$46,000. The Company's practice is to recognize interest and penalties related to income tax matters in income tax

expense and accrued income taxes. As of June 30, 2016, the Company had accrued interest totaling \$0 and \$148,000 of unrecognized net tax benefits that, if recognized, would favorably affect the Company's effective income tax rate in any future period. The Company uses the flow through method to account for investment tax credits earned on eligible research and development expenditures. Under this method, the investment tax credits are recognized as a reduction to income tax expense.

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A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

|  | Tax    | Interest | Total  |
|--|--------|----------|--------|
| Balance of gross unrecognized tax benefits as of July 1, 2015                                  | \$ 102 | \$ —     | \$ 102 |
| Increases to unrecognized tax benefits resulting from the generation of additional R&D credits | 46     | —        | 46     |
| Balance of gross unrecognized tax benefits as of June 30, 2016                                 | \$ 148 | \$ —     | \$ 148 |

The Company plans to permanently reinvest a substantial portion of its foreign earnings and as such has not provided US corporate taxes on the permanently reinvested earnings. As of June 30, 2016, the Company had approximately \$7.6 million of undistributed earnings of foreign subsidiaries.

#### NOTE 6 - Long-Term Debt

As of June 30, 2016, long-term debt consisted of a revolving credit facility of \$11,000,000 (the “Revolving Credit Facility”) which expires in June 2021 and one loan for \$6,000,000 which expires in June 2019 (the “Term Loan”). The Revolving Credit Facility had an expiration date of June 2017 which was extended to June 2021 at the end of fiscal 2016. Repayment of the Term Loan commenced on September 30, 2012. The Term Loan is being repaid with 28 equal, quarterly payments of \$75,000 and the remaining balance of \$1,900,000 due on or before the expiration date.

Outstanding balances and interest rates as of June 30, 2016 and June 30, 2015 are as follows:

|                          | June 30, 2016 |               | June 30, 2015 |               |   |
|--------------------------|---------------|---------------|---------------|---------------|---|
|                          | Outstanding   | Interest Rate | Outstanding   | Interest Rate |   |
| Revolving line of credit | \$ 2,000      | 1.6           | % \$ 3,000    | 1.7           | % |
| Term loans               | 2,800         | 1.6           | % 7,700       | 1.7           | % |
| Total debt               | \$ 4,800      | 1.6           | % \$ 10,700   | 1.7           | % |

The Revolving Credit Facility and Term Loans (collectively the “Agreement”) also provides for a LIBOR-based interest rate option of LIBOR plus 1.15% to 2.00%, 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, and the Company’s corporate headquarters in Amityville, NY, 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 Agreement contains 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 Agreement.

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NOTE 7 - Stock Options

The Company follows ASC 718 (“Share-Based Payment”), which requires that all share based payments to employees, including stock options, be recognized as compensation expense in the consolidated financial statements based on their fair values and over the requisite service period. For the fiscal years ended June 30, 2016 and 2015, the Company recorded non-cash compensation expense of \$103,000 (\$0.01 per basic and diluted share) and \$101,000 (\$0.01 per basic and diluted share), respectively, relating to stock-based compensation

## 2012 Employee Stock Option Plan

In December 2012, the stockholders approved the 2012 Employee Stock Option Plan (the 2012 Employee Plan). The 2012 Employee 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 this 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 Employee 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 this plan shall vest in full upon a “change in control” as defined in the plan. At June 30, 2016, 112,500 stock options were granted, 55,700 stock options were exercisable and 837,500 stock options were available for grant under this plan.

The fair value of each option granted during fiscal 2016 and 2015 were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                          |          |   |          |   |
|--------------------------|----------|---|----------|---|
|                          | 2016     |   | 2015     |   |
| Risk-free interest rates | 1.8      | % | 2.3      | % |
| Expected lives           | 10 years |   | 10 years |   |
| Expected volatility      | 54       | % | 54       | % |
| Expected dividend yields | 0        | % | 0        | % |

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The Company uses a weighted-average expected stock-price volatility assumption that is a combination of both current and historical implied volatilities of the underlying stock. The implied volatilities were obtained from publicly available data sources. For the weighted-average expected option life assumption, the Company considers the exercise behavior of past grants. The average risk-free interest rate is based on the U.S. Treasury Bond rate for the expected term of the options and the average dividend yield is based on historical experience.

