2021 ANNUAL REPORT

The Future of Growth & Profitability In Security is in the Cloud

NAPCO SECURITY TECHNOLOGIES, INC.

Only NAPCO Manufactures Alarms, Access Control & Locking
-Now All with Cloud Service Communications

NASDAQ:NSSC

NAPCO SECURITY TECHNOLOGIES, INC.

Smart Security, Life-Safety, Communications, Access Control & Locking

NAPCO Security Technologies, Inc. (NASDAQ:NSSC) takes its responsibility as a leading global manufacturer of innovative & reliable security solutions very seriously. With products proudly sold and installed by tens-of-thousands of security professionals worldwide, from security dealers to locksmiths, to systems integrators and specifiers, today, they can be found protecting millions of commercial, industrial, educational, institutional, residential and government applications. In an increasingly volatile world and climate seeking safety and security, we continue to develop a broad line of advanced technologies for intrusion, commercial fire, cellular reporting, access control & door locking systems with a concerted effort to integrate them and increase recurring revenues and shareholder value across our portfolio.

At the core of the Company's consistently increasing recurring revenue services is the industry-leading universal cellular alarm communicator, StarLink®. Now available for intrusion, commercial fire and connected home/business applications, it's widely respected as the dealers' choice for replacing older "sunsetting" radio technology &/or obsoleted landlines nationwide. This year, NAPCO also debuted the industry's 1st Certified FirstNet Ready™ Fire Alarm Communicator, a StarLink Fire model, available for use on the U.S. Government-commissioned, FirstNet platform, developed post 9/11, changing public safety communications, by giving first responders, i.e., firefighters, EMTs, EMS, etc., priority access to dedicated and persistent data in an emergency. As proven StarLink technology is one of NAPCO's strongest growth drivers, it is also embedded inside several more award-winning, cloud-managed products: FireLink®, Fire Alarm Control Panels (FACPs); iSecure®, NAPCO's residential solution, for Connected Home Alarms; and most recently, integrated within its all-new AirAccess® Hosted Cloud-Based Cellular Access Control Platform. Termed a "game-changer" upon its introduction, AirAccess has met with great promise across all of NAPCO's sales channels, and combines all the Company's core competencies: Cellular communications, wireless networked locking and panels, plus decades of expertise encompassing physical access control.

Uniquely, AirAccess is the 1st cellular-based access system, that eliminates a top installation pain-point by making networking truly plug and play, automatically making secure cellular connections vs. relying on a customer's overburdened IT Department &/or network. Keyless and virtually wireless from the doors to the cloud, this access system uses either the Alarm Lock Division's wireless Trilogy Networx® or ArchiTech® Locks, or more conventional ID readers, and its all new App with integral mobile credential. An ideal hosted solution, or ACaaS (Access Control as a Service), scalable AirAccess is cloud-based – always up to date, and accessible from anywhere, as such, providing a great, hassle-free security service for commercial customers, and generating new RMR for the dealer hosting accounts, and for NAPCO. With this latest innovation, the Company is leveraging aspects from all its leading brands and technologies, and can target the large, mass high-volume opportunity of today's small and medium size businesses, dramatically increasing both recurring revenue potential and hardware sales growth.

Faced with the seemingly endless epidemic of school violence, NAPCO has long prided itself on creating innovative, practical Safer-School solutions for all budgets, available from each of its divisions, and protecting well-known, private and public colleges, institutions and K12 districts, large and small. The Company's mechanical Marks LocDown® Locks are specified into the largest school districts in the Country; its electronic CA4K® enterprise access control systems are increasingly used and expanding across many prestigious campuses; and class-leading electronic access locks, alarms and communications are relied upon in a growing list, coast to coast, too numerous to name. Building upon this success, NAPCO intends to bring AirAccess to school security as well. Integrating all of NAPCO's protective and monitoring technologies in one, the fast cellular-based system with AirAccess Mobile App provides all users, i.e., students, faculty, staff, not only with the much-preferred ID-card-free credential for accessing doors, but also real-time SMS Text-Alerts for threat level and lockdown conditions. At a time when over three-quarters of universities still are reportedly using aging technology, i.e., mag stripe- or older Prox cards, replacing these often-lost, costly credentials with mobile-capable equipment is a key requirement for making a system change. Additionally, with AirAccess' smart multi-tier privileges, authorized users, such as, security staff or administrators, can also control doors right from their smartphone or device, individually or by area, i.e., creating a global lockdown, a "man-trap" or containment area; or providing a specific immediate unlocked access path to first responders, all while the system securely communicates emergency updates wirelessly to authorities.

NASDAQ:NSSC

CEO Letter to Shareholders

Dear Fellow Shareholders,

Despite the ongoing challenges presented by the COVID-19 pandemic, I am pleased to report that NAPCO achieved a record-setting financial performance during fiscal year ("FY") 2021.

The year saw renewed growth in net sales, which increased by 13% in FY 2021 to a record $114.0 million as compared to $101.4 million in FY 2020. Net income for FY 2021 increased 75% to a record $14.9 million as compared to $8.5 million a year ago. Adjusted EBITDA* for the fiscal year increased by 32% to $19.5 million ($1.06 per diluted share) as compared to $14.7 million ($.80 per diluted share) the prior year.

These gains were largely the result of a continued shift towards recurring service revenue ("RSR"), which increased by 41% during FY 2021 to $33.9 million as compared to $24.0 million for FY 2020. RSR achieved a gross margin of 86% in FY 2021 as compared to 82% the prior year. Future growth prospects for RSR remain strong as sales of Starlink radios, which help generate RSR, continues to grow. Based on July 2021, our annual run rate for RSR is $40.1 million.

Gross margins on equipment sales were adversely affected by a lower overhead absorption rate resulting, in part, from our successful effort to reduce inventories, which decreased by $9.3 million during FY 2021. Also impacting gross margins was a strong increase in radio sales as partially offset by lower locking sales, which resulted from COVID related delays in school security and other institutional projects. While the proportional increase in sales of Starlink radios (the hardware) generates lower gross margins, these sales also lead to increases in RSR. Although the COVID-19 pandemic has temporarily impacted security-related spending at K-12 schools, colleges, and universities, causing some postponements, there have not been any major cancellations of planned security upgrades. With significant amounts of unspent funds and pent-up demand we anticipate the eventual recovery of the education market sector to which we supply higher margin lock-down products.

Our balance sheet has also strengthened as a result of the growth in Cash Provided by Operating Activities, which increased 123% in FY 2021 to $23.0 million versus $10.3 million in 2020. Cash, cash equivalents

Richard L. Soloway
Chairman, President, and CEO

and marketable securities also climbed to $40.2 million as of June 30, 2021 as compared to $18.2 million as of June 30, 2020. Working capital (defined as current assets less current liabilities) reached $75.8 million as of June 30, 2021 versus $61.0 million as of June 30, 2020. Our current ratio (defined as current assets divided by current liabilities) also rose to 4.8:1 as of June 30, 2021 versus 4.5:1 as of June 30, 2020.

Research and development costs as a percentage of sales remained steady at 7% of net sales while selling, general and administrative expenses as a percentage of sales decreased from 23% to 22% reflecting our careful management of expenses.

Accelerating RSR revenues

The disruption of COVID-19 has not significantly affected our growth in RSR, which grew by 41% during FY 2021 to achieve a gross margin of 86%. Robust growth in RSR is closely tied to increased sales of Starlink radios, which generate the recurring service revenues. Starlink radios drive our commercial intrusion and fire alarm business, which was largely unaffected by COVID-19 as commercial buildings must be kept secure and commercial fire alarm protection is a "mandated, non-discretionary business" required to obtain certificates of occupancy and fire code compliance. Because of its essential nature, the commercial fire alarm business remains a primary focus. Upgrading of commercial fire alarm systems with the latest cellular-based technologies has become a significant growth driver for NAPCO since the FCC no longer requires legacy POTS ("Plain Old Telephone Service") copper telephone land lines to be maintained. NAPCO and its dealers are ideally positioned for the federally-mandated replacement of legacy 3G and CDMA cellular-based communications with 4G and 5G technologies.

Recent new product introductions

In FY 2021, we introduced Air Access®, a new cloud-based access locking system that utilizes readily available cellular communications instead of the customer's IT system. Users benefit from savings achieved by not having to invest in IT personnel, hardware, onsite data back-up, or software updates. Air Access also provides the flexibility to remotely access the system from any smart device.

We expect Air Access technology to expand our RSR business model to include our locking and access control divisions. Initial feedback from locking dealers and integrators has been extremely positive.

A leader in product innovation

As the security industry's only manufacturer of fully integrated solutions bridging all three key verticals – alarms and connectivity; locking; and access control – NAPCO is expanding highly profitable RSR opportunities to encompass all four divisions, delivering enterprise class solutions that integrate all NAPCO products and services.

Our resources include over 50 engineers, data centers in NAPCO's headquarters located in Amityville, NY as well as a remote location, a unique B2B business model, and dozens of issued and pending patents, proprietary software, and copyrights.

Focused on cost control

With senior management owning roughly 22% of all outstanding shares, we remain closely aligned with fellow shareholders in seeking out sustainable and profitable growth opportunities and by carefully managing our expenses. Cost management is enhanced by combining our corporate offices, R&D, and manufacturing into our facility in Amityville NY, feeding our ISO-9001 certified, low-cost

manufacturing facility located in the Dominican Republic ("DR"). Our DR facility enables us to significantly reduce tariffs while allowing finished goods to be delivered to our Amityville facility in approximately 6 days, with less risk of intellectual property theft than products made in China.

Our future outlook remains bright

On the strength of over 1,000 dedicated employees working in close partnership with a network of over 200 loyal distributors, more than 10,000 professional security dealers and locksmiths, and over 2,000 systems integrators, we will continue to leverage our financial strength and resources to emerge from COVID-19 even stronger than ever.

On the breadth of innovative products and services that encompass all three industry verticals, – alarms, locking, and access control – all featuring connectivity capabilities, we will strive to deliver accelerating growth and profitability.

While the continuing impact of COVID-19 remains uncertain, last year's results and our continuing shift to an RSR business model lead me to remain highly optimistic about NAPCO's future growth potential in an increasingly security-focused world.

Sincerely,

Richard L. Soloway
Chairman, President, and CEO

*Non-GAAP Financial Measures

Certain non-GAAP measures are included in this annual report, including non-GAAP operating income and Adjusted EBITDA. We define Adjusted EBITDA as GAAP net income plus income tax expense, net interest expense, non-cash stock-based expense and depreciation and amortization expense. Non-GAAP operating income does not include amortization of intangibles or stock-based compensation expense. These non-GAAP measures are provided to enhance the user's overall understanding of our financial performance. By excluding these charges our non-GAAP results provide information to management and investors that is useful in assessing NAPCO's core operating performance and in comparing our results of operations on a consistent basis from period to period. Our use of non-GAAP financial measures has certain limitations in that such non-GAAP financial measures may not be directly comparable to those reported by other companies. For example, the terms used in this press release, such as Adjusted EBITDA, do not have a standardized meaning. Other companies may use the same or similarly named measures, but exclude different items, which may not provide investors with a comparable view of our performance in relation to other companies. The presentation of this information is not meant to be a substitute for the corresponding financial measures prepared in accordance with generally accepted accounting principles. Investors are encouraged to review the reconciliation of GAAP to non-GAAP financial measures included on page 63 of this document.

This letter contains statements relating to future results of the Company (including certain projections and business trends) that are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected as a result of certain risks and uncertainties, including but not limited to, changes in political and economic conditions, demand for and market acceptance of new and existing products, as well as other risks and uncertainties detailed from time to time in the filings of the Company with the Securities and Exchange Commission.

Trademarks of NAPCO: NAPCO, StarLink, StarLink Fire, FireLink, iSecure, AirAccess, Trilogy, Trilogy Networx, ArchiTech, LocDown, CA4K, Alarm Lock, Marks USA, ContinentalAccess NAPCO Commercial, ArchiTech, SAVI

Trademarks of their respective companies: FirstNet Ready™, AT&T, Verizon Network Certified, Control4, NASDAQ

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, 2021

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	11-2277818
(State or other jurisdiction of incorporation or organization)	*(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:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $0.01 per share	NSSC	Nasdaq Stock Market

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 whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐ Emerging growth 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, 2020, 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 $376,476,776.

As of September 10, 2021, 18,351,084 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 2021 Annual Meeting of Stockholders.

PART I

ITEM 1: BUSINESS.

Overview

Napco Security Technologies, Inc ("NAPCO", "the Company", "we") is one of the leading manufacturers and designers of high-tech electronic security devices, cellular communication services for intrusion and fire alarm systems as well as a leading provider of school safety solutions. We offer a diversified array of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products. 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. We have experienced significant growth in recent years, primarily driven by fast growing recurring service revenues generated from wireless communication services for intrusion and fire alarm systems, as well as our school security products that are designed to meet the increasing needs to enhance school security as a result of on-campus shooting and violence in the U.S. While recurring service revenues have continued to increase during the COVID-19 pandemic, equipment sales were negatively impacted by the economic slowdown associated with this pandemic.

Since 1969, NAPCO has established a heritage and proven record in the professional security community for reliably delivering both advanced technology and high-quality security solutions, building many of the industry's widely recognized brands, such as NAPCO Security Systems, Alarm Lock, Continental Access, Marks USA, and other popular product lines: including Gemini and F64-Series hardwire/wireless intrusion systems and iSee Video internet video solutions. We are also dedicated to developing innovative technology and producing the next generation of reliable security solutions that utilize remote communications and wireless networks, including our StarLink, iBridge, and more recently the iSecure product lines. Today, millions of businesses, institutions, homes, and people around the globe are protected by products from the NAPCO Group of Companies.

Our net sales were $114.0 million and $101.4 million for the fiscal years ended June 30, 2021 and 2020, respectively. The change in our net sales was driven primarily by increased sales of our recurring services ($9.9 million) and sales of equipment ($2.7 million) as compared to the same period a year ago. The increase in equipment sales was due primarily to the recovery from the economic effects of the COVID-19 pandemic and the elimination of most of the closures mandated by federal and state governments during the early and peak stages of the pandemic. As these closures abated and economic conditions improved, our equipment sales increased. Our net income was $14.9 million and $8.5 million for the fiscal years ended June 30, 2021 and 2020, respectively. The increase in net income during this period was due primarily to the recovery from the COVID-19 impact described above, as well as by the growth of our recurring revenue business.

Our Products and Services

The Company's products and services are comprised of the following:

- Alarm Lock standalone and networked digital door locks
- Marks USA standard and custom Locksets, Panic Devices and Door Closers
- NAPCO Gemini intrusion alarm equipment
- NAPCO StarLink and FireLink cellular communication devices and services
- NAPCO iSecure integrated cellular intrusion alarm systems
- Continental Access door controllers and hosted services for access control

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 cellular or digital communicator may be used to transmit the alarm signal to a central station or another person selected by a customer. Cellular communicators have become more popular and panels and communicators are trending towards integration so that many alarm panels will contain an integrated cellular communication device.

The Company manufactures and markets the following products for these 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.

