

UNIVERSAL SECURITY INSTRUMENTS INC  
Form 10-Q  
February 12, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period ended December 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-31747

UNIVERSAL SECURITY INSTRUMENTS, INC.

(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| Maryland<br>(State or other jurisdiction of<br>incorporation or organization) | 52-0898545<br>(I.R.S. Employer<br>Identification No.) |
|---|---|

|  |                     |
|--|---------------------|
| 11407 Cronhill Drive, Suites A-D<br>Owings Mills, Maryland<br>(Address of principal executive offices) | 21117<br>(Zip Code) |
|--|---------------------|

Registrant's telephone number, including area code: (410) 363-3000

7-A Gwynns Mill Court, Owings Mills, Maryland 21117  
(Former name, former address and former fiscal year if changed from last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-Accelerated Filer  Smaller Reporting Company

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

At February 6, 2008, the number of shares outstanding of the registrant's common stock was 2,425,142.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

|  | December 31, 2008    | March 31, 2008       |
|--|----------------------|----------------------|
| <b>ASSETS</b>  |                      |                      |
| <b>CURRENT ASSETS</b>  |                      |                      |
| Cash and cash equivalents  | \$ 180,755           | \$ 3,863,784         |
| Accounts receivable:   |                      |                      |
| Trade less allowance for doubtful accounts of \$95,927 and \$15,000 at December 31, 2008 and March 31, 2008  | 1,044,168            | 146,022              |
| Recoverable taxes and other receivables  | 353,187              | 282,083              |
| Receivable from Hong Kong Joint Venture  | 116,938              | 115,656              |
|  | 1,514,293            | 543,761              |
| Amount due from factor   | 3,591,315            | 5,600,408            |
| Inventories, net of allowance for obsolete inventory of \$204,309 and \$40,000 at December 31, 2008 and March 31, 2008, respectively                     | 9,378,114            | 5,357,488            |
| Prepaid expenses   | 156,947              | 206,197              |
| Assets held in receivership  | 219,402              | 2,850,731            |
| <b>TOTAL CURRENT ASSETS</b>  | <b>15,040,826</b>    | <b>18,422,369</b>    |
| <b>DEFERRED TAX ASSET</b>  | <b>2,200,690</b>     | <b>1,914,136</b>     |
| <b>INVESTMENT IN HONG KONG JOINT VENTURE</b>   | <b>10,688,904</b>    | <b>9,986,579</b>     |
| <b>PROPERTY AND EQUIPMENT – NET</b>  | <b>130,530</b>       | <b>130,347</b>       |
| <b>OTHER ASSETS</b>  | <b>16,252</b>        | <b>15,486</b>        |
| <b>TOTAL ASSETS</b>  | <b>\$ 28,077,202</b> | <b>\$ 30,468,917</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                      |                      |
| <b>CURRENT LIABILITIES</b>   |                      |                      |
| Amount due to factor   | \$ 101,911           | \$ 0                 |
| Accounts payable   | 823,968              | 777,342              |
| Hong Kong Joint Venture accounts payable   | 1,924,668            | 1,687,950            |
| Accrued liabilities:   |                      |                      |
| Litigation reserve   | 401,592              | 401,592              |
| Payroll and employee benefits  | 324,830              | 158,057              |
| Commissions and other  | 166,998              | 105,431              |
| Liabilities held in receivership   | 219,402              | 7,823,450            |
| <b>TOTAL CURRENT LIABILITIES</b>   | <b>3,963,369</b>     | <b>10,953,822</b>    |
| Long-term liability – other  | 95,324               | 91,160               |
| <b>COMMITMENTS AND CONTINGENCIES</b>   | <b>-</b>             | <b>-</b>             |
| <b>SHAREHOLDERS' EQUITY</b>  |                      |                      |
| Common stock, \$.01 par value per share; authorized 20,000,000 shares; issued and outstanding 2,443,292 shares at December 31, 2008 and 2,487,867 shares | 24,448               | 24,879               |

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at March 31, 2008

|  |               |               |
|--|---------------|---------------|
| Additional paid-in capital                 | 13,316,830    | 13,453,378    |
| Retained earnings                          | 10,677,231    | 5,890,023     |
| Other comprehensive income                 | -             | 55,655        |
| TOTAL SHAREHOLDERS' EQUITY                 | 24,018,509    | 19,423,935    |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 28,077,202 | \$ 30,468,917 |

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

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UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

|  | Three Months Ended December 31, |                       |
|--|---------------------------------|-----------------------|
|  | 2008                            | 2007                  |
| Net sales  | \$ 5,595,049                    | \$ 7,776,986          |
| Cost of goods sold – acquired from Joint Venture             | 4,222,264                       | 4,762,666             |
| Cost of goods sold – other                                   | 35,000                          | 803,224               |
| <b>GROSS PROFIT</b>  | <b>1,337,785</b>                | <b>2,211,096</b>      |
| Research and development expense                             | 107,632                         | 94,144                |
| Selling, general and administrative expense                  | 1,177,776                       | 1,569,765             |
| Operating income   | 52,377                          | 547,187               |
| Other income (expense):                                      |                                 |                       |
| Interest income  | -                               | 18,370                |
| Interest expense   | (6,967)                         | -                     |
| <b>INCOME BEFORE EQUITY IN EARNINGS OF JOINT VENTURE</b>     | <b>45,410</b>                   | <b>565,557</b>        |
| Equity in earnings of Joint Venture                          | 458,745                         | 688,017               |
| Income from continuing operations before income taxes        | 504,155                         | 1,253,574             |
| Provision for income tax expense                             | 211,642                         | 87,757                |
| <b>INCOME FROM CONTINUING OPERATIONS</b>                     | <b>292,513</b>                  | <b>1,165,817</b>      |
| Discontinued operations:                                     |                                 |                       |
| Loss from operations of the discontinued Canadian subsidiary | -                               | (2,744,256)           |
| Income tax expense – discontinued operations                 | -                               | 57,350                |
| Loss from discontinued operations                            | -                               | (2,801,606)           |
| <b>NET INCOME (LOSS)</b>                                     | <b>\$ 292,513</b>               | <b>\$ (1,635,789)</b> |
| Income (loss) per share:                                     |                                 |                       |
| Basic – from continuing operations                           | \$ 0.12                         | \$ .47                |
| Basic – from discontinued operations                         | \$ 0.00                         | \$ (1.13)             |
| Basic – net income (loss)                                    | \$ 0.12                         | \$ (0.66)             |
| Diluted – from continuing operations                         | \$ 0.12                         | \$ 0.47               |
| Diluted – from discontinued operations                       | \$ 0.00                         | \$ (1.13)             |
| Diluted – net income (loss)                                  | \$ 0.12                         | \$ (0.66)             |
| Shares used in computing net income per share:               |                                 |                       |
| Basic  | 2,467,028                       | 2,489,132             |
| Diluted  | 2,467,028                       | 2,489,132             |