The following table reflects activity under the 2012 Plan for the fiscal years ended June 30,:

|  | 2016      |  | 2015      |  |
|--|-----------|--|-----------|--|
|  | Options   | Weighted<br>average<br>exercise<br>price | Options   | Weighted<br>average<br>exercise<br>price |
| Outstanding, beginning of year                               | 112,500   | \$ 5.30                                  | 78,500    | \$ 5.73                                  |
| Granted  | 15,000    | 6.05                                     | 44,000    | 4.43                                     |
| Terminated   | (15,000 ) | 4.29                                     | (10,000 ) | 4.88                                     |
| Exercised  | —         | —  | —         | —  |
| Outstanding, end of year                                     | 112,500   | \$ 5.54                                  | 112,500   | \$ 5.30                                  |
| Exercisable, end of year                                     | 55,700    | \$ 5.59                                  | 27,500    | \$ 5.26                                  |
| Weighted average fair value at grant date of options granted | \$3.86    |  | \$2.82    |  |
| Total intrinsic value of options exercised                   | n/a       |  | n/a       |  |
| Total intrinsic value of options outstanding                 | \$93,000  |  | \$73,000  |  |
| Total intrinsic value of options exercisable                 | \$43,000  |  | \$18,000  |  |

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The following table summarizes information about stock options outstanding under the 2012 Employee Plan at June 30, 2016:

| Range of exercise prices | Options outstanding |   |                                 | Options exercisable |                                 |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|
|                          | Number outstanding  | Weighted average remaining contractual life | Weighted average exercise price | Number exercisable  | Weighted average exercise price |
| \$4.29-\$6.31            | 112,500             | 7.9   | \$ 5.54                         | 55,700              | \$ 5.59                         |
|                          | 112,500             | 7.9   | \$ 5.54                         | 55,700              | \$ 5.59                         |

As of June 30, 2016, there was \$260,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2012 Employee Plan. 15,000 and 44,000 options were granted during the fiscal years ended June 30, 2016 and 2015, respectively. The total fair value of the options vesting during the fiscal years ended June 30, 2016 and 2015 under this plan was \$119,000 and \$41,000, respectively.

#### 2012 Non-Employee Stock Option Plan

In December 2012, the stockholders approved the 2012 Non-Employee Stock Option Plan (the 2012 Non-Employee Plan). This 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 this 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 this plan shall vest in full upon a "change in control" as defined in the plan. At June 30, 2016, 35,000 stock options were granted, 19,000 stock options were exercisable and 15,000 stock options were available for grant under this plan.

The following table reflects activity under the 2012 Non-Employee Plan for the fiscal years ended June 30,:

| 2016             | 2015             |
|------------------|------------------|
| Options          | Options          |
| Weighted average | Weighted average |



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|  |          | exercise<br>price |          | exercise<br>price |
|--|----------|-------------------|----------|-------------------|
| Outstanding, beginning of year                               | 35,000   | \$ 4.73           | 25,000   | \$ 4.88           |
| Granted  | —        | —                 | 10,000   | 4.37              |
| Terminated   | —        | —                 | —        | —                 |
| Exercised  | —        | —                 | —        | —                 |
| Outstanding, end of year                                     | 35,000   | \$ 4.73           | 35,000   | \$ 4.73           |
| Exercisable, end of year                                     | 19,000   | \$ 4.77           | 12,000   | \$ 4.80           |
| Weighted average fair value at grant date of options granted | n/a      |                   | \$2.86   |                   |
| Total intrinsic value of options exercised                   | n/a      |                   | n/a      |                   |
| Total intrinsic value of options outstanding                 | \$57,000 |                   | \$35,000 |                   |
| Total intrinsic value of options exercisable                 | \$30,000 |                   | \$11,000 |                   |

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The following table summarizes information about stock options outstanding under the 2012 Non-Employee Plan at June 30, 2016:

| Range of exercise prices | Options outstanding |   |                                 | Options exercisable |                                 |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|
|                          | Number outstanding  | Weighted average remaining contractual life | Weighted average exercise price | Number exercisable  | Weighted average exercise price |
| \$4.37 - \$4.88          | 35,000              | 7.5   | \$ 4.73                         | 19,000              | \$ 4.77                         |
|                          | 35,000              | 7.5   | \$ 4.73                         | 19,000              | \$ 4.77                         |

As of June 30, 2016, there was \$73,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2012 Non-Employee Plan. 0 and 10,000 options were granted during the fiscal years ended June 30, 2016 and 2015, respectively. The total fair value of the options vesting during the fiscal years ended June 30, 2016 and 2015 under this plan was \$22,000 and \$6,000, respectively.