- *Cellular communication devices*. A cellular communication device connects to the communicator and is used in lieu of, or in addition to, a landline for communicating with a central monitoring station.

- *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.

Recurring Cellular Communication Services.

The Company provides cellular access for the cellular communication devices described above. These services are provided and invoiced on a month to month basis. Revenues from these services have grown significantly over the past several years, increasing 95% from fiscal 2019 to fiscal 2021. These revenues, which currently have a gross margin of approximately 86% for the fiscal year ended June 30, 2021, represent approximately 30% of our total revenue for the fiscal year ended of June 30, 2021. The Company's long-term goal is to have recurring revenues from these services to represent at least 50% of total revenue.

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.

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.

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.

Peripheral Equipment

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

Our Growth Drivers

Recurring Revenue Business

In 2012, we began to generate recurring revenue by developing our cellular radio technology. Since then, we have continued to introduce additional products generating recurring revenues, primarily in the cellular communication devices such as our StarLink, iBridge, and more recently the iSecure product lines. These products are installed at the premises of end customers and we generate revenue by both upfront purchase of our products and monthly subscription fees for services we perform at our cloud-based operations center to monitor security breaches and fire alarms. The monthly recurring revenue allows us to generate a more consistent and predictable stream of income and mitigates the risk of fluctuation in market demand for our equipment products. In addition, these products generate higher gross margin, which has the effect of improving our profitability. We believe there is a significant market opportunity for these products and services, because many commercial and residential customers prefer to purchase real-time security monitoring services to ensure continuous protection and swift responses to security breaches and fire alarms.

We also experienced accelerating growth in our recurring revenue from sales of fire radio products. In the past few years, we introduced several Starlink fire radio solutions, including a Starlink dual path radio that can utilize cellular or internet technologies for their communication function. Dual path radios are required by local fire codes in certain areas such as New York City or L.A. County. A third fire radio was introduced during fiscal 2019 in the form of a Firelink fire panel with a Starlink fire radio built into it. In general, the gross margin for fire radio products is higher than the other Starlink solutions. The sales of fire radio products have contributed positively to our gross margin during the fiscal year ended June 30, 2021. We expect that fire radio products will continue to be an increasing portion of the overall mix of our recurring revenue and positively impact our gross margin.

We intend to continue pursuing recurring revenue opportunities by developing new and innovative products and continuing our aggressive and effective sales and marketing efforts. For the fiscal year ended June 30, 2021, our recurring revenue constituted approximately 30% of our total revenue. Our strategy is to increase our recurring revenue as a percentage of total revenue in the foreseeable future.

School Security and Public Safety

The recent growth of our business is partly driven by the significant need for increased security in schools and other public spaces. In the U.S., there are over 100,000 K-12 schools, over 10,000 colleges and universities and over 350,000 houses of worship. Management estimates that less than 10% of these institutions have adequate protection from an active shooter or intruder. As a result of increased “active shooter” incidents, a number of U.S. states and local governments have substantially increased school security budgets. Many colleges and universities have large endowments which are starting to be utilized to address this critical issue. Security equipment and services focused on education has reached over $3 billion in revenues and this segment is still in the early stages as many K-12 schools, colleges and universities have still not addressed this issue.

With a full suite of products and solutions, we believe we are well positioned to meet the security needs of schools, houses of worship, and other places where people congregate. Depending on the needs of the school and their budget, we offer (i) Standalone LocDown

locks which can be operated by a teacher, (ii) a series of Networx standalone wireless locks which communicate with central controls, or (iii) enterprise-class access control with cellular connectivity, which allows the head of security to lock down all or part of the campus, including dorm rooms, classrooms and administrative offices, from a centralized office.

The Company has had several significant wins in school security contracts, including the Houston Independent School District, which is the largest school district in Texas and the seventh largest in the U.S. On this project the Company implemented its Enterprise-wide security solution via its Continental Access control with intrusion, video and alarm communicators. Another example is Pepperdine University in Malibu, California, where the Company provided a lockdown system in place for its over 1,700 dorm rooms that required both locking and access control technologies. We were chosen because we were the only security company that has both locking and access control technologies that work on the same platform and met the needs of the university.

Competitive Strengths

The security products industry is highly competitive. The Company's primary competitors are comprised of approximately 12 other companies that manufacture and market security equipment to distributors, dealers, central stations and original equipment manufacturers. The Company believes that not one of these competitors is dominant in the industry. Most of these companies have substantially greater financial and other resources than the Company. However, unlike the Company, we believe that none of these competitors manufactures all key building security products: Intrusion Alarms and Access Control, Connectivity, and Locking devices. As more security installations include multiple security-related systems, which can include, intrusion, fire, access control, door-locking and connectivity, there is more demand for the various systems to communicate with each other. By having everything manufactured under one roof, we can offer customers one integrated platform solution without the risk of incompatible equipment from multiple vendors to “talk” to each other. Furthermore, many of our distributors, customers, and dealers prefer a single source of supply with more consistency in quality, pricing and timely shipment of products. In addition, we believe our competitors will face substantial challenges and barriers to duplicate or establish similar integrated offerings for all of these key markets.

We also have a manufacturing facility located in the Dominican Republic (“D.R.”) that manufactures over 90% of our products. It is located in a free zone which is a tax-advantaged location. The Company also benefits from the lower tariffs available to it under The Dominican Republic-Central America FTA (CAFTA-DR). The D.R. manufacturing operation is vertically integrated and operates in a low-cost location, where the typical labor cost is approximately one-tenth (1/10) of the cost for similar services in the U.S. The D.R. facility allows us to maintain a lower manufacturing overhead and improve our gross margin. This facility is currently running one shift, plus a second shift on select products with the ability to run 3 full shifts. Additional staffing is readily available for future expansion. The annual revenue that can be generated per shift is approximately $100 million. The building is a self-contained “concrete bunker” with ability to withstand Category 5 hurricanes. Both locations contain enough land to build additional space; 180,000 square feet of additional manufacturing space in the D.R., and approximately 100,000 square feet of office and warehousing space in Amityville, should the need arise. The Company has multiple transportation options between the D.R. and Amityville facilities. Shipping times from the D.R. to the Amityville facility are typically 6-8 days.

We perform our managerial and administrative activities in the U.S. in our facility located in Amityville, New York, which is 100,000 square feet and serves as Company’s headquarters, containing its corporate offices, research and development, design, sales administration, technical services, finance, procurement, manufacturing control, warehousing, and shipping operations. We believe that our ability to provide timely and effective technical support and services to our U.S. customers from our U.S. facility in Amityville is an advantage over other companies in the security industry that have moved customer service functions overseas to countries such as India and Philippines. Our dealers and customers rely substantially on the ability to communicate real-time to experts who can provide clear and understandable advice and instruction, because they are usually dealing with highly technical problems on a job site with little time to spare.

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 Strategy

Due to paradigm changes in the security marketplace, the Company’s focus has been on mandatory (non-elective) systems, such as fire systems with central station monitoring in commercial buildings, and iOT-driven connectivity services in high growth and margin

categories. As copper land lines are phased out and more people switch to cellular phone service for their homes, our cellular communication services become increasingly attractive in these installations, both new and existing. We have built a strong competitive position by developing a wide range of software capabilities from embedded micro-coding to enterprise system software, database design, mobile applications development, user portal design, mechanical and electronic mechanisms and telecommunications, featuring our significant radio and cellular communications expertise. This has enabled us to create recurring revenue opportunities across product lines, and we intend to expand such opportunities to generate recurring revenue that will account for over 50% of our total revenue and to sustain profitability from recurring revenue margins of over 80%. We are also focusing on security solutions for the healthcare industry, including anti-ligature lockets designed for life safety and liability reduction in hospitals, behavior health institutions and correctional facilities, and such products are highly profitable while complying with applicable regulatory and health standards. We believe that our ability to design and produce these products and services are possible due to our advanced set of in-house engineering technology capability from mechanical to electronic and electro-mechanical products, digital, microprocessor and analog circuit design, networking products, and wireless and cellular communications electronics.

Research and Development

The success of the Company's business depends substantially on its ability to develop new and proprietary technology and products. The research and development ("R&D") costs incurred by the Company are charged to expense as incurred and are included in "Operating expenses" in the consolidated statements of operations. During the fiscal years ended June 30, 2021, 2020 and 2019, the Company expended approximately $7,620,000, $7,257,000 and $7,212,000, respectively, on 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, 2021, the Company had 1,102 full-time employees.

Marketing

The Company's staff of approximately 62 sales and marketing support employees located at the Company's Amityville offices sells and markets our products primarily to independent distributors, wholesalers and dealers of security alarm and security hardware equipment. The Company currently has approximately 12,000 customers made up of distributors, installing dealers and wholesalers who purchase our products from distributors or directly from the Company. 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 cities.

Seasonality

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 for our products is affected by the housing and construction markets. Deterioration of the current economic conditions may also affect this trend.

Our fourth quarter of fiscal 2020 and fiscal 2021 reflected the challenging business environment resulting from the COVID-19 pandemic. The COVID-19 pandemic had caused difficulties for security equipment professionals getting access to both commercial and residential installation sites. We sell our products primarily through distribution to dealers and we are now seeing strong sell-through statistics from several of our largest distributors. Increased sell-through of our products from our distributors to the alarm and locking dealers during the third and fourth quarters of fiscal 2021, as compared to the three quarters preceding them, indicates that security equipment professionals are getting increased access to both commercial and residential installation sites and using more and more of our products.

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. A majority of purchased components are sourced from U.S. and Asian suppliers and are typically shipped directly to the D.R. 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.

Corporate Information and History

The Company was founded in 1969 and incorporated as NAPCO in December 1971 in the State of Delaware. NAPCO went public on NASDAQ with the ticker symbol "NSSC", in 1972.

In 1987, the Company acquired a locking company, Alarm Lock Systems, the first of its three acquisitions. In 2000, the Company acquired an access control company, Continental Instruments. In 2008, the Company acquired another locking company, Marks USA. In 1990, the Company began the process of moving most of its manufacturing operations offshore. After studying various options, the D.R. was chosen as it is relatively close to our headquarters (three and half hours by plane), is in the same time zone, has a relatively stable political and economic situation and is a low cost manufacturing environment. In 1995, the Company built a state-of-the-art 180,000 square foot facility in the D.R., and we continued to improve and upgrade the facility's manufacturing capability by utilizing and acquiring the latest technology and equipment.

Our executive offices are located at 333 Bayview Ave, Amityville NY 11701. Our telephone number is (631) 842-9400.

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) on the same day they are electronically filed with the Securities and Exchange Commission. The Company has one class of Common Stock which trades on the NASDAQ Global Market under the symbol "NSSC".

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 operation and financial performance are adversely affected by the COVID-19 pandemic and related events.

We are subject to risks related to the global pandemic associated with the COVID-19 disease, which has spread globally to the U.S. and other countries where we have operations, including the Dominican Republic. Numerous federal and state governmental jurisdictions have imposed "stay-at-home" orders, quarantines, travel bans and similar governmental orders and restrictions to control the spread of COVID-19. Such orders or restrictions have resulted in business closures, work stoppages, slowdowns and delays in commercial activities, unprecedented and widespread unemployment, disruptions to ports and other shipping infrastructure, border closures, and other travel or health-related restrictions, thereby negatively impacting our customers, suppliers, distributors, employees, offices, and the industry in which we operate.

As a result of the COVID-19 pandemic and the related economic downturn, we had experienced a decline in the demand for our products, as our distributors and customers reduced orders and adjusted their inventory channel in response to slowdown in spending and demand for security products. While the economic recovery from this pandemic has resulted in increased demand for our products in fiscal 2021, re-institution of a prolonged stay-at-home order, or any other continued decrease in economic activity as a result of COVID-19 pandemic, would have a negative adverse impact on our customers and their financial condition, which could impact their ability to meet their financial obligations and could result in elevated levels of delinquencies and bad debt losses. In addition, we rely upon our third-party vendors to provide parts and materials for us to produce our products. If any of these vendors are unable to continue to provide us with these parts and materials, it could negatively impact our ability to serve our customers. We also could be

adversely affected if key personnel or a significant number of employees were to become unavailable due to the effects and restrictions of COVID-19 pandemic in areas where we operate.

We manufacture substantially all of products in our factory in Dominican Republic, which are then shipped to us in the United States for further distribution. The government authorities in Dominican Republic have imposed restrictions as a result of the pandemic that impacted activities at the factory, which may reduce our productivity and output. Additional restrictions and limitations on international travel and transportation, including air travel, may make it more difficult for us to ship and transport products from Dominican Republic to the U.S., which may cause delays and disruptions in our supply chain.

Moreover, if we determine that long-lived assets are not realizable as a result of a significant reduction in the projected future cash flows resulting from the COVID-19 pandemic, we may be required to write down these assets or incur impairment charge under current accounting standards, which would have a negative effect on our consolidated financial statements. If economic conditions in the U.S. decline due to the pandemic it may reduce revenues associated with our intangible assets, including assets acquired in our prior acquisitions, and result in a reduction of future expected cash flows. Such a reduction could result in significant impairment charges to adjust the carrying value of the intangible assets.

During fiscal 2021, the impact of the COVID-19 pandemic on the Company's operations lessened. However, the future impact of the ongoing COVID-19 pandemic remains highly uncertain and subject to change. We cannot predict when the pandemic will end and when related governmental orders and restrictions will be eased or lifted, and any extension or prolonged implementation of these restrictions will further adversely affect our business, customers and financial results. Even after such orders and restrictions are eased or lifted, the severe economic harm and recession inflicted upon the jurisdictions and areas in which we operate may last for an extended period of time and continue to adversely affect our business and financial performance, and there is no guarantee that we will be able to act quickly and effectively to return to our normal operations.

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 any of these 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.

During weak economic times, the available pool of independent distributors, dealers and installers of security equipment may decline as the prospects for home building and home renovation projects diminish, which may have a corresponding impact on our growth prospects. In addition, there is an increased risk during these periods that an increased percentage of independent distributors, dealers and installers of security equipment will file for bankruptcy protection, which may harm our reputation, revenue, profitability and results of operations.

The markets we serve are highly competitive and we may be unable to compete effectively.

We compete with approximately 12 other companies that manufacture and market security equipment to distributors, dealers, control stations and original equipment manufacturers in the U.S. Most 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, as well as technical support services to its customers. 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 may also 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. Our industry 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. We have historically invested approximately 6% to 8% of annual revenues on R&D to mitigate this risk. However, many of our competitors have dedicated more resources and capabilities to R&D, including committing more engineers and capital expenditures, to develop and design new product that may enter the markets sooner or with more penetration. 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

We may not be able to maintain or control our expenses proportionate to our sales volumes to generate profit for our business.