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



UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

|   | Nine Months Ended December 31 |                     |
|---|-------------------------------|---------------------|
|   | 2008                          | 2007                |
| Net sales   | \$ 20,169,229                 | \$ 27,152,181       |
| Cost of goods sold - acquired from Joint Venture                      | 15,322,425                    | 15,209,299          |
| Cost of goods – other   | 40,680                        | 5,067,583           |
| <b>GROSS PROFIT</b>   | <b>4,806,124</b>              | <b>6,875,299</b>    |
| Research and development expense                                      | 279,050                       | 254,811             |
| Selling, general and administrative expense                           | 4,071,000                     | 4,645,371           |
| Operating income  | 456,074                       | 1,975,117           |
| Other income (expense):   |                               |                     |
| Interest income   | 41,876                        | 18,370              |
| Interest expense  | (33,267)                      | (70,861)            |
| <b>INCOME BEFORE EQUITY IN EARNINGS OF JOINT VENTURE</b>              | <b>464,683</b>                | <b>1,922,626</b>    |
| Equity in earnings of Joint Venture                                   | 1,351,707                     | 1,878,733           |
| Income from continuing operations before income taxes                 | 1,816,390                     | 3,801,359           |
| Provision for income tax expense                                      | 410,437                       | 625,633             |
| <b>INCOME FROM CONTINUING OPERATIONS</b>                              | <b>1,405,953</b>              | <b>3,175,726</b>    |
| Discontinued operations:  |                               |                     |
| Income (loss) from operations of the discontinued Canadian subsidiary | 2,415,382                     | (3,645,023)         |
| Income tax expense (benefit) expense – discontinued operations        | (965,872)                     | 57,350              |
| Income (loss) from discontinued operations                            | 3,381,254                     | (3,702,373)         |
| <b>NET INCOME (LOSS)</b>  | <b>\$ 4,787,207</b>           | <b>\$ (526,647)</b> |
| Income (loss) per share:  |                               |                     |
| Basic – from continuing operations                                    | \$ 0.57                       | \$ 1.28             |
| Basic – from discontinued operations                                  | \$ 1.36                       | \$ (1.49)           |
| Basic – net income (loss)   | \$ 1.93                       | \$ (0.21)           |
| Diluted – from continuing operations                                  | \$ 0.57                       | \$ 1.26             |
| Diluted – from discontinued operations                                | \$ 1.36                       | \$ (1.47)           |
| Diluted – net income (loss)   | \$ 1.93                       | \$ (0.21)           |
| Shares used in computing net income per share:                        |                               |                     |
| Basic   | 2,480,330                     | 2,481,802           |
| Diluted   | 2,480,330                     | 2,523,316           |

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





UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   | Nine Months Ended December, |                     |
|---|-----------------------------|---------------------|
|   | 2008                        | 2007                |
| <b>OPERATING ACTIVITIES</b>   |                             |                     |
| Net income (loss)   | \$ 4,787,208                | \$ (526,647)        |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |                             |                     |
| Operations of discontinued subsidiary   | (3,428,897)                 | 1,219,658           |
| Depreciation and amortization   | 33,936                      | 31,239              |
| Earnings of the Joint Venture   | (1,351,707)                 | (1,878,733)         |
| Changes in operating assets and liabilities:  |                             |                     |
| Decrease in accounts receivable and amounts due from factor                                 | 1,038,561                   | 2,184,654           |
| (Increase) decrease in inventories and prepaid expenses                                     | (3,971,376)                 | 3,433,900           |
| Increase (decrease) in accounts payable and accrued expenses                                | 511,684                     | (1,463,529)         |
| (Increase) decrease in deferred taxes and other assets                                      | (290,076)                   | 122,004             |
| <b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b>                                  | <b>(2,670,667)</b>          | <b>3,122,546</b>    |
| <b>INVESTING ACTIVITIES:</b>  |                             |                     |
| Purchase of property and equipment  | (34,119)                    | (23,801)            |
| Activity of discontinued operation  | 2,590,722                   | (1,906,796)         |
| Dividends received from Joint Venture   | 649,383                     | 323,716             |
| <b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>                                  | <b>3,205,986</b>            | <b>(1,606,881)</b>  |
| <b>FINANCING ACTIVITIES:</b>  |                             |                     |
| Purchase and retirement of common stock   | (136,979)                   | -                   |
| Tax benefit from exercise of stock options  | -                           | 92,926              |
| Borrowing from (payments to) bank   | 101,911                     | (2,254,966)         |
| Activities of discontinued subsidiary   | (4,187,444)                 | 4,786,885           |
| Proceeds from issuance of common stock from exercise of employee stock options              | -                           | 140,729             |
| Other long-term obligations   | 4,164                       | 86,000              |
| <b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>                                  | <b>(4,218,348)</b>          | <b>2,851,574</b>    |
| Impact of foreign currency on cash  | -                           | (329,300)           |
| <b>(DECREASE) INCREASE IN CASH</b>  | <b>(3,683,029)</b>          | <b>4,037,939</b>    |
| Cash at beginning of period   | 3,863,784                   | 240,545             |
| <b>CASH AT END OF PERIOD</b>  | <b>\$ 180,755</b>           | <b>\$ 4,278,484</b> |
| <b>Supplemental information:</b>  |                             |                     |
| Interest paid   | \$ 33,267                   | \$ 298,226          |
| Income taxes  | \$ -                        | \$ 200,000          |

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

UNIVERSAL SECURITY INSTRUMENTS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Statement of Management

The consolidated financial statements include the accounts of Universal Security Instruments, Inc. (USI or the Company) and its majority owned subsidiaries. Significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. The interim consolidated financial statements should be read in conjunction with the Company's March 31, 2008 audited financial statements filed with the Securities and Exchange Commission on Form 10-K. The interim operating results are not necessarily indicative of the operating results for the full fiscal year.

Discontinued Operations

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

In September 2007, Icon entered into a credit agreement with CIT Financial, Ltd. to provide a term loan and a line of credit facility. These loans were secured by all of the assets of Icon and by the corporate guarantees of the Company and our USI Electric subsidiary, as further explained below.

As a result of continuing losses at Icon, management undertook an evaluation of the goodwill from our acquisition of Icon to determine whether the value of the goodwill has been impaired in accordance with FAS No. 142, "Goodwill and Other Intangible Assets". Based on that evaluation, management determined that the value of the goodwill from our acquisition of Icon was impaired, and recognized an impairment charge of US\$1,926,696 for the goodwill as of December 31, 2007. The impairment was recorded in discontinued operations in the consolidated statements of operations for the year ended March 31, 2008.