#### 2002 Employee Stock Option Plan

In December 2002, the stockholders approved the 2002 Employee Stock Option Plan (the 2002 Employee Plan). This plan expired in October 2012. This 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 this 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 Employee 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 June 30, 2016, 1,471,480 stock options had been granted, 102,500 stock options were exercisable and no further stock options were available for grant under this plan after the plans expiration in October 2012.

The following table reflects activity under the 2002 Employee plan for the fiscal years ended June 30,:

2016

2015

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|  | Options   | Weighted<br>average<br>exercise price | Options   | Weighted<br>average<br>exercise price |
|--|-----------|---------------------------------------|-----------|---------------------------------------|
| Outstanding, beginning of year                               | 208,500   | \$ 6.86                               | 265,750   | \$ 6.51                               |
| Granted  | —         | —                                     | —         | —                                     |
| Terminated/Lapsed  | (38,500 ) | 11.03                                 | (57,250 ) | 5.24                                  |
| Exercised  | (67,500 ) | 5.73                                  | —         | —                                     |
| Outstanding, end of period                                   | 102,500   | \$ 6.04                               | 208,500   | \$ 6.86                               |
| Exercisable, end of period                                   | 102,500   | \$ 6.04                               | 208,500   | \$ 6.86                               |
| Weighted average fair value at grant date of options granted | n/a       |                                       | n/a       |                                       |
| Total intrinsic value of options exercised                   | \$42,000  |                                       | n/a       |                                       |
| Total intrinsic value of options outstanding                 | \$40,000  |                                       | \$6,000   |                                       |
| Total intrinsic value of options exercisable                 | \$40,000  |                                       | \$6,000   |                                       |

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As of June 30, 2016, there was no unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2002 Non-Employee Plan. 67,500 and 0 stock options were exercised during the fiscal years ended June 30, 2016 and 2015, respectively. The 67,500 stock options exercised during the fiscal year ended June 30, 2015 were settled by exchanging 53,868 shares of the Company's common stock which was included in Treasury Stock upon receipt. No cash was received from option exercises for either of the fiscal years ended June 30, 2016 and 2015 and the actual tax benefit realized for the tax deductions from option exercises was \$0 for each of these periods.

The following table summarizes information about stock options outstanding under the 2002 Employee Plan at June 30, 2016:

| Range of exercise prices | Options outstanding and exercisable |   |                                 |
|--------------------------|-------------------------------------|---|---------------------------------|
|                          | Number outstanding                  | Weighted average remaining contractual life | Weighted average exercise price |
| \$5.35-\$6.62            | 102,500                             | 0.7   | \$ 6.04                         |
|                          | 102,500                             | 0.7   | \$ 6.04                         |

#### NOTE 8 – Stockholders' Equity Transactions

On September 16, 2014 the Company's board of directors authorized the repurchase of up to 1 million of the approximately 19.4 million shares of the Company's common stock outstanding. The repurchase will be made from time to time in the open market or in privately negotiated transactions subject to market conditions and the market price of the common stock. Relative to the loan agreements described in Note 6, the Company's lender gave its consent to this stock repurchase plan. During the fiscal year ended June 30, 2016 the Company repurchased 192,767 shares of its outstanding common stock for a weighted average price of \$5.73 per share. These repurchased shares are included in the Company's Treasury Stock as of June 30, 2016.

During fiscal 2016, certain employees exercised incentive stock options under the Company's 2002 Plan totaling 67,500 shares. All of these 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 was 53,868 and was based upon the per share price on the effective date of the option exercise.

#### 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 \$111,000 and \$122,000 for the years ended June 30, 2016 and 2015, respectively.