Certain of our expenses are fixed or semi-variable, including our costs for operating our manufacturing facilities. 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 reduce expenses proportionately, our business may be adversely affected. The amount of our operating expenses are subject to variables and factors that may not be within our control, including but are not limited to, unexpected expenses relating to the manufacturing of products; increased compensation requirement for our employees and cost of raw materials. A significant portion of our expense is labor cost, including costs for workers who are operating our facility in the Dominican Republic. While we have been able to control our expenses due to the lower labor costs in the Dominican Republic, there is no guarantee that such costs will not increase in the future, or that sufficient number of workers in Dominican Republic will be available to operate the facility efficiently, and our failure to maintain effective labor costs may adversely affect our results of operations.

Our business could be 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. The sales of our security products tend to increase during period in which new housing and commercial real estate constructions are increasing. If these conditions deteriorate, resulting in declines in new housing or commercial building constructions, 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. The condition of the residential and commercial building markets in which we operate is cyclical and depends on the condition of the economy in the United States, and on the perceptions of investors of the overall economic outlook. Rising interest rates, declining employment levels, declining demand for real estate, declining real estate values or periods of general economic slowdown or recession or the perception that any of these events may occur have negatively impacted the real estate market in the past and may in the future negatively impact our ability to sell products and generate new revenue sources.

We may not be able to grow our recurring revenue business to generate consistent revenue and profitability.

A significant driver of our growth is our recurring revenue business in which customers who purchased our products and equipment are required to pay monthly fees for communications services to maintain the operation of such products. Our recurring revenue products, such as StarLink, iSecure and iBridge, tend to generate higher gross margin and are less susceptible to volatility of market demand and economic conditions. However, our revenue recurring business is relatively new and we have limited experience in developing, marketing and selling such products. We also face intense competition where other companies with greater resources and experience have established a wider and more entrenched customer base for similar products and services, making it more difficult for us to penetrate into such market. In addition, we are required to incur costs to maintain a network operations center to provide customer support and services, and to comply with federal and state regulations governing the operation and communications of these products. Such costs may reduce our profitability if we are not able to grow and expand the recurring revenue business. As we are increasingly dependent on recurring revenue products as a driver for growth, our failure to execute our strategy for this business line will materially adversely affect our financial conditions and prospects.

We may not be able to sustain and continue the growth of school security products.

We recently experienced significant growth of demand for our security products from schools, universities and other educational institutions as a result of the national focus on prevention of school violence. Federal and state governmental authorities have proposed and enacted numerous legislation and laws, including the School Violence Prevention and Mitigation Act of 2019 that provide increased funding to public schools to implement and enhance security systems. While our business has benefited from such additional federal and state funding and increased demand, there is no guarantee that such funding and trend will continue. For example, if school shutdown continues as a result of the COVID-19 pandemic and various stay-at-home orders imposed by state governments, there could be a reduced need for schools to acquire and implement security systems, and state and federal government may also decide to reduce funding or impose additional criteria for funding. These factors may result in a decline of demand for our school security products which in turn may adversely affect our financial performance.

We rely on distributors to sell our products and an adverse change in our relationship with such distributors may adversely affect our financial performance.

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 or reduce their effort to market and sell our products as effectively or to devote resources necessary to provide effective sales, which would adversely affect our financial performance. In addition, our distributors order our products and maintain their inventory based on forecasts of potential demands from dealers and end customers, and our distributors may not be able to forecast such demand accurately, which may adversely affect our ability to generate sales and revenue in a timely manner. In some cases, distributors may delay ordering our products until they receive confirmation of orders from dealers and end customers, and this delay may cause disruption and make it more difficult for us to fill their order timely and effectively, which may adversely affect our revenue and sales.

The financial health of our distributors and wholesalers and our continuing relationships with them are important to our success. Some of these distributors and wholesalers, particularly smaller firms with limited working capital and resources, may not be able to withstand adverse changes in business conditions or mitigate the negative impact of a prolonged economic downturn or recession, including the impact of the COVID-19 pandemic. The failure of our distributors to maintain financial heath and success will impact our ability to generate revenues. Furthermore, our relationship with distributors may change or terminate due to other factors beyond our control, including but are not limited to, acquisition of distributors by third parties may not be willing to continue the relationship with us; internal restructuring or refocus of business strategies; and changes in management, all of which may negatively impact our ability to continue to sell to such distributors. Finally, we generally do not have long-term agreements with distributors who purchase our products primarily through purchase orders. Without an agreement, we are not able to guarantee that such distributors will not discontinue or terminate relationship with us at any time, and any loss of distributor will negatively impact our financial conditions and results of operations.

We may not able to gain widespread or timely market acceptance of our new products and continue to build and enhance our brand to achieve growth.

We rely on introduction of new products and services to penetrate new markets and identify additional sources of revenues order to grow our business. However, many of our distributors and customers may not be willing to change or switch to new products and equipment, or may require an extended period time to assess, test and evaluate functionalities and performance of our new products. Any delays in establishing widespread acceptance of our new products may adversely affect our financial performance and growth. In order to ensure market acceptance of new products, we have incurred and expect to incur significant expenses in sales and marketing campaign, and we may not be able to justify such costs if the effort does not produce sufficient sales and customer accounts.

We believe that building and maintaining market awareness, brand recognition and goodwill of our business and products in a cost-effective manner is important to our overall success in achieving widespread acceptance of our existing and future products and is an important element in attracting new customers. An important part of our business strategy is to increase awareness of our brand and to provide marketing leadership, services and support to our distributor and customer network. While we may choose to engage in a broader marketing campaign to further promote our brand, this effort may not be successful. Our efforts in developing our brand may be hindered by the marketing efforts of our competitors and our reliance on our third parties to promote our brand. If we are unable to cost-effectively maintain and increase awareness of our brand, our business, financial condition, cash flows and results of operations could be harmed.

Our financial results could be materially adversely affected as a result of offering extended payment terms to customers or if we are not able to collect our accounts receivables on a timely basis from major customers.

We regularly grant credit terms beyond 30 days to certain distributors and customers primarily 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 the collection of those receivables. We cannot guarantee that distributors and customers will be able to make payments on a timely basis even after a thorough review of their credit and financial history. The ability of distributors and customers to make such payments may be subject to factors beyond our control, including their financial conditions and business operation. We may also incur additional costs and effort to collect past due receivables without assurance that a sufficient or any amount of bad debt can be collected.

We sell security products and systems and if our solutions fail for any reason, we could be subject to liability and our business could suffer.

We sell security products and services, which are designed to secure the safety of our customer and their commercial, residential, institutional, industrial or governmental properties. Our products and services may contain undetected defects in the software, infrastructure, third-party components or processes. If these solutions fail for any reason, including due to defects in our equipment, software, a carrier outage or user error, we could be subject to liability for such failures and our business could suffer. In addition, our products and systems are not installed by us, and if third parties do not install or maintain our products correctly, our products and systems may not function properly. If the improper installation or maintenance of our products and systems leads to service or equipment failures after introduction of, or an upgrade to, our products and systems, we could experience harm to our branded reputation, claims by our customers or installers or lost revenue during the period required to address the cause of the problem. Any defect in, or disruption to, our products and systems could cause consumers not to purchase additional products or systems from us, prevent potential consumers from purchasing our products and systems or harm our reputation.

We are subject to risks relating to the operation of a manufacturing facility in Dominican Republic.

We operate a manufacturing facility in Dominican Republic where the majority of our products is made and shipped to our U.S. distributors. The facility requires us to incur certain fixed operating costs that do not fluctuate with changes in production levels or utilization of our manufacturing capacity. If production levels decline due to lower demand or reduced customer orders, our fixed costs are spread over reduced levels, which may contribute to decreasing margins and reduced profitability. Operation of a manufacturing facility also subjects us to certain additional risks, including but not limited to the following:

- Unavailability of workers or insufficient workforce to operate the factory;
- Compliance with local regulatory requirements, including labor laws and tax requirements;
- Difficulties in communication and coordination with U.S. headquarters;
- Natural disasters such as hurricanes which may damage our factory; and
- Effect of general political and economic conditions of the Dominican Republic.

The occurrence of any of these factors may adversely affect the production output and operation of our factory, which will disrupt our supply chain and negatively impact our financial performance. Furthermore, we have not identified any alternative third-party factory that can manufacture our products; therefore it would be difficult for us to replace any loss of output of capacity if our factory in Dominican Republic is not functioning properly or at all.

Our business could be materially adversely affected by a weakening of the U.S. 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 conducts certain transactions 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. For example, if the U.S. dollars weakens and the currency exchange rate is less favorable, it may be more costly for us to pay expenses for our factory in the Dominican Republic, which may adversely affect our financial conditions and results of operations.

Our business could be materially adversely affected by adverse tax consequences of offshore operations.

We have operations both within the United States and offshore, 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 expense. 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 withholding taxes.

Our failure to maintain the security of our information and technology networks could adversely affect us.

We are dependent on information technology networks and systems, including the Internet, to process, transmit and store electronic information and, in the normal course of our business, we collect and retain certain information pertaining to our distributors,

customers, partners and employees, including personal information. If security breaches in connection with the delivery of our solutions allow unauthorized third parties to access any of this data or obtain control of our systems, our reputation, business, financial condition, cash flows and results of operations could be harmed.

The legal, regulatory and contractual environment surrounding information security, privacy and credit card fraud is constantly evolving and companies that collect and retain such information are under increasing attack by cyber-criminals around the world. Further, as the regulatory focus on privacy issues continues to increase and worldwide laws and regulations concerning the protection of data and personal information expand and become more complex, these potential risks to our business will intensify. A significant actual or potential theft, loss, fraudulent use or misuse of distributors, customers, employee or other personally identifiable data, whether by third parties or as a result of employee malfeasance or otherwise, non-compliance with our contractual or other legal obligations regarding such data or a violation of our privacy and security policies with respect to such data could result in loss of confidential information, damage to our reputation, early termination of our business relationships, litigation, regulatory investigations or actions and other liabilities or actions against us, including significant fines by U.S. federal and state authorities, and other countries and private claims by companies and individuals for violation of data privacy and security regulations.

In addition, cyber-attacks from computer hackers and cyber criminals and other malicious Internet-based activity continue to increase generally, and perpetrators of cyber-attacks may be able to develop and deploy viruses, worms, ransomware, malware, DNS attacks, wireless network attacks, attacks on our cloud networks, phishing attempts, social engineering attempts, distributed denial of service attacks and other advanced persistent threats or malicious software programs that attack our products and services, our networks and network endpoints or otherwise exploit any security vulnerabilities of our products, services and networks. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. We cannot be certain that advances in cyber-capabilities or other developments will not compromise or breach the technology protecting the networks that access our platforms and solutions, and we can make no assurance that we will be able to detect, prevent, timely and adequately address or mitigate the negative effects of cyber-attacks or other security breaches. If any one of these risks materializes, our business, financial condition, cash flows or results of operations could be materially and adversely affected.

We rely on the effort and service of Richard L. Soloway, our founder, Chief Executive Officer and major stockholder.

The success of the Company is largely dependent on the effort and service of Richard L. Soloway, who is our founder, President, Chief Executive Officer, Chairman of the Board and a major stockholder. We depend on Mr. Soloway on various aspects of our business operation, including his experience and knowledge in the industry, extensive relationships with distributors and customers, and his leadership to develop and implement business strategies. The loss or reduction of services by Mr. Soloway could have a material adverse effect on the Company's business and prospects.

Our business could be materially adversely affected as a result of the inability to maintain adequate financing.

While our business is currently solely dependent on cash-flows from operations to fund operations and capital expenditures we have an unused credit facility in the event that we need to supplement current cash-flows with outside financing. The credit facility provides for 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 and we require outside financing, 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.

We are obligated to develop and maintain a system of effective internal controls over financial reporting. These internal controls may be determined to be not effective, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.

We have been and are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting on an annual basis. This assessment includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective and would be required to disclose any material weaknesses identified in Management’s Report on Internal Control over Financial Reporting. While we have established certain procedures and control over our financial reporting processes, we cannot assure you that these efforts will prevent restatements of our financial statements in the future.

Our independent registered public accounting firm is also required, pursuant to Section 404 of the Sarbanes-Oxley Act, to report on the effectiveness of our internal control over financial reporting. For future reporting periods, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. We may not be able to remediate any future material weaknesses, or to complete our evaluation, testing and any required remediation in a timely fashion.

If we are unable to conclude that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion that our internal controls over financial reporting are effective, investors could lose confidence in the accuracy and completeness of our financial reports, which could cause the price of our common stock to decline, and we could be subject to sanctions or investigations by regulatory authorities, including the SEC and Nasdaq. Failure to remediate any material weakness in our internal control over financial reporting, or to maintain other effective control systems required of public companies, could also restrict our future access to the capital markets.

Risks Related to Ownership of Our Common Stock

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.

The trading market for our common stock depends, in part, on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If our financial performance fails to meet analyst estimates or one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

Mr. Soloway, members of management and certain directors own a significant portion of our outstanding voting stock and exert significant influence over our business and affairs.

Richard L. Soloway, our Chief Executive Officer, members of management and our board of directors ("Board") beneficially own approximately 21% of our common stock. Their significant ownership will, for the foreseeable future, enable them to control our management and affairs, and most matters requiring stockholder approval, including the election of directors, financing activities, a merger or sale of our assets and other significant corporate transactions. They may, in their discretion, elect to exercise these or similar rights at any time. Furthermore, the Company has established a staggered Board where the election of only one class of directors can be held at each annual meeting. This concentration of ownership, as well as a staggered or classified Board, could have the effect of delaying or preventing a change in our control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could materially adversely affect our stock price and may prevent attempts by our stockholders to replace or remove our Board or management.

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 building of approximately 100,000 square foot on a six acre plot. This six-acre plot provides the Company with space for expansion of office, manufacturing and storage capacities.

The Company's foreign subsidiary located in the Dominican Republic, Napco DR, S.A., owns a building of approximately 180,000 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, 2021, 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.

Approximate Number of Security Holders

The number of holders of record of NAPCO's Common Stock as of September 10, 2021 was 62 (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.