At the time of the investment in Icon, management projected that the established U.S. sales network would allow us to increase sales of EMT to U.S. customers. Despite the Company's efforts, Icon suffered continuing losses, and the Company was not successful in increasing Icon's sales in the face of competition and a weakening U.S. dollar. On January 29, 2008, Icon received notice from CIT Financial, Ltd. (CIT Canada), Icon's principal and secured lender, that Icon was in default under the terms of the Credit Agreement dated September 22, 2007 between Icon and CIT Canada and demanding immediate payment of all of Icon's obligations to CIT Canada under the Credit Agreement. On February 11, 2008, the assets of Icon were placed under the direction of a court appointed receiver and the operations of Icon were suspended. As a result of the February 11, 2008 court appointed receivership of Icon's assets, we no longer controlled Icon as of that date. In accordance with Statement of Financial Accounting Standards No. 94, the financial statements of Icon are not consolidated with the financial statements of the Company. Accordingly, the accounts and operations of Icon in our consolidated financial statements are presented as assets and liabilities held in receivership and as the results of discontinued operations.

The production machinery and equipment of Icon were recorded at their appraised net realizable value of US\$831,555 as of March 31, 2008. During the quarter ended June 30, 2008, the Company revised its estimate based on communications with the auctioneer and appraisers and adjusted the carrying value to approximately \$1,020,000, resulting in a write-up of approximately US\$190,000 during the quarter ended June 30, 2008. On July 16, 2008, the receiver in possession of Icon's assets held a public auction to liquidate production machinery and equipment held for sale. Auction proceeds, net of auction fees, amounted to US\$1,033,652.

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On September 22, 2008, Icon's obligations were settled in the receivership action by order of the Ontario Superior Court. After complete liquidation of the assets of Icon, the receiver held CAD\$2,419,831 (US\$2,314,326). Of this amount, CAD\$2,150,000 (US\$2,056,260) was distributed to CIT Canada in partial settlement of Icon's secured obligations to CIT Canada. The remaining cash as of September 22, 2008 of CAD\$260,009 (US\$258,066) is held by the receiver for other obligations. As a result of the settlement of Icon's obligations, a gain of CAD\$5,101,674 (US\$4,910,718) was realized by Icon in the quarter ended September 30, 2008. Approximately US\$3,000,000 of the gain related to extinguishment of liabilities due to unsecured creditors. The company applied guidance in FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and determined that a legal release of the liabilities had been achieved to allow recognition of the gain on extinguishment of liabilities. This gain was partially offset in consolidation by the US\$1,481,003 after-tax effect loss recognized by the Company in settlement of its guarantee of Icon's secured debt and other losses attributable to the Icon discontinued operations to arrive at the gain from discontinued operations of \$3,381,254 reported for the nine months ended December 31, 2008.

At December 31, 2008, the assets of Icon held by the receiver consisted of cash of US\$219,402, and its liabilities include post-receivership accounts payable of US\$72,806 and a pre-receivership trade account payable of approximately US\$146,596. The pre-receivership trade account payable is subject to settlement in accordance with a "claim process" administrated by the receiver. To the extent any portion of the pre-receivership account payable is ultimately disallowed, that portion will increase the gain from discontinued operations.

The major classes of assets and liabilities held in receivership reported as discontinued operations included in the accompanying consolidated balance sheets shown below.

December 31, 2008    March 31, 2008

| Assets                                 |    |         |              |
|--|----|---------|--------------|
| Cash                                   | \$ | 219,402 | \$ 823,550   |
| Trade receivables, net                 |    | 0       | 371,793      |
| Inventories                            |    | 0       | 817,022      |
| Property, plant and equipment – net    |    | 0       | 831,555      |
| Other assets                           |    | 0       | 6,811        |
| Assets of discontinued operations      | \$ | 219,402 | \$ 2,850,731 |
| Liabilities                            |    |         |              |
| Accounts payable, trade and other      | \$ | 219,402 | \$ 3,344,624 |
| Notes payable – bank                   |    | 0       | 4,478,826    |
| Liabilities of discontinued operations | \$ | 219,402 | \$ 7,823,450 |

In the accompanying consolidated financial statements, the results of Icon for the three and nine months ended December 31, 2008 have been restated and are presented as the results of discontinued operations, and certain other prior year amounts have been reclassified in order to conform with the current year's presentation.

#### Income Taxes

A provision for federal and state income taxes on continuing operations of \$410,437 and \$625,633 has been provided for the nine month periods ended December 31, 2008 and 2007, respectively. For income tax purposes, this provision is reduced by a \$0 and \$44,076 benefit derived from deductions associated with the exercise of employee stock options for the nine month periods ended December 31, 2008 and 2007, respectively. Under FAS 123, the tax benefit of this deduction has been treated as a credit to additional paid in capital and will not require a cash payment for income taxes. As discussed above, the Company guaranteed certain indebtedness of its Canadian subsidiary which has since been placed in receivership. The Company settled its guarantee of the indebtedness for approximately

\$2,150,000 and recognized a \$965,872 income tax benefit on the portion of the guaranteed indebtedness which related to U.S. operations. The benefit is presented in the discontinued operations section of the accompanying consolidated statements of earnings and as a deferred tax asset on the accompanying consolidated balance sheet. For the three month periods ended December 31, 2008 and 2007, federal and state income taxes from continuing operations are \$211,642 and \$87,757, respectively. The Company has net operating loss carryover and foreign tax credits sufficient to offset current tax expenses.

On April 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 prescribes a recognition threshold that a tax position is required to meet before recognition in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues.

In connection with the adoption of FIN 48, the Company recorded an initial liability of approximately \$86,000 for income taxes, interest and penalties related to unrecognized tax benefits. Simultaneously, the Company recorded a reduction to retained earnings. With the adoption of FIN 48, the Company has chosen to treat interest and penalties related to uncertain tax liabilities as income tax expense. As of December 31, 2008, this liability with imputed interest is \$95,324.

#### Joint Venture

The Company and its co-venturer, a Hong Kong corporation, each owns a 50% interest in a Hong Kong joint venture, Eyston Company Limited (the "Joint Venture"), that has manufacturing facilities in the People's Republic of China, for the manufacturing of security products. The following represents summarized balance sheet and income statement information of the Joint Venture as of and for the nine months ended December 31, 2008 and 2007:

|                           | 2008          | 2007          |
|---------------------------|---------------|---------------|
| Net sales                 | \$ 29,270,914 | \$ 23,722,803 |
| Gross profit              | 7,925,541     | 6,078,838     |
| Net income                | 3,592,801     | 2,991,477     |
| Total current assets      | 17,594,219    | 15,962,261    |
| Total assets              | 28,312,610    | 25,793,201    |
| Total current liabilities | 5,900,157     | 5,803,207     |

During the nine months ended December 31, 2008 and 2007, respectively, the Company purchased \$18,787,069 and \$15,157,285 of products from the Joint Venture. For the quarters ended December 31, 2008 and 2007, the Company adjusted its equity in earnings of the Joint Venture to respectively reflect a reduction of \$471,840 and an increase of \$127,900 for inter-company profit in inventory as required by US GAAP.