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NOTE 10 - Commitments and Contingencies

Leases

The Company is committed under various operating leases, not including the land lease discussed below, which do not extend beyond fiscal 2019. Minimum lease payments through the expiration dates of these leases, with the exception of the land leases referred to below, are as follows:

| Year Ending June 30, | Amount   |
|----------------------|----------|
| 2017                 | \$23,000 |
| 2018                 | 22,000   |
| 2019                 | 14,000   |
| Total                | \$59,000 |

Rent expense, with the exception of the land lease referred to below, totaled approximately \$26,000 and \$30,000 for the fiscal years ended June 30, 2016 and 2015, 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 June 30, 2016, the Company was obligated under three employment agreements and one severance agreement. The employment agreements are with the Company's CEO, Senior Vice President of Sales and Marketing ("the SVP of Sales") and the Senior Vice President of Engineering ("the SVP of Engineering"). The employment agreement with the CEO provides for an annual salary of \$670,000, 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 of Sales expires in October 2018 and provides for an annual salary of \$315,000, a bonus arrangement for fiscal 2016 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. The employment agreement with the SVP of Engineering expires in August 2018 and provides for an annual salary of \$285,000, a bonus arrangement and, if terminated by the Company without cause, severance of nine month's salary and continued company-sponsored health insurance for six months from the date of termination. The severance agreement is with the Senior Vice President of Operations and Finance and provides for, if terminated by the Company without cause or within three months of a change in corporate control of the Registrant, severance of nine month's salary, continued company-sponsored health insurance for six months from the date of termination and certain non-compete and other restrictive provisions.

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NOTE 11 - Geographical Data

The Company is engaged in one major line of business: the development, manufacture, and distribution of access control systems, door security products, intrusion and fire alarm systems and video surveillance products 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.

Financial Information Relating to Domestic and Foreign Operations

|                                 | 2016           | 2015     |
|---------------------------------|----------------|----------|
|                                 | (in thousands) |          |
| Sales to external customers(1): |                |          |
| Domestic                        | \$79,931       | \$74,736 |
| Foreign                         | 2,582          | 3,026    |
| Total Net Sales                 | \$82,513       | \$77,762 |
| Identifiable assets:            |                |          |
| United States                   | \$51,272       | \$50,998 |
| Dominican Republic (2)          | 13,497         | 14,039   |
| Total Identifiable Assets       | \$64,769       | \$65,037 |

(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 (2016 = \$10,076; 2015 = \$10,546) and fixed assets (2016 = \$3,311; 2015 = \$3,347) located at the Company's principal manufacturing facility in the Dominican Republic.

NOTE 12 – Subsequent Events

The Company has evaluated subsequent events occurring after the date of the consolidated financial statements for events requiring recording or disclosure in the financial statements.



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**ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None

**ITEM 9A: CONTROL AND PROCEDURES**

Evaluation of Disclosure Controls and Procedures. At the conclusion of the period ended June 30, 2016, 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 as of June 30, 2016.

Management's Annual Report on Internal Control Over Financial Reporting. Management is responsible for the preparation of the Company's consolidated financial statements and related information. Management uses its best judgment to ensure that the consolidated financial statements present fairly, in all material respects, the Company's consolidated financial position and results of operations in conformity with generally accepted accounting principles.

The consolidated financial statements have been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board. Their report expresses the independent accountant's judgment as to the fairness of management's reported operating results, cash flows and financial position. This judgment is based on the procedures described in the second paragraph of their report.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision of management, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework *Internal Control — Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and other guidance prepared specifically for smaller public companies. Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of June 30, 2016.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of our Company; and (3) unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements are prevented or timely detected.

#### *Limitations on Internal Control*

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of Baker Tilly Virchow Krause, LLP, our registered public accounting firm, regarding internal control over financial reporting. Management's Report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only Management's Report in this annual report.

The Board of Directors of the Company has an Audit Committee comprised of three non-management directors. The Committee meets periodically with financial management and the independent auditors to review accounting, control, audit and financial reporting matters. Baker Tilly Virchow Krause, LLP has full and free access to the Audit Committee, with and without the presence of management.

#### *Changes in Internal Control over Financial Reporting*

There have been no changes in our internal control over financial reporting during the quarter ended June 30, 2016 that has materially affected or is likely to materially affect our internal controls over financial reporting.

#### **ITEM 9B: OTHER INFORMATION**

None

### **PART III**

#### **ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information about our directors appearing in the Company's Definitive Proxy Statement for the 2016 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K ("Proxy Statement") under the heading "Election of Directors", is incorporated herein by reference.