Equity Compensation Plan Information as of June 30, 2021

PLAN CATEGORY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS (a)	WEIGHTED AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS (b)	NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE (EXCLUDING SECURITIES REFLECTED IN COLUMN (a) (c)
Equity compensation plans approved by security holders:	153,090	$20.13	800,010
Equity compensation plans not approved by security holders:	—	—	—
Total	153,090	$20.13	800,010

(1) In May 2020, the stockholders approved the 2020 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. In December 2018, the stockholders approved the 2018 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. 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 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)				
	2021	2020 (5)	2019 (4)	2018	2017
Statement of earnings data:					
Net Sales	$114,035	$101,359	$102,932	$91,746	$87,374
Gross Profit (3)	50,151	43,592	43,890	37,995	36,301
Income from Operations	17,335	10,813	13,466	8,414	6,378
Net Income	14,901	8,520	12,223	7,649	5,599
Cash Flow Data:					
Net cash flows provided by operating activities	22,987	10,305	8,653	7,864	2,448
Net cash flows used in investing activities	(6,429)	(1,615)	(1,988)	(1,280)	(1,414)
Net cash flows provided by (used in) financing activities	—	1,530	(3,945)	(4,730)	(1,385)
Per Share Data:					
Net earnings per common share:					
Basic	$ 0.81	$ 0.46	$ 0.66	$ 0.41	$ 0.30
Diluted	$ 0.81	$ 0.46	$ 0.66	$ 0.41	$ 0.30
Weighted average common shares outstanding:					
Basic	18,348,000	18,444,000	18,574,000	18,788,000	18,809,000
Diluted	18,404,000	18,493,000	18,624,000	18,825,000	18,854,000
Cash Dividends declared per common share (1)	$ —	$ —	$ —	$ —	$ —
Balance sheet data:					
Working capital (2)	$75,810	$61,046	$51,083	$44,301	$40,798
Total assets	123,293	105,838	85,908	73,269	70,862
Long-term debt	1,518	2,110	—	—	3,500
Stockholders' equity	93,237	77,901	71,172	63,453	56,889

(1) The Company has never paid a cash dividend on its common stock.
(2) Working capital is calculated by deducting Current Liabilities from Current Assets.
(3) Prior period balances have been reclassified to conform to the current period presentation.
(4) Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) was adopted on July 1, 2018, which resulted in an increase in sales allowance reserves (i.e. refund liabilities) by a net of $1,627,000 and increase in other assets (i.e. return related assets) by a net of $716,000. See Footnote 2 to the consolidated financial statements.
(5) ASU No. 2016-02, Leases (Topic 842) (ASU 2016-02) was adopted on July 1, 2019. Adoption of the new standard resulted in the recording of an operating ROU asset and lease liabilities of approximately $7.7 million. See Footnote 13 to the consolidated financial statements.

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

Overview

Napco Security Technologies, Inc ("NAPCO", "the Company", "we") is one of the leading manufacturers and designers of high-tech electronic security devices, wireless communication services for intrusion and fire alarm systems as well as a leading provider of school safety solutions. We offer a diversified array of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products. 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. We have experienced significant growth in recent years, primarily driven by fast growing recurring service revenues generated from wireless communication services for intrusion and fire alarm systems, as well as our school security products that are designed to meet the increasing needs to enhance school security as a result of on-campus shooting and violence in the U.S. While recurring service revenues have continued to increase during the COVID-19 pandemic, equipment sales were negatively impacted by the economic slowdown associated with this pandemic.

Since 1969, NAPCO has established a heritage and proven record in the professional security community for reliably delivering both advanced technology and high-quality security solutions, building many of the industry's widely recognized brands, such as NAPCO Security Systems, Alarm Lock, Continental Access, Marks USA, and other popular product lines: including Gemini and F64-Series hardwire/wireless intrusion systems and iSee Video internet video solutions. We are also dedicated to developing innovative technology and producing the next generation of reliable security solutions that utilize remote communications and wireless networks, including our StarLink, iBridge, and more recently the iSecure product lines. Today, millions of businesses, institutions, homes, and people around the globe are protected by products from the NAPCO Group of Companies.

Our net sales were $114.0 million, $101.4 million and $102.9 million for the fiscal years ended June 30, 2021, 2020 and 2019, respectively. The change in our net sales from fiscal 2020 to 2021 was driven primarily by increased sales of our products in the recurring revenue business ($9.9 million) and sales of equipment ($2.7 million) as compared to the same period a year ago. This increase was due primarily to the recovery from the economic effects of the COVID-19 pandemic and the related closures mandated by federal and state governments. The change in our net sales from fiscal 2019 to 2020 was driven primarily by increased sales of our products in the recurring revenue business as offset by a 34% decrease in sales of equipment in the fourth quarter of fiscal 2020 as compared to the same period a year ago. This decrease was due primarily to the economic effects of the COVID-19 pandemic and the related closures mandated by federal and state governments. Our net income was $14.9 million, $8.5 million and $12.2 million for the fiscal years ended June 30, 2021, 2020 and 2019, respectively. The changes in net income during this period was due primarily to the COVID-19 impact and subsequent recovery described above, as well as by the growth of our recurring revenue business.

Economic and Other Factors

We are subject to the effects of general economic and market conditions. If 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 fixed and semi-variable expenses becoming 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 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 for our products is affected by the housing and construction markets. Deterioration of the current economic conditions may also affect this trend.

Our fourth quarter of fiscal 2020 and fiscal 2021 reflected the challenging business environment resulting from the COVID-19 pandemic. The COVID-19 pandemic had caused difficulties for security equipment professionals getting access to both commercial and residential installation sites. We sell our products primarily through distribution to dealers and we are now seeing strong sell-through statistics from several of our largest distributors. Increased sell-through of our products from our distributors to the alarm and locking dealers during the third and fourth quarters of fiscal 2021, as compared to the three quarters preceding them, indicates that security equipment professionals are getting increased access to both commercial and residential installation sites and using more and more of our products.

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 2021 Annual Report on Form 10-K. Management believes these critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services.

For product sales, the Company typically transfers control at a point in time upon shipment or delivery of the product. For monthly communication services the Company satisfies its performance obligation as the services are rendered and therefore recognizes revenue over the monthly period.

Typically timing of revenue recognition coincides with the timing of invoicing to the customers, at which time the Company has an unconditional right to consideration. As such, the Company typically records a receivable when revenue is recognized.

The contract with the customer states the final terms of the sale, including the description, quantity, and price of each product purchased. Payment for product sales is typically due within 30 and 180 days of the delivery date. Payment for monthly communication services is billed on a monthly basis and is typically due at the beginning of the month of service.

The Company provides limited standard warranty for defective products, usually for a period of 24 to 36 months. The Company accepts returns for such defective products as well as for other limited circumstances. The Company also provides rebates to customers for meeting specified purchasing targets and other coupons or credits in limited circumstances. The Company establishes reserves for the estimated returns, rebates and credits and measures such variable consideration based on the expected value method using an analysis of historical data. Changes to the estimated variable consideration in subsequent periods are not material.

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.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 10% and 9% for the fiscal years ended June 30, 2021 and 2020, respectively.

Reserve for Doubtful Accounts

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. The Company had one customer with an accounts receivable balance that comprised 19%, 24% and 19% of the Company's accounts receivable at June 30, 2021, 2020 and 2019, respectively. Sales to this customer did not exceed 10% of net sales in either of the fiscal years ended June 30, 2021 or 2020. Sales to this customer comprised 10% of net sales during fiscal year ended June 30, 2019. The Company had another customer with an accounts receivable balance that comprised 10% of the Company's accounts receivable at June 30, 2021. Sales to this customer did not exceed 10% of net sales in any of the fiscal years ended June 30, 2021, 2020 and 2019, respectively. The Company had another customer with an accounts receivable balance that comprised 10% of the Company's accounts receivable at June 30, 2020. Sales to this customer did not exceed 10% of net sales in any of the fiscal years ended June 30, 2021, 2020 and 2019, respectively. The Company had another customer with an accounts receivable balance that comprised 10% of the Company's accounts receivable at June 30, 2021 and 2019. Sales to this customer did not exceed 10% of net sales in any of the fiscal years ended June 30, 2021, 2020 and 2019.

In the ordinary course of business, we have established a reserve for doubtful accounts and customer deductions in the amount of $226,000 and $326,000 as of June 30, 2021 and 2020, 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 net realizable 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 realizable 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.

Long-Lived and Intangible Assets

Long-lived assets are amortized over their useful lives and 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. Intangible assets determined to have indefinite lives were not amortized but were tested for impairment at least annually.

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 customer relationships are amortized over their estimated useful lives of twenty years. At the acquisition date, the Marks trade name was deemed to have an indefinite life. During the 4th quarter of fiscal 2020, the Company determined that the trade-name was impaired. Accordingly, the Company recorded an impairment charge of $1,852,000 and reclassified the remaining balance of the underlying asset from indefinite-lived to a long-lived asset with a remaining useful life of 20 years as of June 30, 2020.

Income Taxes

The Company has identified the United States and New York State as its major tax jurisdictions. Fiscal year 2018 and forward years are still open for examination. In addition, the Company has a wholly-owned subsidiary which operates in a Free Zone in the Dominican Republic ("DR") and is exempt from DR income tax.

For the year ended June 30, 2021, the Company recognized a net income tax expense of $2,429,000. During the year ending June 30, 2021, the Company decreased its reserve for uncertain income tax positions by $208,000. 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, 2021, the Company had accrued interest totaling $63,000 and $678,000 of unrecognized net tax benefits that, if recognized, would favorably affect the Company's effective income tax rate in any future period. The Company claims research and development ("R&D") tax credits on eligible research and development expenditures. The R&D 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. 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.

Leases

Effective July 1, 2019, the Company adopted the new lease accounting standard using the modified retrospective transition option of applying the new standard at the adoption date. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to not reassess (1) whether any expired or existing

contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. Adoption of the new standard resulted in the recording of an operating ROU asset and lease liabilities of approximately $7.7 million. Given the length of the lease term, the right-of-use asset and corresponding liability assume a weighted discount rate as disclosed below. A change in the rate utilized could have a material effect on the amounts reported. Financial positions for reporting periods beginning on or after July 1, 2019 are presented under new guidance, while prior period amounts are not adjusted and continue to be reported in accordance with previous guidance.

Liquidity and Capital Resources

During the year ended June 30, 2021 the Company utilized a portion of its cash generated from operations ($6,429,000 of $22,987,000) to purchase property, plant and equipment ($1,007,000) and marketable securities ($5,422,000). The Company believes its current working capital, cash flows from operations and its revolving credit agreement will be sufficient to fund the Company's operations through the next twelve months.

As of June 30, 2021, the Company maintained a revolving credit facility of $11,000,000 which expires in June 2024 and term loans from the U.S. Small Business Administration totaling $3,904,000 through its Payroll Protection Program ("PPP"). As of June 30, 2021, the Company had no outstanding borrowings and $11,000,000 in availability under the revolving credit facility and $3,904,000 outstanding under the PPP term loans. Pursuant to the CARES Act, the loans may be forgiven by the SBA. The Company has applied to have the balance of the Loan forgiven. Following year-end, $2,850,000 of the PPP Loan was forgiven in accordance with guidelines set for in the PPP. The Company will recognize debt forgiveness in the first quarter of 2022 in the amount of $2,850,000 and will recognize further forgiveness income in the quarter that the remaining forgiveness application may be granted. While the Company believes that it meets to requirements for forgiveness, there can be no assurance that its remaining application will be granted. The revolving credit facility contains various restrictions and covenants including, among others, restrictions on borrowings and compliance with certain financial ratios, as defined in the agreement. The Company's long-term debt is described more fully in Note 8 to the condensed consolidated financial statements.

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,		
	2021	2020	2019
Current Ratio	4.8 to 1	4.5 to 1	4.6 to 1
Sales to Receivables	4.1 to 1	4.4 to 1	4.0 to 1
Total debt to equity	0.0 to 1	0.1 to 1	0.0 to 1

As of June 30, 2021, 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 rent of approximately $288,000.

Working Capital. Working capital increased by $14,764,000 to $75,810,000 at June 30, 2021 from $61,046,000 at June 30, 2020. Working capital is calculated by deducting Current Liabilities from Current Assets.

Accounts Receivable. Accounts Receivable increased by $5,149,000 to $28,081,000 at June 30, 2021 as compared to $22,932,000 at June 30, 2020. The increase in Accounts Receivable was due primarily to an increase in net sales for the quarter ended June 30, 2021 as compared to the same quarter a year ago.

Inventories. Inventories, which include both current and non-current portions, decreased by $9,313,000 to $32,442,000 at June 30, 2021 as compared to $41,755,000 at June 30, 2020. The decrease was due, in part, to the Company completing the rollout of several new products that were introduced during fiscal 2020. Inventories of these items were built up during fiscal 2020 in anticipation of initial stocking orders from the Company's customers. The decrease in inventory was also due to the Company's efforts to move closer to "just in time" procurement and production cycles where component parts and finished goods are scheduled for delivery closer to the expected requirement date.

Accounts Payable and Accrued Expenses. Accounts payable and accrued expenses, not including income taxes payable, increased by $1,683,000 to $16,155,000 as of June 30, 2021 as compared to $14,472,000 at June 30, 2020. This increase is primarily due to an increase in the Company's accrued refund liability, which is explained in Note 2 to the Notes to the Company's Consolidated Financial Statements, as well as higher accrued incentive compensation as of June 30, 2021 as compared to June 30, 2020.

Off-Balance Sheet Arrangements

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

Results of Operations
Fiscal 2021 Compared to Fiscal 2020

	Fiscal year ended June 30, (dollars in thousands)		
	2021	2020	% Increase/ (decrease)
Net sales	$114,035	$101,359	12.5 %
Gross profit	50,151	43,592	15.0 %
Gross profit as a % of net sales	44.0 %	43.0 %	2.3 %
Research and development	7,620	7,257	5.0 %
Selling, general and administrative	25,196	23,670	6.4 %
Selling, general and administrative as a % of net sales	22.1 %	23.4 %	(5.6)%
Impairment of intangible asset	—	1,852	(100.0)%
Income from operations	17,335	10,813	60.3 %
Interest expense, net	5	9	(44.4)%
Provision for income taxes	2,429	2,284	6.3 %
Net income	14,901	8,520	74.9 %

Net sales in fiscal 2021 increased by $12,676,000 to $114,035,000 as compared to $101,359,000 in fiscal 2020. The increase in net sales was primarily due to increased sales of the Company's recurring alarm communication services ($9,859,000), Napco brand intrusion products ($5,972,000) and Marks brand door-locking products ($2,051,000), as partially offset by decreased sales of the Company's Alarm Lock brand door-locking products ($4,720,000) and Continental brand access control products ($191,000). The Company's increase in equipment sales was primarily due to customer demand returning after the decline during the COVID-19 pandemic and the related closures throughout the United States. This was partially offset by a decrease in the Company's Alarm Lock products, which was due primarily to school districts and other institutions postponing their capital projects in the latter portion of the Company's 2020 fiscal year and throughout fiscal 2021.

The Company's gross profit increased by $6,559,000 to $50,151,000 or 44.0% of net sales in fiscal 2021 as compared to $43,592,000 or 43.0% of net sales in fiscal 2020. Gross profit on equipment sales was $21,133,000 or 26.4% of net equipment sales in fiscal 2021 and $23,880,000 or 30.9% of net equipment sales, in fiscal 2020. Gross profit on service revenues was $29,018,000 or 85.6% of net service revenues in fiscal 2021 and $19,712,000 or 82.0% of net service revenues, in fiscal 2020. Gross profit on equipment sales was primarily affected by the shift in sales to the Company's Starlink radio products, which typically have lower margins but result in recurring service revenues, and from the Company's Alarm Lock products as discussed above. The Alarm Lock products are among the Company's highest margin equipment products. Gross profit on equipment sales was also affected by the Company's reduction in it's production and inventories which impacted it's overhead absorption rate.

Research and Development expenses increased by $363,000 to $7,620,000 in fiscal 2021 as compared to $7,257,000 in fiscal 2020. This increase was due primarily to salary increases and additional staff.