#### Net Income Per Common Share

Basic earnings per common share is computed based on the weighted average number of common shares outstanding during the periods presented. Diluted earnings per common share is computed based on the weighted average number of common shares outstanding plus the effect of stock options and other potentially dilutive common stock equivalents. The dilutive effect of stock options and other potentially dilutive common stock equivalents is determined using the treasury stock method based on the Company's average stock price.

A reconciliation of the weighted average shares of common stock utilized in the computation of basic and diluted earnings per share for the three month period ended December 31, 2008 and 2007 is as follows:

|  | Three Months Ended<br>December 31, |           | Nine Months Ended<br>December 31, |           |
|--|------------------------------------|-----------|-----------------------------------|-----------|
|  | 2008                               | 2007      | 2008                              | 2007      |
| Weighted average number of common shares outstanding for basic EPS                         | 2,467,028                          | 2,489,132 | 2,480,330                         | 2,481,802 |
| Shares issued upon the assumed exercise of outstanding stock options                       | 0                                  | 0         | 0                                 | 41,514    |
| Weighted average number of common and common equivalent shares outstanding for diluted EPS | 2,467,028                          | 2,489,132 | 2,480,330                         | 2,523,316 |

Total outstanding options to purchase 72,422 shares of common stock as of December 31, 2008 are not included in the above calculations as the effect would be anti-dilutive.



## Stock Based Compensation

As of December 31, 2008, under the terms of the Company's Non-Qualified Stock Option Plan, as amended, 877,777 shares of our common stock are reserved for the granting of stock options, of which 857,546 have been issued, leaving 20,231 available for issuance.

Adoption of SFAS No. 123R. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment, which requires compensation costs related to share-based payment transactions to be recognized in financial statements. SFAS No. 123R eliminates the intrinsic value method of accounting available under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, which generally resulted in no compensation expense being recorded in the financial statements related to the grant of stock options to employees if certain conditions were met.

Effective April 1, 2006, we adopted SFAS No. 123R using the modified prospective method. Under this method, compensation costs for all awards granted after the date of adoption and the unvested portion of previously granted awards will be measured at an estimated fair value and included in operating expenses or capitalized as appropriate over the vesting period during which an employee provides service in exchange for the award. Accordingly, prior period amounts presented have not been restated to reflect the adoption of SFAS No. 123R.

As a result of adopting SFAS No. 123R, net income for the nine months ended December 31, 2008 was reduced by \$7,736. No portion of employees' compensation, including stock compensation expense, was capitalized during the period.

During the nine month period ended December 31, 2008, no shares of our common stock have been issued as a result of the exercise of the options granted under the plan.

**Fair Value Determination.** Under SFAS No. 123R, we have elected to continue using the Black-Scholes option pricing model to determine fair value of our awards on date of grant. We will reconsider the use of the Black-Scholes model if additional information becomes available in the future that indicates another model would be more appropriate, or if grants issued in future periods have characteristics that cannot be reasonably estimated under this model.

**Stock Option Activity.** During the nine month period ended December 31, 2008 and 2007, no stock options were granted.

**Stock Compensation Expense.** We have elected to continue straight-line amortization of stock-based compensation expense over the requisite service period. Prior to the adoption of SFAS No. 123R, we recognized the effect of forfeitures in our pro forma disclosures as they occurred. In accordance with the new standard, we have estimated forfeitures and are only recording expense on shares we expect to vest. For the nine months ended December 31, 2008 and 2007, we recorded \$7,736 and \$16,369 respectively of stock-based compensation cost as general and administrative expense in our statement of operations. No forfeitures have been estimated. No portion of employees' compensation including stock compensation expense was capitalized during the period.

As of December 31, 2008, there was no unrecognized compensation cost related to share-based compensation arrangements that we expect to vest. The aggregate intrinsic value of currently exercisable options was \$0 at December 31, 2008.

#### Stock Purchase Program

In July 2008, the Company announced a stock buyback program and authorized the purchase of up to 100,000 shares of common stock. Shares may be purchased from time to time under this program in the open market, through block trades and/or in negotiated transactions. Unless extended by the Company's Board of Directors, the program will terminate when 100,000 shares of common stock have been repurchased by the Company pursuant to the program (unless increased or decreased by the Board of Directors). See Part II, Item 2 of this form 10-Q.

#### Recently Issued Accounting Pronouncements

**Business Combinations:** In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141(R), "Business Combinations," ("SFAS No. 141(R)"), which replaces SFAS No. 141 and issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements," ("SFAS No. 160"), an amendment of Accounting Research Bulletin No. 51. These two new standards will change the accounting for and the reporting for business combination transactions and noncontrolling (minority) interests in the consolidated financial statements, respectively. SFAS No. 141(R) will change how business acquisitions are accounted for and will impact financial

statements both on the acquisition date and in subsequent periods. SFAS No. 160 will change the accounting and reporting for minority interests, which will be re-characterized as noncontrolling interests and classified as a component of equity. These two standards will be effective for the Company for acquisitions undertaken and financial statements issued for fiscal years beginning after December 31, 2008.

**Fair Value Measurements:** In September 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2008. The Company has not yet determined the impact that the implementation of SFAS 157 will have on its results of operations or financial condition.

**The Fair Value Option for Financial Assets and Financial Liabilities:** In February 2008, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statements No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the “fair value option”). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. This accounting standard is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2008. The effect, if any, of adopting SFAS No. 159 on the Company’s financial position and results of operations has not been finalized.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS 162”), SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to Interim Auditing Standards Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The implementation of this standard is not expected to have a material impact on our consolidated financial position and results of operation.

#### Reclassifications

Certain prior year amounts have been reclassified in order to conform with current year presentation.

## ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

As used throughout this Report, "we," "our," "the Company" "USI" and similar words refers to Universal Security Instruments, Inc.

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements reflecting our current expectations with respect to our operations, performance, financial condition, and other developments. These forward-looking statements may generally be identified by the use of the words "may", "will", "believes", "should", "expect", "anticipates", "estimates", and similar expressions. These statements are necessarily estimates reflecting management's best judgment based upon current information and involve a number of risks and uncertainties. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and readers are advised that various factors could affect our financial performance and could cause our actual results for future periods to differ materially from those anticipated or projected. While it is impossible to identify all such factors, such factors include, but are not limited to, those risks identified in our periodic reports filed with the Securities and Exchange Commission, including our most recent Annual Report on Form 10-K.