We have adopted a Code of Ethics which applies to our senior executive and financial officers, among others. The Code is posted on our website, [www.napcosecurity.com](http://www.napcosecurity.com), under the "Investors – Other" caption. We intend to make all required disclosures regarding any amendment to, or waiver of, a provision of the Code of Ethics for senior executive and financial officers by posting such information on our website.

The information appearing in the Proxy Statement relating to the members of the Audit Committee and the Audit Committee financial expert under the headings “Corporate Governance and Board Matters – Board Structure and Committee Composition” and “Corporate Governance and Board Matters – Board Structure and Committee Composition – Audit Committee” and the information appearing in the Proxy Statement under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” is incorporated herein by this reference.

The information set forth in the Proxy Statement under the heading “Information Concerning Executive Officers” is incorporated herein by reference.

#### **ITEM 11: EXECUTIVE COMPENSATION**

The information appearing in the Proxy Statement under the heading “Executive Compensation” and the information appearing in the Proxy Statement relating to the compensation of directors under the caption “Compensation of Directors” is incorporated herein by this reference.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information appearing in the Proxy Statement under the heading “Beneficial Ownership of Common Stock” is incorporated herein by this reference.

Information regarding Equity Compensation Plan Information as of June 30, 2016 is included in Item 5.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information appearing in the Proxy Statement under the headings “Corporate Governance and Board Matters – Independence of Directors,” “Corporate Governance and Board Matters – Board Structure and Committee Composition,” “Corporate Governance – Policy with Respect to Related Person Transactions,” and “Executive Compensation – Certain Transactions” is incorporated herein by this reference.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information appearing in the Proxy Statement under the headings “Principal Accountant Fees” and “Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors” is incorporated herein by this reference.

PART IV

**ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

(a) 1. Financial Statements

The following consolidated financial statements of NAPCO Security Technologies, Inc. and its subsidiaries are included in Part II, Item 8:

|   | Page |
|---|------|
| Report of Independent Registered Public Accounting Firm   | FS-1 |
| Consolidated Financial Statements:  |      |
| Consolidated Balance Sheets as of June 30, 2016 and 2015  | FS-2 |
| Consolidated Statements of Operations for the Fiscal Years Ended June 30, 2016 and 2015           | FS-4 |
| Consolidated Statements of Stockholders' Equity for the Fiscal Years Ended June 30, 2016 and 2015 | FS-5 |
| Consolidated Statements of Cash Flows for the Fiscal Years Ended June 30, 2016 and 2015           | FS-6 |
| Notes to Consolidated Financial Statements, June 30, 2016   | FS-7 |

(a)3 and (b). Exhibits

Management Contracts designated by asterisk.

Exhibit  
No. Title

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|            |  |   |
|------------|--|---|
| Ex-3.(i)   | Certificate of Amendment of Certificate of Incorporation         | Exhibit-3.(i) to Report on Form 10-K (Commission file No. 0-10004) for the fiscal year ended June 30, 2011  |
| Ex-3.(ii)  | Certificate of Incorporation as amended                          | Exhibit-3.(ii) to Report on Form 10-K (Commission file No. 0-10004) for the fiscal year ended June, 30 2011 |
| Ex-3.(iii) | Amended and Restated By-Laws                                     | Exhibit 3.(ii) to Report on Form 10-K (Commission file No. 0-10004) for the fiscal year ended June 30, 2010 |
| Ex 4.01    | Third Amended and Restated Credit Agreement dated June 29, 2012. | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                        |