Selling, general and administrative expenses for fiscal 2021 increased by $1,526,000 to $25,196,000 as compared to $23,670,000 in fiscal 2020. Selling, general and administrative expenses as a percentage of net sales decreased to 22.1% in fiscal 2021 from 23.4% in fiscal 2020. The increase in dollars resulted primarily from increases in employee compensation. The decrease as a percentage of sales was primarily the result of the increase in net sales as described above, as partially offset by the aforementioned increase in employee compensation expenses.

During the 4th quarter of fiscal 2020, the Company determined that its indefinite-lived intangible asset relating to its Marks USA I subsidiary trade-name was impaired. Accordingly, the Company recorded an impairment charge of $1,852,000 and reclassified the

remaining balance of the underlying asset from indefinite-lived to a long-lived asset with a remaining useful life of 20 years as of June 30, 2020. There was no impairment charge for the year ended June 30, 2021.

Interest and other expense, net for fiscal 2021 remained relatively constant at $5,000 as compared to $9,000 for the same period a year ago.

The Company's provision for income taxes for fiscal 2021 increased by $145,000 to $2,429,000 as compared to $2,284,000 for the same period a year ago. The Company's effective tax rate decreased to 14% for fiscal 2021 as compared to 21% for fiscal 2020. The decrease in the Company's fiscal 2021 effective tax rate is a direct result of additional tax expense recorded in fiscal 2020 for the IRS audit of the Company's 2016 fiscal year.

Net income for fiscal 2021 increased by $7,448,000 to $15,968,000 as compared to $8,520,000 in fiscal 2020. This resulted primarily from the items discussed above.

Results of Operations
Fiscal 2020 Compared to Fiscal 2019

	Fiscal year ended June 30, (dollars in thousands)		
	2020	2019	% Increase/ (decrease)
Net sales	$101,359	$102,932	(1.5)%
Gross profit	43,592	43,890	(0.7)%
Gross profit as a % of net sales	43.0 %	42.6 %	0.9 %
Research and development	7,257	7,212	0.6 %
Selling, general and administrative	23,670	23,212	2.0 %
Selling, general and administrative as a % of net sales	23.4 %	22.6 %	3.5 %
Impairment of intangible asset	1,852	—	100.0 %
Income from operations	10,813	13,466	(19.7)%
Interest expense, net	9	21	(57.1)%
Provision for income taxes	2,284	1,222	86.9 %
Net income	8,520	12,223	(30.3)%

Net sales in fiscal 2020 decreased by $1,573,000 to $101,359,000 as compared to $102,932,000 in fiscal 2019. The decrease in net sales was primarily due to decreased sales of the Company's Alarm Lock brand door-locking products ($2,565,000), Marks brand door-locking products ($5,258,000), and Continental brand access control products ($542,000) as partially offset by increased sales of the Company's recurring alarm communication services ($6,608,000) and Napco brand intrusion products ($200,000). The Company's equipment sales were negatively impacted by the COVID-19 pandemic, which has caused difficulties for security equipment professionals getting access to both commercial and residential installation sites. The Company believes this access issue is an industry-wide issue related to COVID-19 and not reflective of the loss of any market share unique to the Company or any long-term negative reflection of the post-pandemic vibrancy of the security industry as a whole.

The Company's gross profit decreased by $298,000 to $43,592,000 or 43.0% of net sales in fiscal 2020 as compared to $43,890,000 or 42.6% of net sales in fiscal 2019. Gross profit on equipment sales was $23,380,000 or 30.1% of net equipment sales in fiscal 2020 and $30,265,000 or 35.4% of net equipment sales, in fiscal 2019. Gross profit on service revenues was $19,712,000 or 82.0% of net service revenues in fiscal 2020 and $13,625,000 or 78.2% of net service revenues, in fiscal 2019. Gross profit was primarily affected by the decrease in equipment sales as discussed above as partially offset by increased service revenues.

Research and Development expenses remained relatively constant at $7,257,000 in fiscal 2020 as compared to $7,212,000 in fiscal 2019.

Selling, general and administrative expenses for fiscal 2020 increased by $458,000 to $23,670,000 as compared to $23,212,000 in fiscal 2019. Selling, general and administrative expenses as a percentage of net sales increased to 23.4% in fiscal 2020 from 22.6% in fiscal 2019. The increase in dollars resulted primarily from increases in employee compensation. The increase as a percentage of sales was primarily the result of the decrease in net sales as described above and the increased employee compensation expenses.

During the 4th quarter of fiscal 2020, the Company determined that its indefinite-lived intangible asset relating to its Marks USA I subsidiary trade-name was impaired. Accordingly, the Company recorded an impairment charge of $1,852,000 and reclassified the remaining balance of the underlying asset from indefinite-lived to a long-lived asset with a remaining useful life of 20 years as of June 30, 2020. There was no impairment charge for the year ended June 30, 2019.

Interest expense for fiscal 2020 remained relatively constant at $9,000 as compared to $21,000 for the same period a year ago.

The Company's provision for income taxes for fiscal 2020 increased by $1,062,000 to $2,284,000 as compared to $1,222,000 for the same period a year ago. The Company's effective tax rate increased to 21% for fiscal 2020 as compared to 9% for fiscal 2019. The increase in the Company's effective tax rate resulted from the resolution of an IRS audit of the Company's 2016 fiscal year, resulting in an additional provision of $1,555,000.

Net income for fiscal 2020 decreased by $3,703,000 to $8,520,000 as compared to $12,223,000 in fiscal 2019. This resulted primarily from the items discussed above.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and the documents we incorporate by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements, other than statements of historical fact, included or incorporated in this prospectus regarding our strategy, future operations, clinical trials, collaborations, intellectual property, cash resources, financial position, future revenues, projected costs, prospects, plans, and objectives of management are forward-looking statements. The words "believes," "anticipates," "estimates," "plans," "expects," "intends," "may," "could," "should," "potential," "likely," "projects," "continue," "will," "schedule," "would," and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee that we actually will achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties, and other factors, which may be beyond our control, and which may cause our actual results, performance, or achievements to be materially different from future results, performance, or achievements expressed or implied by such forward-looking statements. There are a number of important factors that could cause our actual results to differ materially from those indicated or implied by forward-looking statements. See "Risk Factors" in our Annual Report on Form 10-K for the year ended June 30, 2021 for more information. These factors and the other cautionary statements made in this prospectus and the documents we incorporate by reference should be read as being applicable to all related forward-looking statements whenever they appear in this prospectus and the documents we incorporate by reference. In addition, any forward-looking statements represent our estimates only as of the date that this prospectus is filed with the SEC and should not be relied upon as representing our estimates as of any subsequent date. We do not assume any obligation to update any forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as may be required by law.

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) that provides for interest based on the prime rate or LIBOR as described in the agreement and the PPP loans which provides for interest at 1%. 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.

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 $720,000.

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

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Management Report on Internal Control

Management has prepared and is responsible for our consolidated financial statements and related notes. Management is also responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Napco Technologies, Inc. (the "Company") internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with the authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements prepared for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management conducted an assessment of the effectiveness of internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* as issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management determined that as of June 30, 2021, the Company did maintain effective internal control over financial reporting.

The effectiveness of our internal control over financial reporting as of June 30, 2021 has been audited by Baker Tilly US, LLP, an independent registered public accounting firm, as stated in their report included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and the board of directors of Napco Security Technologies, Inc. and Subsidiaries:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Napco Security Technologies, Inc. and Subsidiaries (the "Company") as of June 30, 2021 and 2020, the related consolidated statements of income, stockholders' equity, and cash flows, for each of the three years in the period ended June 30, 2021, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of June 30, 2021, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2021 and 2020, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2021, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2021, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control

over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding

prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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.

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Obsolete Inventory Reserve

Critical Audit Matter Description

As described in Notes 1 and 5 to the consolidated financial statements, the Company's consolidated net inventory and inventory reserves as of June 30, 2021 were approximately $32,442,000 and $2,092,000, respectively. Management establishes its reserve for obsolete inventory equal to the difference between the cost of the inventory and the estimated net realizable value of the inventory. The estimated reserve percentages consider future inventory requirements to support forecasted sales based on historical usage, known trends, market conditions, and the ability to find alternate applications of its raw materials into finished goods to better match customer demand. We identified the reserve for inventory obsolescence as a critical audit matter because of the significant estimates and assumptions management makes to determine the reserve, specifically the future inventory requirements and related forecasted sales and usage. Performing audit procedures to evaluate the reasonableness of these estimates, including the estimated reserve percentages, and assumptions is subjective and requires a high degree of auditor judgment.

How We Addressed the Matter in Our Audit

The primary procedures we performed to address this critical audit matter included:

- We tested the design and operating effectiveness of the controls over management's evaluation of the key estimates and assumptions used in the determination of the inventory reserve on the Company's books at year-end.
- We tested management's process in developing the estimate for reserve for obsolete inventory; including performing a retrospective review of management's estimates in order to determine management's ability to make such estimates.
- We evaluated the appropriateness of management's approach and estimates and whether the assumptions were consistent with evidence obtained in other audit areas.
- We tested the completeness and accuracy of underlying data used in the approach, including historical usage, inventory age, and subsequent sales of the Company's products.
- We evaluated the reasonableness of the estimated reserve percentages used by management to determine the obsolete inventory reserve and tested the clerical accuracy of the model.

We have served as the Company's auditor since 2009.

/s/BAKER TILLY US, LLP

Melville, New York
September 13, 2021

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2021	June 30, 2020
	(in thousands, except share data)	
CURRENT ASSETS		
Cash and cash equivalents	$34,806	$18,248
Marketable securities	5,413	—
Accounts receivable, net of allowance for doubtful accounts of $226 and $326 at June 30, 2021 and June 30, 2020, respectively, and other reserves	28,081	22,932
Inventories, net	25,278	35,231
Prepaid expenses and other current assets	2,408	2,049
Total Current Assets	95,986	78,460
Inventories - non-current, net	7,164	6,524
Property, plant and equipment, net	7,836	8,088
Intangible assets, net	4,691	5,116
Operating lease asset	7,373	7,395
Other assets	243	255
TOTAL ASSETS	$123,293	$105,838
CURRENT LIABILITIES		
Accounts payable	$6,095	$6,547
Accrued expenses	6,582	5,744
Accrued salaries and wages	3,478	2,181
Current portion of long-term debt	2,386	1,794
Accrued income taxes	1,635	1,148
Total Current Liabilities	20,176	17,414
Long term debt, net of current portion	1,518	2,110
Deferred income taxes	347	112
Accrued income taxes	925	1,188
Long term operating lease liabilities	7,090	7,113
Total Liabilities	30,056	27,937
COMMITMENTS AND CONTINGENCIES (Note 13)		
STOCKHOLDERS' EQUITY		
Common Stock, par value $0.01 per share; 40,000,000 shares authorized; 21,244,799 and 21,241,066 shares issued; and 18,351,084 and 18,347,351 shares outstanding, respectively	212	212
Additional paid-in capital	18,201	17,766
Retained earnings	94,345	79,444
Less: Treasury Stock, at cost (2,893,715 shares)	(19,521)	(19,521)
TOTAL STOCKHOLDERS' EQUITY	93,237	77,901
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$123,293	$105,838

See accompanying notes to consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended June 30,		
	2021	2020	2019
Net sales:	(in thousands, except for share and per share data)		
Equipment revenues	$80,131	$77,314	$85,505
Service revenues	33,904	24,045	17,427
	114,035	101,359	102,932
Cost of sales:			
Equipment related expenses	58,998	53,434	55,240
Service-related expenses	4,886	4,333	3,802
	63,884	57,767	59,042
Gross Profit	50,151	43,592	43,890
Operating expenses:			
Research and development	7,620	7,257	7,212
Selling, general, and administrative expenses	25,196	23,670	23,212
Impairment of intangible asset	—	1,852	—
	32,816	32,779	30,424
Operating Income	17,335	10,813	13,466
Other expense:			
Interest and other expense, net	5	9	21
Income before Provision for Income Taxes	17,330	10,804	13,445
Provision for Income Taxes	2,429	2,284	1,222
Net Income	$14,901	$8,520	$12,223
Income per share:			
Basic	$ 0.81	$ 0.46	$ 0.66
Diluted	$ 0.81	$ 0.46	$ 0.66
Weighted average number of shares outstanding:			
Basic	18,348,000	18,444,000	18,574,000
Diluted	18,404,000	18,493,000	18,624,000

See accompanying notes to consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Fiscal Years ended June 30, 2021, 2020 and 2019 (in thousands except for share data)						
	Common Stock			Treasury Stock			
	Number of Shares Issued	Amount	Additional Paid-in Capital	Number of Shares	Amount	Retained Earnings	Total
Balance at June 30, 2018	21,204,327	$212	$16,890	(2,475,245)	$(13,069)	$59,420	$63,453
Implementation of ASC 606	—	—	—	—	—	(719)	(719)
Repurchase of treasury shares	—	—	—	(274,065)	(3,998)	—	(3,998)
Stock options exercised	22,767	—	53	—	—	—	53
Stock-based compensation expense	—	—	160	—	—	—	160
Net income	—	—	—	—	—	12,223	12,223
Balances at June 30, 2019	21,227,094	$212	$17,103	(2,749,310)	$(17,067)	$70,924	$71,172
Repurchase of treasury shares	—	—	—	(144,405)	(2,454)	—	(2,454)
Stock options exercised	13,972	—	80	—	—	—	80
Stock-based compensation expense	—	—	583	—	—	—	583
Net income	—	—	—	—	—	8,520	8,520
Balances at June 30, 2020	21,241,066	$212	$17,766	(2,893,715)	$(19,521)	$79,444	$77,901
Stock options exercised	3,733	—	—	—	—	—	—
Stock-based compensation expense	—	—	435	—	—	—	435
Net income	—	—	—	—	—	14,901	14,901
Balances at June 30, 2021	21,244,799	$212	$18,201	(2,893,715)	$(19,521)	$94,345	$93,237

See accompanying notes to consolidated financial statements.

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year ended June 30,		
	2021	2020	2019
		(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$14,901	$8,520	$12,223
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,696	1,495	1,409
Impairment of intangible asset	—	1,852	—
Loss on marketable securities	9	—	—
(Recovery of) provision for doubtful accounts	(100)	238	(26)
Change to inventory obsolescence reserve	519	(124)	(272)
Deferred income taxes	235	40	755
Stock based compensation expense	435	583	160
Changes in operating assets and liabilities:			
Accounts receivable	(5,049)	2,800	(1,440)
Inventories	8,794	(6,793)	(5,991)
Prepaid expenses and other current assets	(359)	(168)	318
Other assets	—	—	(11)
Accounts payable, accrued expenses, accrued salaries and wages, accrued income taxes	1,906	1,862	1,528
Net Cash Provided by Operating Activities	22,987	10,305	8,653
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property, plant, and equipment	(1,007)	(1,615)	(1,988)
Purchases of marketable securities	(5,422)	—	—
Net Cash Used in Investing Activities	(6,429)	(1,615)	(1,988)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	—	3,904	—
Proceeds from stock option exercises	—	80	53
Cash paid for purchase of treasury stock	—	(2,454)	(3,998)
Net Cash Provided by (Used in) Financing Activities	—	1,530	(3,945)
Net increase in Cash and Cash Equivalents	16,558	10,220	2,720
CASH AND CASH EQUIVALENTS - Beginning	18,248	8,028	5,308
CASH AND CASH EQUIVALENTS - Ending	$34,806	$18,248	$8,028
SUPPLEMENTAL CASH FLOW INFORMATION			
Interest paid	$18	$29	$23
Income taxes paid	$1,970	$749	$262
Surrender of Common Shares	$ —	$ —	$ 8

See accompanying notes to consolidated financial statements.