### overview

We are in the business of marketing and distributing safety and security products which are primarily manufactured through our 50%-owned Hong Kong Joint Venture. Our financial statements detail our sales and other operational results only, and report the financial results of the Hong Kong Joint Venture using the equity method. Accordingly, the following discussion and analysis of the three and nine months ended December 31, 2008 and 2007 relate to the operational results of the Company only. A discussion and analysis of the Hong Kong Joint Venture's operational results for these periods is presented below under the heading "Joint Venture."

### Discontinued Canadian Operations

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

In September 2007, Icon entered into a credit agreement with CIT Financial, Ltd. to provide a term loan and a line of credit facility. These loans are secured by all of the assets of Icon and by the corporate guarantees of the Company and our USI Electric subsidiary, as further explained below.

As a result of continuing losses at Icon, management undertook an evaluation of the goodwill from our acquisition of Icon to determine whether the value of the goodwill has been impaired in accordance with FAS No. 142, "Goodwill and Other Intangible Assets". Based on that evaluation, management determined that the value of the goodwill from our acquisition of Icon was impaired, and recognized an impairment charge of US\$1,926,696 for the goodwill as of December 31, 2007. The impairment was recorded in discontinued operations in the consolidated statements of operations for the year ended March 31, 2008.

At the time of the investment in Icon, management projected that the established U.S. sales network would allow us to increase sales of EMT to U.S. customers. Despite the Company's efforts, Icon suffered continuing losses, and the Company was not successful in increasing Icon's sales in the face of competition and a weakening U.S. dollar. On January 29, 2008, Icon received notice from CIT Financial, Ltd. (CIT Canada), Icon's principal and secured lender, that Icon was in default under the terms of the Credit Agreement dated September 22, 2007 between Icon and CIT Canada and demanding immediate payment of all of Icon's obligations to CIT Canada under the Credit Agreement. On February 11, 2008, the assets of Icon were placed under the direction of a court appointed receiver and the operations of Icon were suspended. As a result of the February 11, 2008 court appointed receivership of Icon's assets, we no longer controlled Icon as of that date. In accordance with Statement of Financial Accounting Standards No. 94, the financial statements of Icon are not consolidated with the financial statements of the Company. Accordingly, the accounts and operations of Icon in our consolidated financial statements are presented as assets and liabilities held in receivership and as the results of discontinued operations.

The production machinery and equipment of Icon were recorded at their appraised net realizable value of US\$831,555 as of March 31, 2008. During the quarter ended June 30, 2008, the Company revised its estimate based on communications with the auctioneer and appraisers and adjusted the carrying value to approximately \$1,020,000, resulting in a write-up of approximately US\$190,000 during the quarter ended June 30, 2008. On July 16, 2008, the receiver in possession of Icon's assets held a public auction to liquidate production machinery and equipment held for sale. Auction proceeds, net of auction fees, amounted to US\$1,033,652.

On September 22, 2008, Icon's obligations were settled in the receivership action by order of the Ontario Superior Court. After complete liquidation of the assets of Icon, the receiver held CAD\$2,419,831 (US\$2,314,326). Of this amount, CAD\$2,150,000 (US\$2,056,260) was distributed to CIT Canada in partial settlement of Icon's secured obligations to CIT Canada. The remaining cash of CAD\$260,009 (US\$258,066) is currently held by the receiver for other obligations. As a result of the settlement of Icon's obligations, a gain of CAD\$5,101,674 (US\$4,910,718) was realized by Icon in the quarter ended December 31, 2008. Approximately US\$3,000,000 of the gain related to extinguishment of liabilities due to unsecured creditors. The company applied guidance in FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and determined that a legal release of the liabilities had been achieved to allow recognition of the gain on extinguishment of liabilities. This gain was partially offset in consolidation by the US\$1,481,003 after-tax effect loss recognized by the Company in settlement of its guarantee of Icon's secured debt and other losses attributable to the Icon discontinued operations to arrive at the gain from discontinued operations of \$3,381,254 reported for the nine months ended December 31, 2008.

At December 31, 2008, the assets of Icon held by the receiver consisted of cash of US\$219,402, and its liabilities include post-receivership accounts payable of US\$72,806 and a pre-receivership trade account payable of approximately US\$146,596. The pre-receivership trade account payable is subject to settlement in accordance with a "claim process" administered by the receiver. To the extent any portion of the pre-receivership account payable is ultimately disallowed, that portion will increase the gain from discontinued operations.

The major classes of assets and liabilities held in receivership reported as discontinued operations included in the accompanying consolidated balance sheets shown below.

|  | December 31, 2008 | March 31, 2008 |
|--|-------------------|----------------|
| <b>Assets</b>                          |                   |                |
| Cash                                   | \$ 219,402        | \$ 823,550     |
| Trade receivables, net                 | 0                 | 371,793        |
| Inventories                            | 0                 | 817,022        |
| Property, plant and equipment – net    | 0                 | 831,555        |
| Other assets                           | 0                 | 6,811          |
| Assets of discontinued operations      | \$ 219,402        | \$ 2,850,731   |
| <b>Liabilities</b>                     |                   |                |
| Accounts payable, trade and other      | \$ 219,402        | \$ 3,344,624   |
| Notes payable – bank                   | 0                 | 4,478,826      |
| Liabilities of discontinued operations | \$ 219,402        | \$ 7,823,450   |

In the accompanying consolidated financial statements, the results of Icon for the three and nine months ended December 31, 2008 have been restated and are presented as the results of discontinued operations, and certain other prior year amounts have been reclassified in order to conform with the current year's presentation.

#### Results of Operations

Three Months Ended December 31, 2008 and 2007

Sales. Net sales for the three months ended December 31, 2008 were \$5,595,049 compared to \$7,776,986 for the comparable three months in the prior fiscal year, a decrease of \$2,181,937 (28.1%). The primary reason for the decrease in net sales was lower sales volumes of our core product lines, including smoke alarms and carbon monoxide alarms, to the electrical distribution trade due to a decrease in new home construction during the quarter.

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**Gross Profit Margin.** Gross profit margin is calculated as net sales less cost of goods sold expressed as a percentage of net sales. Our gross profit margin was 23.9% and 28.4% of sales for the quarters ended December 31, 2008 and 2007, respectively. Typically, our sales to retail customers have lower gross profit margins than our sales to the electrical distribution trade, and the product mix we sell to retail customers are generally lower margin items. Our decrease in gross profit margin for the 2008 period was primarily due to the lower electrical distribution trade sales.

**Expenses.** Research and development, and selling, general and administrative expenses decreased by \$378,501 from the comparable three months in the prior year. As a percentage of net sales, these expenses increased to 23.0% for the three month period ended December 31, 2008, from 21.4% for the 2007 period. The increase in costs as a percentage of net sales was primarily due to fixed costs that did not decrease at the same rate as sales.