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|                  |   |   |
|------------------|---|---|
| Ex 4.02          | Second Amended and Restated Term A Loan Note  | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.03          | Second Amended and Restated Term B Loan Note  | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.04          | Second Amended and Restated Revolving Credit Note                                   | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.05          | Second Amended and Restated Swing Line Note   | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.06          | Continuing General Security Agreement   | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.07          | Reaffirmation of Collateral Documents   | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.08          | Reaffirmation of Negative Pledge  | Exhibit 4.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 29, 2012                                    |
| Ex 4.09          | Amendment No. 3 to Third Amended and Restated Credit Agreement                      | Exhibit 1.01 to Report on Form 8-K (Commission file No. 0-10004) dated June 28, 2016                                    |
| *Ex-10.A<br>(ii) | 2002 Employee Stock Option Plan   | Exhibit 10.A(II) to Report on Form 10-K (Commission file No. 0-10004) for the fiscal year ended June 30, 2008           |
| *Ex-10.B         | 2012 Employee Stock Option Plan   | Appendix A to Proxy Statement dated October 29, 2012 for Annual Meeting of Stockholders to be held on December 11, 2012 |
| *Ex-10.C         | 2012 Non-Employee Stock Option Plan   | Appendix B to Proxy Statement dated October 29, 2012 for Annual Meeting of Stockholders to be held on December 11, 2012 |
| *Ex-10.I         | Amended and Restated Employment Agreement with Richard Soloway                      | Exhibit 10.I to Report on Form 10-K (Commission file No. 0-10004) for fiscal year ended June 30, 2010                   |
| *Ex-10.J         | Employment Agreement between the Registrant and Jorge Hevia dated December 20, 1999 | Exhibit 10.J to Report on Form 8-K (Commission file No. 0-10004) dated November 29, 2012                                |
| *Ex-10.M         | Indemnification Agreement dated August 9, 1999                                      | Exhibit 10.M to Report on Form 10-K (Commission file No. 0-10004) for fiscal year ended June 30, 2012                   |

\*Ex-10.N Two (2) Year Extension, dated November 13, 2015, of Employment Agreement between the Registrant and Michael Carrieri Exhibit 10.N to Report on Form 10-Q (Commission file No. 0-10004) dated February 1, 2015

|            |  |   |
|------------|--|---|
| *Ex-10.O   | Severance Agreement between the Registrant and Kevin S Buchel dated December 30, 2015                                    | Exhibit 10.O to Report on Form 10-Q (Commission file No. 0-10004) dated February 1, 2015                  |
| *Ex-10.P   | Two (2) Year Extension, dated November 13, 2015, of Employment Agreement between the Registrant and Jorge Hevia          | Exhibit 10.N to Report on Form 10-Q (Commission file No. 0-10004) dated February 1, 2015                  |
| Ex-14.0    | Code of Ethics   | Exhibit 14.0 to Report on Form 10-K (Commission file No. 0-10004) for the fiscal year ended June 30, 2010 |
| Ex-21.0    | Subsidiaries of the Registrant   | E-18  |
| Ex-23.1    | Consent of Independent Auditors  | E-19  |
| Ex-31.1    | Section 302 Certification of Chief Executive Officer   | E-20  |
| Ex-31.2    | Section 302 Certification of Chief Financial Officer   | E-21  |
| Ex-32.1    | Certification of Chief Executive Officer Pursuant to 18 USC Section 1350 and Section 906 of Sarbanes - Oxley Act of 2002 | E-22  |
| Ex-32.2    | Certification of Chief Financial Officer Pursuant to 18 USC Section 1350 and Section 906 of Sarbanes - Oxley Act of 2002 | E-23  |
| Ex-101.INS | XBRL Instance Document   |   |
| Ex-101.SCH | XBRL Taxonomy Extension Schema Document  |   |
| Ex-101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |   |
| Ex-101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |   |
| Ex-101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |   |
| Ex-101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |   |

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

September 8, 2016

### NAPCO SECURITY TECHNOLOGIES, INC.

(Registrant)

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and the dates indicated.

| Signature                                     | Title   | Date              |
|---|---|-------------------|
| /s/RICHARD SOLOWAY<br>Richard Soloway         | Chairman of the Board of Directors,<br>President and Secretary and Director<br>(Principal Executive Officer)                  | September 8, 2016 |
| /s/KEVIN S. BUCHEL<br>Kevin S. Buchel         | Senior Vice President of Operations<br>and Finance and Treasurer and Director<br>(Principal Financial and Accounting Officer) | September 8, 2016 |
| /s/PAUL STEPHEN BEEBER<br>Paul Stephen Beeber | Director  | September 8, 2016 |
| /s/RANDY B. BLAUSTEIN<br>Randy B. Blaustein   | Director  | September 8, 2016 |

/s/ARNOLD BLUMENTHAL Director  
Arnold Blumenthal

September 8, 2016

/s/DONNA SOLOWAY Director  
Donna Soloway

September 8, 2016

/s/ANDREW J. WILDER Director  
Andrew J. Wilder

September 8, 2016