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

Nature of Business:

Napco Security Technologies, Inc ("NAPCO", "the Company", "we") is one of the leading manufacturers and designers of high-tech electronic security devices, as well as a leading provider of school safety solutions. We offer a diversified array of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products. 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. We have experienced significant growth in recent years, primarily driven by fast growing recurring service revenues generated from wireless communication services for intrusion and fire alarm systems, as well as our school security products that are designed to meet the increasing needs to enhance school security as a result of on-campus shooting and violence in the U.S.

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 for our products is affected by the housing and construction markets. Deterioration of the current economic conditions may also affect this trend.

Our results for fiscal 2021 reflects the increase in customer demand after the creation of the challenging business environment resulting from the COVID-19 pandemic. While the Company believes this recovery will continue, there can be no assurances in the event of a return to building and construction restrictions that might result from a return to last year's levels of COVID-19 cases.

Significant Accounting Policies:

Principles of Consolidation

The consolidated financial statements include the accounts of Napco Security Technologies, Inc. and 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 Generally Accepted Accounting Principles ("GAAP") 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, allowance for doubtful accounts, inventory reserves, valuation of 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 and cash equivalents, certificates of deposits, current receivables and payables and certain other short-term financial instruments approximate their fair value as of June 30, 2021 and 2020 due to their short-term maturities. Long-term debt and lease liabilities reflect fair value based on prevailing market rates.

Cash and Cash Equivalents

Cash and cash equivalents include approximately $63,000 and $460,000 of short-term time deposits at June 30, 2021 and 2020, respectively. 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, 2021 and 2020. The Company has not historically experienced any credit losses with balances in excess of FDIC limits.

Marketable Securities

The Company's marketable securities include investments in mutual funds, which invest primarily in various government and corporate obligations, stocks and money market funds. The Company's marketable securities are reported at fair value with the related unrealized and realized gains and losses included in other expense (income). Realized gains or losses on mutual funds are determined on a specific identification basis. The Company evaluates its investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value had been below cost basis, the financial condition of the issuer and the Company's ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery of market value. The Company records an impairment charge to the extent that the cost of the available-for-sale securities exceeds the estimated fair value of the securities and the decline in value is determined to be other-than-temporary. During the year ended June 30, 2021, the Company did not record an impairment charge regarding its investment in marketable securities because management believes, based on its evaluation of the circumstances, that the decline in fair value below the cost of certain of the Company's marketable securities is temporary.

Accounts Receivable

Accounts receivable is stated net of the reserves for doubtful accounts of $226,000 and $326,000 as of June 30, 2021 and 2020, respectively. Our reserves for doubtful accounts 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 net realizable 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 realizable 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.

Long-Lived and Intangible Assets

Long-lived assets are amortized over their useful lives and 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. Intangible assets determined to have indefinite lives were not amortized but were tested for impairment at least annually.

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 customer relationships are amortized over their estimated useful lives of twenty years. At the acquisition date, the Marks trade name was deemed to have an indefinite life. During the 4th quarter of fiscal 2020, the Company determined that the trade-name was impaired. Accordingly, the Company recorded an impairment charge of $1,852,000 and reclassified the remaining balance of the underlying asset from indefinite-lived to a long-lived asset with a remaining useful life of 20 years as of June 30, 2020.

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

	June 30, 2021			June 30, 2020			June 30, 2019		
	Carrying value	Accumulated amortization	Net book value	Carrying value	Accumulated amortization	Net book value	Carrying value	Accumulated amortization	Net book value
Customer relationships	$9,800	$(8,955)	$845	$9,800	$(8,732)	$1,068	$9,800	$(8,468)	$1,332
Trade name	4,048	(202)	3,846	4,048	—	4,048	5,900	—	5,900
	$13,848	$(9,157)	$4,691	$13,848	$(8,732)	$5,116	$15,700	$(8,468)	$7,232

Amortization expense for intangible assets subject to amortization was approximately $425,000, $264,000 and $313,000 for the fiscal years ended June 30, 2021, 2020 and 2019, respectively. Amortization expense for each of the next five fiscal years is estimated to be as follows: 2022-$390,000; 2023 - $361,000; 2024 - $336,000; 2025 - $315,000; and 2026-$297,000. The weighted average remaining amortization period for intangible assets was 16.9 years and 17.5 years at June 30, 2021 and 2020, respectively.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services.

For product sales, the Company typically transfers control at a point in time upon shipment or delivery of the product. For monthly communication services the Company satisfies its performance obligation as the services are rendered and therefore recognizes revenue over the monthly period.

Typically timing of revenue recognition coincides with the timing of invoicing to the customers, at which time the Company has an unconditional right to consideration. As such, the Company typically records a receivable when revenue is recognized.

The contract with the customer states the final terms of the sale, including the description, quantity, and price of each product purchased. Payment for product sales is typically due within 30 and 180 days of the delivery date. Payment for monthly communication services is billed on a monthly basis and is typically due at the beginning of the month of service.

The Company provides limited standard warranty for defective products, usually for a period of 24 to 36 months. The Company accepts returns for such defective products as well as for other limited circumstances. The Company also provides rebates to customers for meeting specified purchasing targets and other coupons or credits in limited circumstances. The Company establishes reserves for the estimated returns, rebates and credits and measures such variable consideration based on the expected value method using an analysis of historical data. Changes to the estimated variable consideration in subsequent periods are not material.

The Company analyzes sales returns and is able to make reasonable and reliable estimates of product returns based on the Company's past history. Estimates for sales returns are based on several factors including actual returns and based on expected return data

communicated to it by its customers. Accordingly, the Company believes that its historical returns analysis is an accurate basis for its allowance for sales returns. Actual results could differ from those estimates.

Advertising and Promotional Costs

Advertising and promotional costs are included in "Selling, General and Administrative" expenses in the consolidated statements of income and are expensed as incurred. Advertising expense for fiscal years ended June 30, 2021, 2020 and 2019 was $1,306,000, $1,722,000 and $2,047,000, respectively.

Research and Development Costs

Research and development costs incurred by the Company are charged to expense as incurred and are included in operating expenses in the consolidated statements of income. Company-sponsored research and development expense for the fiscal years ended June 30, 2021, 2020 and 2019 was $7,620,000, $7,257,000 and $7,212,000, respectively.

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. 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. The Company records uncertain tax positions in accordance with ASC 740 on the basis of a two-step process in which (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

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		
	2021	2020	2019	2021	2020	2019	2021	2020	2019
Basic EPS	$14,901	$8,520	$12,223	18,348	18,444	18,574	$ 0.81	$ 0.46	$ 0.66
Effect of Dilutive Securities:									
Stock Options	—	—	—	56	49	50	—	—	—
Diluted EPS	$14,901	$8,520	$12,223	18,404	18,493	18,624	$ 0.81	$ 0.46	$ 0.66

Options to purchase 20,000, 38,819 and 2,957 shares of common stock were excluded for the fiscal years ended June 30, 2021, 2020 and 2019, respectively, and 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 three share incentive programs as discussed in Note 9.

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 $435,000, $583,000 and $160,000 were recognized for the fiscal years ended June 30, 2021, 2020 and 2019, respectively.

Foreign Currency

The Company has determined the functional currency of all foreign subsidiaries is the U.S. Dollar. All foreign operations are considered a direct and integral part or extension of the Company's operations. The day-to-day operations of all foreign subsidiaries are dependent on the economic environment of the U.S. Dollar. Therefore, no realized and unrealized gains and losses associated with foreign currency translation are recorded for the fiscal years ended June 30, 2021, 2020 or 2019.

Comprehensive Income

For the fiscal years ended June 30, 2021, 2020 and 20219, 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 14.

Shipping and Handling Sales and Costs

The Company records the amount billed to customers for shipping and handling in net sales ($395,000, $452,000 and $430,000 in the fiscal years ended June 30, 2021, 2020 and 2019, respectively) and classifies the costs associated with these sales in cost of sales ($1,058,000, $1,034,000 and $1,115,000 in the fiscal years ended June 30, 2021, 2020 and 2019, respectively).

Leases

Effective July 1, 2019, the Company adopted the new lease accounting standard using the modified retrospective transition option of applying the new standard at the adoption date. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to not reassess (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. Adoption of the new standard resulted in the recording of an operating ROU asset and lease liabilities of approximately $7.7 million. Given the length of the lease term, the right-of-use asset and corresponding liability assume a weighted discount rate as disclosed below. A change in the rate utilized could have a material effect on the amounts reported. Financial positions for reporting periods beginning on or after July 1, 2019 are presented under new guidance, while prior period amounts are not adjusted and continue to be reported in accordance with previous guidance. See Note 13 – Commitments and Contingencies; Leases for additional accounting policies and transition disclosures.

Recently Adopted Accounting Standards

On July 1, 2019, we adopted Accounting Standards Update No. 2016-02, Leases (Topic 842) (ASU 2016-02), as amended, which supersedes the lease accounting guidance under Topic 840, and generally requires lessees to recognize operating and financing lease liabilities and corresponding right-of-use assets on the balance sheet and to provide enhanced disclosures surrounding the amount, timing and uncertainty of cash flows arising from leasing arrangements. We adopted the new guidance using the modified retrospective transition approach by applying the new standard to all leases existing at the date of initial application and not restating

comparative periods. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases. For information regarding the impact of Topic 842 adoption, see Significant Accounting Policies - Leases and Note 13- Leases.

Recently Issued Accounting Standards

Reference Rate Reform (ASC Topic 848)

In March 2020, the FASB issued authoritative guidance to provide optional relief for companies preparing for the discontinuation of interest rates such as the London Interbank Offered Rate ("LIBOR"), which is expected to be phased out at the end of calendar 2021, and applies to lease contracts, hedging instruments, held-to-maturity debt securities and debt arrangements that have LIBOR as the benchmark rate.

In January 2021, the FASB issued authoritative guidance that makes amendments to the new rules on accounting for reference rate reform. The amendments clarify that for all derivative instruments affected by the changes to interest rates used for discounting, margining or contract price alignment, regardless of whether they reference LIBOR or another rate expected to be discontinued as a result of reference rate reform, an entity may apply certain practical expedients in ASC Topic 848.

Effective for the Company – This guidance can be applied for a limited time through December 31, 2022. The guidance will no longer be available to apply after December 31, 2022.

Impact on consolidated financial statements – The Company is currently assessing the impact of applying this guidance on its existing derivative contracts, leases and other arrangements, as well as when to adopt this guidance.

NOTE 2 – Revenue Recognition and Contracts with Customers

Adoption

On July 1, 2018 the Company adopted new guidance on revenue from contracts with customers using the modified retrospective method applied to contracts that were not completed as of July 1, 2018. Results for reporting periods beginning after July 1, 2018 are presented under the new guidance, while prior period amounts are not adjusted and continue to be reported in accordance with previous guidance.

The Company recorded a net decrease to opening retained earnings of approximately $719,000 (net of tax benefit of $191,000) as of July 1, 2018, for the cumulative impact of adopting the new guidance. The impact primarily related to the change in the recognition and measurement of certain types of variable considerations, which resulted in the increase in sales allowance reserves (i.e. refund liabilities) by a net of $1,627,000 and increased other assets (i.e. return related assets) by approximately $716,000.

The Company is engaged in one major line of business: the development, manufacture, and distribution of security products, encompassing access control systems, door security products, intrusion and fire alarm systems, alarm communication services, and video surveillance products for commercial and residential use. The Company also provides wireless communication service for intrusion and fire alarm systems on a monthly basis. 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. Sales to unaffiliated customers are primarily shipped from the United States.

As of June 30, 2021 and 2020, the Company included refund liabilities of approximately $4,277,000 and $3,331,000, respectively, in current liabilities. As of June 30, 2021 and 2020, the Company included return-related assets of approximately $890,000 and $701,000, respectively, in other current assets.

As a percentage of gross sales, sales returns, rebates and allowances were 10%, 9% and 8% for the fiscal years ended June 30, 2021, 2020 and 2019, respectively.

The Company disaggregates revenue from contracts with customers into major product lines. The Company determines that disaggregating revenue into these categories achieves the disclosure objective to depict how the nature, amount, timing, and

uncertainty of revenue and cash flows are affected by economic factors. As noted in the accounting policy footnote, the Company's business consists of one operating segment. Following is the disaggregation of revenues based on major product lines (in thousands):

	Year ended June 30,		
	2021	2020	2019
Major Product Lines:			
Intrusion and access alarm products	$36,794	$31,310	$31,557
Door locking devices	43,337	46,004	53,948
Services	33,904	24,045	17,427
Total Revenues	$114,035	$101,359	$102,932

NOTE 3 – Reserve for Doubtful Accounts

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. The Company had one customer with an accounts receivable balance that comprised 19%, 24% and 19% of the Company's accounts receivable at June 30, 2021, 2020 and 2019, respectively. Sales to this customer did not exceed 10% of net sales during fiscal year ended June 30, 2020. Sales to this customer comprised 10% of net sales during fiscal year ended June 30, 2021 and 2019. The Company had another customer with an accounts receivable balance that comprised 10% of the Company's accounts receivable at June 30, 2021. Sales to this customer did not exceed 10% of net sales in any of the fiscal years ended June 30, 2021, 2020 and 2019, respectively. The Company had another customer with an accounts receivable balance that comprised 10% of the Company's accounts receivable at June 30, 2020. Sales to this customer did not exceed 10% of net sales in any of the fiscal years ended June 30, 2021, 2020 and 2019, respectively. The Company had another customer with an accounts receivable balance that comprised 10% of the Company's accounts receivable at June 30, 2021 and 2019. Sales to this customer did not exceed 10% of net sales in any of the fiscal years ended June 30, 2021, 2020 and 2019.

NOTE 4 – Marketable Securities

Marketable securities include investments in fixed income mutual funds, which are reported at their fair values. The disaggregated net gains and losses on the marketable securities recognize in the income statement for the year ended June 30, 2021, are as follows:

	June 30, 2021
Net gains recognized during the period on marketable securities	$ —
Less: Net gains recognized during the year on marketable securities sold during the period	—
Unrealized (losses) gains recognized during the reporting year on marketable securities still held at the reporting date	(9)
	$ (9)

The fair values of the Company's marketable securities are determined as being the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the Company utilizes the three-tier value hierarchy, as prescribed by US GAAP, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company's marketable securities, which are considered available-for-sale securities, are re-measured to fair value on a recurring basis and are valued using Level 1 inputs using quoted prices (unadjusted) for identical assets in active markets.