**Interest Expense and Income.** Our interest expense on cash deposits, net of interest charges, was \$6,967 for the quarter ended December 31, 2008, compared to net interest income of \$18,370 for the quarter ended December 31, 2007. Net interest expense in the current quarterly period resulted from higher borrowings by us in support of increased inventory balances.

**Income Taxes.** During the quarter ended December 31, 2008, the Company had a net income tax expense of \$211,642. For the corresponding 2007 period, the Company has a provision for income taxes of \$87,757. The effective rate of tax is 42.0% and 7.0% for the quarters ended December 31, 2008 and 2007, respectively. The reduced effective rate in the prior year's quarter is due to the recognition of the U.S. portion of the loss on the discontinued Canadian subsidiary.

**Net Income.** We reported net income of \$292,513 for the quarter ended December 31, 2008, compared to a net loss of \$1,635,789 for the corresponding quarter of the prior fiscal year. As discussed above under the section titled "Discontinued Canadian Operations", the net loss in the quarter ended December 31, 2007 was principally a result of the impairment of goodwill related to our discontinued Canadian subsidiary.

#### Nine Months Ended December 31, 2008 and 2007

**Sales.** Net sales for the nine months ended December 31, 2008 were \$20,169,229 compared to \$27,152,181 for the comparable nine months in the prior fiscal year, a decrease of \$6,982,952 (25.7%). The primary reason for the decrease in net sales was lower sales volumes of our core product lines, including smoke alarms and carbon monoxide alarms, to the electrical distribution trade due to a decrease in new home construction during the period.

**Gross Profit Margin.** The gross profit margin is calculated as net sales less cost of goods sold expressed as a percentage of net sales. The Company's gross profit margin decreased from 25.3% for the period ended December 31, 2007 to 23.8% for the current period ended December 31, 2008. Typically, our sales to retail customers have lower gross profit margins than our sales to the electrical distribution trade, and the product mix we sell to retail customers are generally lower margin items. Our decrease in gross profit margin for the 2008 period was primarily due to the lower electrical distribution trade sales.

**Expenses.** Research and development, and selling, general and administrative expenses decreased by \$550,132 from the comparable nine months in the prior year. As a percentage of sales, these expenses were 21.6% for the nine month period ended December 31, 2008 and 18.0% for the comparable 2007 period. The primary reason for the increase in expenses as a percentage of sales is that these expenses did not decrease at the same rate as sales.

**Interest Expense and Income.** Our interest income net of interest expense was \$8,609 for the nine months ended December 31, 2008, compared to net interest expense of \$52,491 for the nine months ended December 31, 2007. Interest expense in the comparable period of the last year resulted primarily from borrowings to support the Canadian subsidiary.

**Income Taxes.** During the nine months ended December 31, 2008, the Company recorded an income tax expense from continuing operations of \$410,437. For the corresponding 2007 period, the Company had a tax expense of \$625,633. The effective rate of tax is 22.6% and 16.5% for the nine month periods ended December 31, 2008 and 2007, respectively. The reduced effective rate in the prior year's nine month period is due to the recognition of the U.S. portion of the loss on the discontinued Canadian subsidiary.

**Net Income.** We reported net income of \$4,787,207 for the nine months ended December 31, 2008 compared to a net loss of \$526,647 for the corresponding period of the prior fiscal year. As discussed above under the section titled "Discontinued Canadian Operations", the primary reason for the increase is the gain of \$3,381,254 recognized as a result of the settlement of the obligations of our Canadian subsidiary.

## Financial Condition and Liquidity

The Company has a Factoring Agreement which supplies both short-term borrowings and letters of credit to finance foreign inventory purchases. The maximum amount available under the Factoring Agreement is currently \$7,950,000. Based on specified percentages of our accounts receivable and inventory and letter of credit commitments, we had \$6,883,000 available under the Factoring Agreement at December 31, 2008. There is \$101,911 borrowed under this agreement as of December 31, 2008. The interest rate under the Factoring Agreement on the uncollected factored accounts receivable and any additional borrowings is equal to the prime rate of interest charged by our lender. At December 31, 2008, the prime rate was 4.0%. Borrowings are collateralized by all of our accounts receivable and inventory.

Our factored accounts receivable as of the end of our last fiscal year were \$5,600,408, and were \$3,591,315 as of December 31, 2008. Our prepaid expenses as of the end of our last fiscal year were \$206,197, and were \$156,947 as of December 31, 2008. The decrease in prepaid expenses is due to the timing of premium payments to various insurance carriers.

Operating activities used cash of \$2,670,667 for the nine months ended December 31, 2008. This was primarily due to the operations of the discontinued subsidiary and an increase of \$3,971,376 in inventories and prepaid expenses, and earnings of the Joint Venture of \$1,351,707. For the same period last year, operating activities provided cash of \$3,122,546, primarily as a result of increases in receivables, inventory and prepaid expenses, and the operations of the discontinued subsidiary.

Investing activities provided cash of \$3,205,986 during the nine months ended December 31, 2008, principally as a result of the liquidation of remaining assets of the discontinued operations. Investing activities used \$1,606,881 in the prior period., primarily related to acquisition of property and equipment related to the discontinued operations.

Financing activities used cash of \$4,218,348 during the nine months ended December 31, 2008, principally as a result of the payment of guaranteed debt and other activities of discontinued operations. In the comparable nine months in the prior year, financing activities provided cash of \$2,851,574, primarily related to borrowings to fund the activities of the discontinued operations.

We believe that funds available under the Factoring Agreement, distributions from the Joint Venture, and our line of credit facilities provide us with sufficient resources to meet our requirements for liquidity and working capital in the ordinary course of our business over the next twelve months and over the long term.

## Joint Venture

**Net Sales.** Net sales of the Joint Venture for the three and nine months ended December 31, 2008 were \$9,603,152 and \$29,270,914, respectively, compared to \$7,949,391 and \$23,722,803, respectively, for the comparable period in the prior fiscal year. The 20.8% and 23.4% respective increases in net sales by the Joint Venture for the three and nine month periods were due to higher sales to the Company, primarily for products purchased by the Company for sale to a national home improvement retailer customer of the Company, and higher volumes of sales of smoke alarm products by the Joint Venture to non-related customers in the Australian and European market. The Joint Venture's management believes that the increases in net sales to the European market were due to increased market share in those markets.

**Gross Margins.** Gross margins of the Joint Venture for the three month period ended December 31, 2008 increased to 28.9% from 24.8% for the 2007 corresponding period. For the nine month period ended December 31, 2008, gross margins increased to 27.1% from the 25.6% gross margin of the prior year's corresponding period. Since gross margins depend on sales volume of various products, with varying margins, increased sales of higher margin products

and decreased sales of lower margin products affect the overall gross margins. The increase in the Joint Venture's gross margins for the three and nine month periods were due to the increase in the sales of products to customers in the Australian and European markets.