The following tables summarize the Company's investments:

	Cost	Fair Value	Unrealized Gain (Loss)
Marketable Securities	$5,422	$5,413	$ (9)

Investment income is recognized when earned and consists principally of interest income from fixed income mutual funds. Realized gains and losses on sales of investments are determined on a specific identification basis.

For the year ended June 30, 2021, there were no transfers between Levels 1 and 2 investments and no transfers in or out of Level 3.

NOTE 5 - Inventories

Inventories, net of reserves are valued at lower of cost (first-in, first-out method) or net realizable value. Inventories, net of reserves consist of the following as of June 30, (in thousands):

	June 30, 2021	June 30, 2020
Component parts	$17,929	$22,877
Work-in-process	6,158	7,276
Finished product	8,355	11,602
	$32,442	$41,755
Classification of inventories, net of reserves:		
Current	$25,278	$35,231
Non-current	7,164	6,524
	$32,442	$41,755

NOTE 6 - Property, Plant, and Equipment

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

	June 30, 2021	June 30, 2020	Useful Life in Years
Land	$904	$904	N/A
Buildings	8,911	8,911	30 to 40
Molds and dies	7,416	7,337	3 to 5
Furniture and fixtures	2,813	2,792	5 to 10
Machinery and equipment	25,548	24,878	7 to 10
Building improvements	2,409	2,173	Shorter of the lease term or life of asset
	48,001	46,995	
Less: accumulated depreciation and amortization	(40,165)	(38,907)	
	$7,836	$8,088	

Depreciation and amortization expense on property, plant, and equipment was approximately $1,260,000, $1,221,000 and $1,085,000 in fiscal 2021, 2020 and 2019, respectively.

NOTE 7 - Income Taxes

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

	For the Year ended June 30,		
	2021	2020	2019
Current income taxes:			
Federal	$1,915	$1,715	$310
State	279	404	141
	2,194	2,119	451
Deferred income tax provision	235	165	771
Provision for income taxes	$2,429	$2,284	$1,222

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):

	2021		2020		2019	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Tax at Federal statutory rate	$3,639	21.0 %	$2,269	21.0 %	$2,822	21.0 %
Increases (decreases) in taxes resulting from:						
Meals and entertainment	29	0.2 %	44	0.4 %	49	0.3 %
State income taxes, net of Federal income tax benefit	146	0.8 %	112	1.0 %	103	0.8 %
Foreign source income not subject to tax	(1,617)	(9.3)%	(1,213)	(11.2)%	(1,219)	(9.1)%
R&D Credit	(523)	(3.0)%	(523)	(4.8)%	(408)	(3.0)%
Foreign withholding tax	205	1 %	—	— %	—	— %
Release of accrued tax reserves	—	— %	—	— %	(151)	(1.1)%
Uncertain Tax Positions	312	1.8 %	775	7 %	—	— %
IRS examination settlements	—	— %	832	7.7 %	12	0.1 %
Other, net	238	1.3 %	(12)	(0.1)%	14	0.1 %
Effective tax rate	$2,429	14.0 %	$2,284	21.1 %	$1,222	9.1 %

Deferred tax assets and deferred tax liabilities at June 30, 2021 and 2020 are as follows (in thousands):

	Deferred Tax Assets (Liabilities)	
	2021	2020
Accounts receivable	$43	$40
Inventories	346	374
Accrued liabilities	374	262
Stock based compensation expense	102	96
Intangibles	(454)	(300)
Property, plant and equipment	(539)	(484)
Revenue reserves	394	308
Other deferred tax liabilities	(613)	(408)
	(347)	(112)
Valuation allowance	—	—
Net deferred tax liabilities	$(347)	$(112)

The Company has identified the United States and New York State as its major tax jurisdictions. Fiscal year 2018 and forward years are still open for examination. In addition, the Company has a wholly-owned subsidiary which operates in a Free Zone in the Dominican Republic (“DR”) and is exempt from DR income tax.

The Company was audited by the IRS for the fiscal year 2016. In July 2019, the Company received Form 4549-A, Income Tax Examination Changes from the IRS proposing an adjustment to income for the fiscal 2016 tax year regarding deemed dividends based on its interpretation of Internal Revenue Code ("IRC") Section 956 arising from the intercompany balances on the books of the Company. In August 2019, the Company filed a formal protest with the IRS requesting an opportunity to appeal the examination findings to the Appeals Office. During fiscal year 2020, the Company settled the issue at Appeals. There was a provision recorded for the federal and state impact of $762,000 and $70,000, respectively.

The Company was audited by the IRS for the fiscal year 2017. The Company received Form 4549-A, Income Tax Examination Changes from the IRS proposing an adjustment to income for the fiscal 2017 tax year regarding deemed dividends based on its interpretation under IRC Section 956 arising from the intercompany balances on the books of the Company. During the third quarter of fiscal 2021, the Company settled the issue and paid the IRS $399,000. The Company reported the results of the IRS exam to all the jurisdictions in which it files and paid taxes and interest totaling $97,000. Subsequent to the quarter end, the Company paid the IRS $68,000 for interest. None of the payments were recorded to expense since liabilities had previously been established.

The provision for income taxes represents Federal, foreign, and state and local income taxes. The effective rate differs from statutory rates due to the effect of tax rates in foreign jurisdictions, state and local income taxes, tax benefit of R&D credits, certain nondeductible expenses, uncertain tax positions, audit settlements and global intangible low-taxed income ("GILTI").

During the year ending June 30, 2021 the Company decreased its reserve for uncertain income tax positions by $208,000. 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, 2021, the Company had accrued interest totaling $63,000 and $678,000 of unrecognized net tax benefits that, if recognized, would favorably affect the Company's effective income tax rate in any future period. The Company does not expect that its unrecognized tax benefits will significantly change within the next twelve months. The Company claims R&D tax credits on eligible research and development expenditures. The R&D tax credits are recognized as a reduction to income tax expense.

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, 2018	$221	$ —	$221
Decrease to unrecognized tax benefits resulting from release of R&D credits due to the IRS audit	(151)	—	(151)
Increases to unrecognized tax benefits resulting from the generation of additional R&D credits	55	—	55
Balance of gross unrecognized tax benefits as of June 30, 2019	$125	—	$125
Increase to unrecognized tax benefits resulting from deemed dividends for investments in US property	682	83	765
Increases to unrecognized tax benefits resulting from the generation of additional R&D credits	59	—	59
Balance of gross unrecognized tax benefits as of June 30, 2020	$866	$83	$949
Decrease to unrecognized tax benefits from deemed dividends for investments in US property	(3)	(20)	(23)
Decrease to unrecognized tax benefits resulting from the release of R&D credits due to the settled IRS audit	(185)	—	(185)
Balance of gross unrecognized tax benefits as of June 30, 2021	$678	$63	$741

The Company plans to permanently reinvest a substantial portion of its foreign earnings and as such has not provided withholding tax on the permanently reinvested earnings. The Company has accrued $613,000 for withholding taxes on undistributed earnings that are not permanently reinvested. As of June 30, 2021 the Company had approximately $60.4 million of undistributed earnings of foreign subsidiaries.

NOTE 8 - Long-Term Debt

As of June 30, 2021 and 2020, long-term debt consisted of a revolving line of credit of $11,000,000 (“Revolver Agreement”) which expires in June 2024 and term loans from the U.S. Small Business Administration totaling $3,904,000 through its Payroll Protection Program.

Outstanding balances and interest rates as of June 30, 2021 and June 30, 2020 are as follows (dollars in thousands):

	June 30, 2021		June 30, 2020	
	Outstanding	Interest Rate	Outstanding	Interest Rate
Revolving line of credit	$ —	n/a	$ —	n/a
Term loans	3,904	1 %	3,904	1 %
	3,904		3,904	
Less: current maturities	(2,386)		(1,794)	
Long-term debt	$1,518		$2,110	

The Revolver 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 Revolver Agreement. The Company’s obligations under the Revolver Agreement continue to be secured by substantially all of its domestic assets, including but not limited to, deposit accounts, accounts receivable, inventory, 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 Revolver 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 Revolver Agreement. The Revolver 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 Revolver Agreement. In September 2020, the Company and its lender amended the Revolver Agreement, which had an expiration date of June 2021, to expire in June 2024. The amended Revolver Agreement also removed certain requirements and restrictions on the Company as well as removing the mortgage on the Company’s Amityville facility.

During the fourth quarter of fiscal 2020, the Company received the proceeds of promissory notes dated between April 17, 2020 and May 7, 2020 (the "PPP Loan Agreement"), entered into between the Company and HSBC Bank USA N.A., as lender (the "Lender). Lender made the loans pursuant to the Paycheck Protection Program (the "PPP"), created by Section 1102 of the CARES Act and governed by the CARES Act, Section 7(a)(36) of the Small Business Act, any rules or guidance that has been issued by the Small Business Association (“SBA”) implementing the PPP and acting as guarantor, or any other applicable loan program requirements, as defined in 13 CFR § 120.10, as amended from time to time. Pursuant to the PPP Loan Agreement, the Lender made loans to the Company with an aggregate principal amount of $3,904,000 (the "PPP Loan").

Pursuant to the CARES Act, the loans may be forgiven by the SBA. The Company has applied to have the balance of the Loan forgiven. Following year-end, $2,850,000 of the PPP Loan was forgiven in accordance with guidelines set for in the PPP. The Company will recognize debt forgiveness in the first quarter of 2022 in the amount of $2,850,000 and will recognize further forgiveness income in the quarter that the remaing forgiveness application may be granted. While the Company believes that it meets to requirements for forgiveness, there can be no assurance that its remaining application will be granted.

NOTE 9 - 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, 2021, 2020 and 2019, the Company recorded non-cash compensation expense of $435,000 ($0.02 per basic and diluted share), $583,000 ($0.03 per basic and diluted share) and $160,000 ($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, 2021, 107,040 stock options were outstanding, 49,088 stock options were exercisable and 738,460 stock options were available for grant under this plan. No options were granted under this plan during the year ended June 30, 2021.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2021	2020	2019
Risk-free interest rates	n/a %	.6% - 2.10 %	2.5% - 3.10 %
Expected lives	n/a	10 years	10 years
Expected volatility	n/a %	44% - 46 %	48% - 52 %
Expected dividend yields	n/a %	0 %	0 %

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,:

	2021		2020		2019	
	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	117,840	$18.84	72,500	$11.01	57,200	$7.09
Granted	—	—	70,940	24.50	29,000	16.59
Forfeited	(6,500)	13.82	(10,000)	19.84	—	—
Exercised	(4,300)	18.08	(15,600)	7.55	(13,700)	6.42
Outstanding, end of period	107,040	$19.18	117,840	$18.84	72,500	$11.01
Exercisable, end of period	49,088	$16.14	35,000	$13.13	33,800	$8.05
Weighted average fair value at grant date of options granted	n/a		$13.43		$9.15	
Total intrinsic value of options exercised	$65,000		$ 278,000		$ 160,000	
Total intrinsic value of options outstanding	$ 1,840,000		$ 696,000		$ 1,353,000	
Total intrinsic value of options exercisable	$ 993,000		$ 389,000		$ 731,000	

The following table summarizes information about stock options outstanding under the 2012 Employee Plan at June 30, 2021:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
$4.37 - $33.59	107,040	7.4	$19.18	49,088	$16.14
	107,040	7.4	$19.18	49,088	$16.14

As of June 30, 2021, there was $555,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2012 Employee Plan. 0 and 70,940 options were granted during the fiscal years ended June 30, 2021 and 2020, respectively. 4,300 stock options exercised during the fiscal year ended June 30, 2021, were settled by exchanging 2,302 shares of the Company's common stock which were retired and returned to unissued status upon receipt. 3,600 of the 15,600 stock options exercised during the fiscal year ended June 30, 2020 were settled by exchanging 1,628 shares of the Company's common stock which were retired and returned to unissued status upon receipt. 8,200 of the 13,700 stock options exercised during the fiscal year ended June 30, 2019 were settled by exchanging 3,106 shares of the Company's common stock which were retired and returned to unissued status upon receipt. The total grant date fair value of the options vesting during the fiscal years ended June 30, 2021, 2020 and 2019 under this plan was $244,000, $197,000 and $95,000, respectively. $0, $79,000 and $31,000 was received from option exercises for the fiscal years ended June 30, 2021, 2020 and 2019, respectively, and the actual tax benefit realized for the tax deductions from option exercises was $0 for each of these periods.

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, 2021, 6,000 stock options were outstanding, 3,120 stock options were exercisable and 4,800 stock options were available for grant under this plan. No options were granted under this plan during the year ended June 30, 2021.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2021	2020	2019
Risk-free interest rates	n/a %	1.6 %	n/a %
Expected lives	n/a	10 years	n/a
Expected volatility	n/a %	44 %	n/a %
Expected dividend yields	n/a %	0 %	n/a %

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

	2021		2020		2019	
	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	12,000	$10.29	10,200	$7.99	27,800	$6.85
Granted	—	—	1,800	23.35	—	—
Forfeited	(4,800)	7.18	—	—	(1,800)	8.70
Exercised	(1,200)	8.70	—	—	(15,800)	5.91
Outstanding, end of period	6,000	$13.10	12,000	$10.29	10,200	$7.99
Exercisable, end of period	3,120	$12.08	5,760	$8.35	3,000	$6.27
Weighted average fair value at grant date of options granted	n/a		$12.94		n/a	
Total intrinsic value of options exercised	$31,000		n/a		$192,000	
Total intrinsic value of options outstanding	$140,000		$157,000		$221,000	
Total intrinsic value of options exercisable	$76,000		$87,000		$70,000	

The following table summarizes information about stock options outstanding under the 2012 Non-Employee Plan at June 30, 2021:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
$4.37 - $23.35	6,000	7.1	$13.10	3,120	$12.08
	6,000	7.1	$13.10	3,120	$12.08

As of June 30, 2021, there was $15,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2012 Non-Employee Plan. 0 and 1,800 options were granted during the fiscal years ended June 30, 2021 and 2020, respectively. 1,200 stock options exercised during the fiscal year ended June 30, 2021 were settled by exchanging 306 shares of the Company's common stock which were retired and returned to unissued status upon receipt. 14,600 of the 15,800 stock options exercised during the fiscal year ended June 30, 2019 were settled by exchanging 4,832 shares of the Company common stock which were retired and returned to unissued status upon receipt. No options were exercised during the fiscal year ended June 30, 2020. The actual tax benefit realized for the tax deductions from option exercises was $6,000, $0 and $35,000 in fiscal 2021, 2020 and 2019, respectively.The total grant date fair value of the options vesting during each of the fiscal years ended June 30, 2021, 2020 and 2019 under this plan was $18,000, $18,000 and $22,000, respectively.