Expenses. Selling, general and administrative expenses were \$1,372,705 and \$3,980,375, respectively, for the three and nine month periods ended December 31, 2008, compared to \$982,291 and \$3,279,276 in the prior year's respective periods. As a percentage of sales, expenses were 14.3% and 13.6% for the three and nine month periods ended December 31, 2008, compared to 12.4% and 13.8% for the three and six month periods ended December 31, 2007. The increase in selling, general and administrative expense as a percent of sales for the three and nine month periods was primarily due to increased advertising and marketing expenses and increased insurance expenses.

**Interest Income and Expense.** Interest expense, net of interest income, was \$7,163 and \$12,924 respectively, for the three and nine month periods ended December 31, 2008, compared to net interest expense of \$4,519 and \$20,088, respectively, for the prior year's periods. The reduction in net interest expense resulted from a decrease in the Joint Venture's borrowings.

**Net Income.** Net income for the three and nine months ended December 31, 2008 were \$1,273,660 and \$3,592,801, respectively, compared to \$1,120,235 and \$2,991,477, respectively, in the comparable periods last year. The 13.7% and 20.1% respective increases in net income for the three and nine month periods were due primarily to changes in the mix of products sold and gross margins as noted above

**Liquidity.** Cash needs of the Joint Venture are currently met by funds generated from operations. During the nine months ended December 31, 2008, working capital increased by \$2,740,191 from \$8,953,871 on March 31, 2008 to \$11,694,062 on December 31, 2008.

### Critical Accounting Policies

Management's discussion and analysis of our consolidated financial statements and results of operations are based on our Consolidated Financial Statements included as part of this document. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate these estimates, including those related to bad debts, inventories, income taxes, and contingencies and litigation. We base these estimates on historical experiences and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect management's more significant judgments and estimates used in the preparation of its consolidated financial statements. For a detailed discussion on the application on these and other accounting policies, see Note A to the consolidated financial statements included in Item 8 of the Form 10-K for the year ended March 31, 2008. Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty and actual results could differ from these estimates. These judgments are based on our historical experience, terms of existing contracts, current economic trends in the industry, information provided by our customers, and information available from outside sources, as appropriate. Our critical accounting policies include:

Our revenue recognition policies are in compliance with Staff Accounting Bulletin No. 10, "Revenue Recognition in Financial Statements" issued by the Securities and Exchange Commission. We recognize sales upon shipment of products net of applicable provisions for any discounts or allowances. The shipping date from our warehouse is the appropriate point of revenue recognition since upon shipment we have substantially completed our obligations which entitle us to receive the benefits represented by the revenues, and the shipping date provides a consistent point within our control to measure revenue. Customers may not return, exchange or refuse acceptance of goods without our approval. We have established allowances to cover anticipated doubtful accounts based upon historical experience.

Inventories are valued at the lower of market or cost. Cost is determined on the first-in first-out method. We have recorded a reserve for obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. Management reviews the reserve quarterly. Shipping and handling costs incurred by the Company to deliver goods to its customers are not included in costs of goods sold but are presented as an element of selling, general and administrative expense within the condensed consolidated statements of earnings. The Company incurred \$84,987 and \$186,163 of shipping

and handling costs in the quarters ended December 31, 2008 and 2007, respectively and \$424,899 and \$556,658 for the nine month period ended December 31, 2008 and 2007, respectively.

**Impairment of Long-Lived Assets:** The Company's policy is to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards ("SFAS"), SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets", ("SFAS No. 144"). The Company recognizes an impairment loss when the sum of the expected undiscounted future cash flows is less than the carrying amount of the asset. The measurement of the impairment losses to be recognized is based upon the difference between the fair value and the carrying amount of the assets.

We are subject to lawsuits and other claims, related to patents and other matters. Management is required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is based on a careful analysis of each individual issue with the assistance of outside legal counsel. The required reserves may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters.

We generally provide warranties from one to ten years to the non-commercial end user on all products sold. The manufacturers of our products provide us with a one-year warranty on all products we purchase for resale. Claims for warranty replacement of products beyond the one-year warranty period covered by the manufacturers are immaterial and we do not record estimated warranty expense or a contingent liability for warranty claims.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

No material changes have occurred in our quantitative and qualitative market risk disclosures as presented in our Annual Report Form 10-K for the year ended March 31, 2008.

### ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be disclosed by us in the reports that we file or submit under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to management in a timely manner. Our Chief Executive Officer and Chief Financial Officer have evaluated this system of disclosure controls and procedures as of the end of the period covered by this quarterly report, and have concluded that the system is effective. There have been no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1.

LEGAL PROCEEDINGS

On June 11, 2003, Walter Kidde Portable Equipment, Inc. (“Kidde”) filed a civil suit against the Company in the United States District Court for the Middle District of North Carolina (Case No. 03cv00537), alleging that certain of the Company’s AC powered/battery backup smoke detectors infringe on a patent acquired by Kidde. Kidde is seeking injunctive relief and damages to be determined at trial. On March 31, 2006, following numerous procedural and substantive rulings which the Company believes were favorable to the Company, Kidde obtained dismissal, without prejudice, of its suit. On November 28, 2005, prior to the March 31, 2006 dismissal of the original suit, Kidde filed a second lawsuit in the same court (Case No. 05cv1031) based on virtually identical infringement allegations as the earlier case. Discovery is now closed in this second case. Although the asserted patent is now expired, prior to its expiration, the Company sought and has now successfully obtained re-examination of the asserted patent in the United States Patent and Trademark Office (USPTO) largely based on the references cited and analysis presented by the Company which correspond to defenses raised in the litigation. In September, the USPTO rejected all of the claims asserted against the Company based on the references. Kidde responded to the rejection to which further action by the USPTO is pending. Kidde also filed for and the Court granted a stay of the litigation pending the conclusion of the reexamination. The USPTO action fully supports the Company’s substantive position and its defenses to Kidde. The Company and its counsel believe that regardless of the outcome of the reexamination, the Company has significant defenses relating to the patent in suit. In the event of an unfavorable outcome, the amount of any potential loss to the Company is not yet determinable.

On June 25, 2008, Maple Chase Company which was acquired in January 2008 by United Technologies Corporation (which also owns Walter Kidde Portable Equipment, Inc.), filed a civil suit against the Company in the United States District Court for the Northern District of Illinois (Case No. 08cv3641) for patent infringement of Re 33920, a patent that expired in March of 2007. On January 13, 2009, the Court granted permission to substitute Kidde for Maple Chase as the party plaintiff. This action involves the same patent that formed the basis of the suit filed by Maple Chase against the Company in February 2004 (Case No. 03cv07205). In that case, the Company successfully sought and obtained reexamination of the asserted patent in the USPTO based on the references cited and analysis presented by the Company. In April 2005, the Court dismissed the earlier case subject to the outcome of the reexamination. After pending for more than three years and after the expiration of the patent, a Reexamination Certificate was granted confirming patentability of many of the claims and canceling the remaining claims. The 2008 case asserts infringement of the claims emerging out of reexamination and is in its preliminary stages where discovery is about to commence. The Company believes that it has meritorious and substantial technical defenses to the action and that it is entitled to a number of legal/equitable defenses due to the long period of inaction and acquiescence by Maple Chase and its predecessors, the amount, if any, of potential loss to the Company is not yet determinable. The Company intends to vigorously defend the suit and press its pending counterclaims.

On August 21, 2008, Kidde again filed a civil suit against the Company for patent infringement (Case No. 08cv2202) but this time in the United States District Court for the District of Maryland. Kidde accuses the Company of infringement of U.S. patent 6,791,453 by communication protocols for interconnected hazardous condition (smoke, heat and Carbon monoxide) detectors sold by the Company. The Company believes that it has meritorious and substantial technical defenses to the action. The amount, if any, of potential loss to the Company is not yet determinable. The Company intends to vigorously defend the suit and press its pending counter and third party claims.

On September 25, 2008, the Company with its Answer and Counterclaims to Kidde filed a third-party Complaint against United Technologies Corporation in the United States District Court for the District of Maryland in Case No. 08cv2202 for the predatory litigation campaign by the defendant and its subsidiary, Kidde. On December 17, the Company filed a motion to amend its Answer and Counterclaims which has been opposed by both Kidde and United



Technologies Corporation. That motion is pending and case remains in a preliminary, pre-discovery stage. In both the original and the Amended Counterclaim, the Company is seeking injunctive and antitrust damages. The Company intends to vigorously prosecute its claims.

From time to time, the Company is involved in various lawsuits and legal matters. It is the opinion of management, based on the advice of legal counsel, that these matters will not have a material adverse effect on the Company's financial statements, beyond what has been recognized in the financial statements.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth information with respect to purchases of common stock by the Company or any affiliated purchasers during the three months ended December 31, 2008:

| Period                           | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------------------|----------------------------------|------------------------------|--|--|
| Quarter ended September 20, 2008 | 4,000                            | \$ 5.36                      | 4,000  | 96,000   |
| Quarter ended December 31, 2008  | 40,575                           | \$ 3.06                      | 40,575   | 55,425   |
| Total                            | 44,575                           | \$ 3.27                      | 44,575   | 55,425   |

In July, 2008, the Company announced a stock buyback program and authorized the purchase of up to 100,000 shares of common stock. Shares may be purchased from time to time under this program in the open market, through block trades and/or in negotiated transactions. Unless extended by the Company's Board of Directors, the program will terminate when 100,000 shares of common stock have been repurchased by the Company pursuant to the program (unless increased or decreased by the Board of Directors).

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

On September 8, 2008, the Company held its Annual Meeting of Stockholders. The only matter submitted to the stockholders for a vote was the election of one director in the Class of 2011. The nominee was Harvey B. Grossblatt. At the Meeting, at least 1,908,379 shares were voted in favor of the nominee, no more than 289 shares abstained, were voted against, or were voted to withhold approval of the nominee's election (any of which has the same effect as a "no" vote). As a result, the nominee was elected.

Directors not up for re-election and continuing in office after the Meeting are: Ira Bormel, Cary Luskin, and Ronald A. Seff, M.D.

## ITEM 5. OTHER INFORMATION.

On November 4, 2008, we entered into an operating lease for new headquarters space located in Baltimore County, Maryland. The lease is for 12,000 square feet of office and warehouse space for a term of 10 years through February 28, 2019. The current rental, with common area maintenance, is approximately \$8,250 per month during the current fiscal year, with increasing rentals at 3% per year through the term of the lease.

ITEM 6.

EXHIBITS

Exhibit No.

- 3.1 Articles of Incorporation (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 1988, File No. 1-31747)
- 3.2 Articles Supplementary, filed October 14, 2003 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed October 31, 2002, File No. 1-31747)
- 3.3 Bylaws, as amended (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed July 25, 2008, File No. 1-31747)
- 10.1 Non-Qualified Stock Option Plan, as amended (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2003, File No. 1-31747)
- 10.2 Hong Kong Joint Venture Agreement, as amended (incorporated by reference to Exhibit 10.2 to Amendment No. 1 on Form 10-K/A to the Company's Annual Report on Form 10-K for the year ended March 31, 2006, File No. 1-31747)
- 10.3 Amended and Restated Factoring Agreement between the Registrant and The CIT Group Commercial Services Inc. ("CIT"), dated September 22, 2007 (substantially identical agreement entered into by the Registrant's wholly-owned subsidiary, USI Electric, Inc.) (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 26, 2007, File No. 1-31747)
- 10.4 Amended and Restated Inventory Security Agreement between the Registrant and CIT, dated September 22, 2007 (substantially identical agreement entered into by the Registrant's wholly-owned subsidiary, USI Electric, Inc.) (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed September 26, 2007, File No. 1-31747)
- 10.5 Credit Agreement between International Conduits Ltd. ("Icon") and CIT Financial Ltd. ("CIT Canada"), dated September 22, 2007 ("CIT Canada Credit Agreement") (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed September 26, 2007, File No. 1-31747)
- 10.6 General Security Agreement between CIT Canada and Icon, dated September 22, 2007, with respect to the obligations of Icon under the CIT Canada Credit Agreement (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed September 26, 2007, File No. 1-31747)
- 10.7 Guaranty made by the Registrant and USI Electric Inc., in favor of CIT Canada, dated September 22, 2007, with respect to the obligations of Icon under the CIT Canada Credit Agreement (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed September 26, 2007, File No. 1-31747)
- 10.8 Lease between Universal Security Instruments, Inc. and St. John Properties, Inc. dated November 4, 2008 for its office and warehouse located at 11407 Cronhill Drive, Suites A-D, Owings Mills, Maryland 21117\*
- 10.9 Second Amended and Restated Employment Agreement dated July 18, 2006 between the Company and Harvey B. Grossblatt (incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2006, File No. 1-31747)
- 10.10 Addendum to Second Amended and Restated Employment Agreement dated September 8, 2008 between the Company and Harvey B. Grossblatt (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 8, 2008, File No. 1-31747)
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer\*
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer\*
- 32.1 Section 1350 Certifications\*
- 99.1 Press Release dated February 12, 2009\*

\*Filed herewith



SIGNATURES

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

UNIVERSAL SECURITY INSTRUMENTS, INC.  
(Registrant)

Date: February 12, 2009

By: /s/ Harvey B. Grossblatt  
Harvey B. Grossblatt  
President, Chief Executive Officer

By: /s/ James B. Huff  
James B. Huff  
Vice President, Chief Financial Officer