2018 Non-Employee Stock Option Plan

In December 2018, the stockholders approved the 2018 Non-Employee Stock Option Plan (the "2018 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 2018 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, 2021, 35,050 stock options were outstanding, 14,980 stock options were exercisable and 11,750 stock options were available for grant under this plan. No options were granted under this plan during the year ended June 30, 2021.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2021	2020	2019
Risk-free interest rates	n/a %	1.60 - 1.80 %	2.90 %
Expected lives	n/a	10 years	10 years
Expected volatility	n/a %	44 - 45 %	50 %
Expected dividend yields	n/a %	— %	— %

The following table reflects activity under the 2018 Non-Employee plan for the fiscal year ended June 30,:

	2021		2020		2019	
	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	48,400	$23.48	15,200	$16.20	—	$ —
Granted	—	—	33,200	26.82	20,000	16.20
Forfeited/Lapsed	(11,750)	23.36	—	---	(3,200)	16.20
Exercised	(1,600)	16.20	—	—	(1,600)	16.20
Outstanding, end of period	35,050	$23.85	48,400	$23.48	15,200	$16.20
Exercisable, end of period	14,980	$23.36	12,240	$21.96	2,400	$16.20
Weighted average fair value at grant date of options granted	n/a		$15.09		$10.24	
Total intrinsic value of options exercised	$29,000		n/a		$24,000	
Total intrinsic value of options outstanding	$439,000		$110,000		$205,000	
Total intrinsic value of options exercisable	$195,000		$40,000		$32,000	

The following table summarizes information about stock options outstanding under the 2018 Non- Employee Plan at June 30, 2021:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
$16.20 - $30.54	35,050	8.2	$23.85	14,980	$23.36
	35,050	8.2	$23.85	14,980	$23.36

As of June 30, 2021, there was $278,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2018 Non-Employee Plan. 0, 33,200 and 20,000 options were granted during the fiscal years ended June 30, 2021, 2020 and 2019, respectively. 1,600 of the stock options exercised during the fiscal year ended June 30, 2021 were settled by exchanging 759 shares of the Company's common stock which were retired and returned to unissued status upon receipt. 800 of the 1,600 stock options exercised during the fiscal year ended June 30, 2019 were settled by exchanging 395 shares of the Company's common stock which were retired and returned to unissued status upon receipt. There were no options exercised during the fiscal year ended June 30, 2020. The actual tax benefit realized for the tax deductions from option exercises was $6,000, $0 $3,000 in fiscal 2021, 2020 and 2019, respectively. The total grant date fair value of the options vesting during the fiscal year ended June 30, 2021, 2020 and 2019 under this plan was $133,000, $133,000 and $41,000, respectively.

2020 Non-Employee Stock Option Plan

In May 2020, the stockholders approved the 2020 Non-Employee Stock Option Plan (the "2020 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 2020 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, 2021, 5,000 stock options were outstanding, 1,000 stock options were exercisable and 45,000 stock options were available for grant under this plan.

The fair value of each option granted during the fiscal year ended June 30, 2021 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2021
Risk-free interest rates	0.62 %
Expected lives	10
Expected volatility	45 %
Expected dividend yields	0 %

The following table reflects activity under the 2020 Non-Employee plan for the fiscal year ended June 30,:

	2021	
	Options	Weighted average exercise price
Outstanding, beginning of year	—	$ —
Granted	5,000	22.80
Exercised	—	—
Outstanding, end of period	5,000	$22.80
Exercisable, end of period	1,000	$22.80
Weighted average fair value at grant date of options granted	$12.20	
Total intrinsic value of options exercised	n/a	
Total intrinsic value of options outstanding	$68,000	
Total intrinsic value of options exercisable	$14,000	

The following table summarizes information about stock options outstanding under the 2020 Non- Employee Plan at June 30, 2021:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
$22.80	5,000	9.2	$22.80	1,000	$22.80
	5,000	9.2	$22.80	1,000	$22.80

As of June 30, 2021, there was $37,000 of unearned stock-based compensation cost related to share-based compensation arrangements granted under the 2020 Non-Employee Plan. 5,000 and 0 options were granted during the fiscal years ended June 30, 2021 and 2020, respectively. The total grant date fair value of the options vesting during the fiscal year ended June 30, 2021 and 2020 under this plan was $12,000 and $0, respectively. There were no options exercised in either of the fiscal years ended June 30, 2021 and 2020.

NOTE 10 – 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 then outstanding. Such repurchases may 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 agreement described in Note 8, the Company's lender gave its consent to this stock repurchase plan. During the fiscal year ended June 30, 2021 the Company did not repurchase any shares of its outstanding common stock. During the fiscal year ended June 30,

2020 the Company repurchased 144,405 shares of its outstanding common stock at a weighted average price of $16.99. Shares repurchased through June 30, 2021 are included in the Company's Treasury Stock as of June 30, 2021 and 2020. Pursuant to the PPP Loan Agreement described in Note 8, the Company may not repurchase any of its shares of common stock until 12 months after the termination of the term loans described therein.

During fiscal 2021, certain employees and Directors exercised stock options under the Company's 2012 Employee and Non-Employee and 2018 Non-employee Stock Option Plans totaling 7,100 shares. All of these exercises were completed as cashless exercises as allowed for under the Plans, 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 3,367 and was based upon the per share price on the effective date of the option exercise.

During fiscal 2020, certain employees and Directors exercised stock options under the Company's 2012 Employee and Non-Employee Stock Option Plans totaling 15,600 shares. 3,600 of these exercises were completed as cashless exercises as allowed for under the Plans, 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 1,628 and was based upon the per share price on the effective date of the option exercise.

During fiscal 2019, certain employees and Directors exercised stock options under the Company's 2012 Employee and Non-Employee Stock Option Plans and the Company's 2002 Employee Stock Option Plan totaling 31,100 shares. 23,600 of these exercises were completed as cashless exercises as allowed for under the Plans, 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 8,333 and was based upon the per share price on the effective date of the option exercise.

NOTE 11 – Related Party Transaction

On December 15, 2020, 2,333,071 shares of common stock were sold in a secondary offering by the Company's President and Chairman. On December 21, 2020, the underwriters of the secondary offering fully exercised the option granted at the time of the secondary offering to purchase an additional 334,961 shares of common stock at the secondary offering price of $26.00 per share ("Greenshoe"), less underwriting discounts and commissions, which consists solely of shares sold by the Company's President and Chairman. The Company received no proceeds from the secondary offering or the Greenshoe, but incurred $289,000 in offering expenses, which are recorded in selling, general, and administrative expenses in the accompanying condensed consolidated statements of income.

NOTE 12 - 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 $138,000, $133,000 and $133,000 for the years ended June 30, 2021, 2020 and 2019, respectively.

NOTE 13 - Commitments and Contingencies

Leases

Effective July 1, 2019, the Company adopted the new lease accounting standard using the modified retrospective transition option of applying the new standard at the adoption date. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to not reassess (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. Adoption of the new standard resulted in the recording of an operating ROU asset and lease liabilities of approximately $7.7 million. Given the length of the lease term, the right-of-use asset and corresponding liability assume a weighted discount rate as disclosed below. A change in the rate utilized could have a material effect on the amounts reported. Financial positions for reporting periods beginning on or after July 1, 2019 are presented under new guidance, while prior period amounts are not adjusted and continue to be reported in accordance with previous guidance.

Our lease obligation consists of a 99 year lease which commenced on April 26, 1993 with one of the Company's foreign subsidiaries, 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.

Operating leases are included in operating lease right-of-use assets, accrued expenses and operating lease liabilities, non-current on our condensed consolidated balance sheets.

For the fiscal year ended June 30, 2021 and 2020, cash payments against operating lease liabilities totaled $288,000 and $240,000 respectively.

Supplemental balance sheet information related to operating leases was as follows:

Weighted-average remaining lease term	71 Years
Weighted-average discount rate	3.55 %

The following is a schedule, by years, of maturities of lease liabilities as of June 30, 2021 (in thousands):

Year Ending June 30,	Amount
2022	$282
2023	272
2024	263
2025	254
2026	245
Thereafter	6,057
Total	$7,373

Operating lease expense totaled approximately $316,000, $315,000 and $330,000, for the fiscal years ended June 30, 2021, 2020 and 2019, respectively.

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, 2021, the Company was obligated under two employment agreements and one severance agreement. The employment agreements are with the Company's CEO and the Senior Vice President of Engineering ("the SVP of Engineering"). The employment agreement with the CEO provides for an annual salary of $838,000, 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 Engineering expires in August 2021 and provides for an annual salary of $347,000, 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 Company, 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.

NOTE 14 - Geographical Data

The Company is engaged in one major line of business: the development, manufacture, and distribution of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems and video surveillance products for commercial and residential use. The Company also provides wireless communication service for intrusion and fire alarm systems. These products are used for commercial, residential, institutional, industrial and governmental applications, and are sold worldwide principally to independent distributors, dealers and installers of security equipment. 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 (in thousands):

	Year ended June 30,		
	2021	2020	2019
Sales to external customers (1):			
Domestic	$112,618	$99,496	$100,716
Foreign	1,417	1,863	2,216
Total Net Sales	$114,035	$101,359	$102,932

	June 30, 2021	June 30, 2020
Identifiable assets:		
United States	$91,375	$69,436
Dominican Republic (2)	31,918	36,402
Total Identifiable Assets	$123,293	$105,838

(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 (2021 = $21,020; 2020 = $25,246), operating lease assets (2021 = $7,373; 2020 = $7,395) and fixed assets (2021 = $3,208; 2020 = $3,481) located at the Company's principal manufacturing facility in the Dominican Republic.

NOTE 15 – 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 consolidated financial statements.

During the fourth quarter of fiscal 2020, the Company received the proceeds of promissory notes dated between April 17, 2020 and May 7, 2020 (the "PPP Loan Agreement"), entered into between the Company and HSBC Bank USA N.A., as lender (the "Lender). Lender made the loans pursuant to the Paycheck Protection Program (the "PPP"), created by Section 1102 of the CARES Act and governed by the CARES Act, Section 7(a)(36) of the Small Business Act, any rules or guidance that has been issued by the Small Business Association ("SBA") implementing the PPP and acting as guarantor, or any other applicable loan program requirements, as defined in 13 CFR § 120.10, as amended from time to time. Pursuant to the PPP Loan Agreement, the Lender made loans to the Company with an aggregate principal amount of $3,904,000 (the "PPP Loan").

Pursuant to the CARES Act, the loans may be forgiven by the SBA. Subsequent to June 30, 2021, the Company received notice from the SBA that its loans had been forgiven in full. Based on the guidance in FASB ASC 405-20-40-1, the proceeds from the loan will remain recorded as a liability until either (1) the loan is, in part or wholly, forgiven and the debtor has been "legally released" or (2) the debtor pays off the loan to the creditor. Accordingly, the Company will eliminate the liability and record a gain of $3,904,000 on the extinguishment of this debt in its fiscal quarter ended September 30, 2021.

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, 2021, 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, 2021.

Management's Annual Report on Internal Control over Financial Reporting. Management's Report on Internal Control over Financial Reporting is set forth on page FS-1.

Audit Opinion on Internal Control over Financial Reporting. The effectiveness of the Company's internal control over financial reporting has been audited by Baker Tilly US, LLP an independent registered public accounting firm, as stated in their report, which is included herein on page FS-2.

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.

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 US, 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, 2021 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 2021 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, 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 "Delinquent Section 16(c) 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" are 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, 2021 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

Omitted.

Upon any request of any shareholder of the Company, the Company will provide such shareholder a copy of the Company's Annual Report Form 10-K for 2021, including the financial statements and schedules thereto, filed with the Security and Exchange Commission. Any such request should be directed to Secretary, NAPCO Security Technologies, Inc., 333 Bayview Avenue, Amityville, New York, 11701. There will be no charge for such reports unless one or more exhibits thereto are requested, in which case the Company's reasonable expenses of furnishing such exhibits requested may be charged.

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 13, 2021

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 Richard Soloway	Chairman of the Board of Directors, President and Secretary and Director (Principal Executive Officer)	September 13, 2021
/s/ KEVIN S. BUCHEL Kevin S. Buchel	Senior Vice President of Operations and Finance and Treasurer and Director (Principal Financial and Accounting Officer)	September 13, 2021
/s/ PAUL STEPHEN BEEBER Paul Stephen Beeber	Director	September 13, 2021
/s/ RICK LAZIO Rick Lazio	Director	September 13, 2021
/s/ DONNA SOLOWAY Donna Soloway	Director	September 13, 2021
/s/ ROBERT UNGAR Robert Ungar	Director	September 13, 2021
/s/ ANDREW J. WILDER Andrew J. Wilder	Director	September 13, 2021

NAPCO SECURITY TECHNOLOGIES, INC. AND SUBSIDIARIES

NON-GAAP MEASURES OF PERFORMANCE* (unaudited)

(In thousands, except share and per share data)

	Three months ended June 30,		Twelve months ended June 30,	
	2021	2020	2021	2020
Net (loss) income (GAAP)	$5,025	$(1,900)	$14,901	$ 8,520
Add back provision for income taxes	1,007	1,059	2,429	2,284
Add back interest and other expense	(48)	6	5	9
Operating (loss) income (GAAP)	5,984)	(835)	17,335	10,813
Adjustments for non-GAAP measures of performance:				
Add back amortization of acquisition-related intangibles	106	66	425	264
Add back stock-based compensation expense	163	85	435	583
Add back impairment of Goodwill and Other intangibles	-	1,852	-	1,852
Adjusted non-GAAP operating income	6,253	1,168	18,195	13,512
Add back depreciation and other amortization	323	312	1,271	1,232
Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization)	$6,576	$1,480	$19,466	$14,744
Adjusted EBITDA* per Diluted Share	$0.36	$0.08	$1.06	$0.80
Weighted average number of Diluted Shares outstanding	18,420,000	18,375,000	18,404,000	18,493,000

*** Non-GAAP Information**

Certain non-GAAP measures are included above, including non-GAAP operating income and Adjusted EBITDA. We define Adjusted EBITDA as GAAP net income plus income tax expense, net interest expense, non-cash stock-based expense and depreciation and amortization expense. Non-GAAP operating income does not include amortization of intangibles or stock-based compensation expense. These non-GAAP measures are provided to enhance the user's overall understanding of our financial performance. By excluding these charges our non-GAAP results provide information to management and investors that is useful in assessing NAPCO's core operating performance and in comparing our results of operations on a consistent basis from period to period. Our use of non-GAAP financial measures has certain limitations in that such non-GAAP financial measures may not be directly comparable to those reported by other companies. For example, the terms used in this press release, such as Adjusted EBITDA, do not have a standardized meaning. Other companies may use the same or similarly named measures, but exclude different items, which may not provide investors with a comparable view of our performance in relation to other companies. The presentation of this information is not meant to be a substitute for the corresponding financial measures prepared in accordance with generally accepted accounting principles. Investors are encouraged to review the reconciliation of GAAP to non-GAAP financial measures set forth above..

2021 ANNUAL REPORT

NAPCO SECURITY TECHNOLOGIES, INC.

Officers

Richard L. Soloway
Chairman, President
and CEO

Kevin S. Buchel
Executive Vice President of
Operations and CFO
and Treasurer

Michael Carrieri
Senior Vice President
of Engineering

Stephen Spinelli
Senior Vice President
of Sales

Alfred DePierro
Vice President
of Engineering
Microcomputer Applications

Common Stock Listing

Nasdaq Global
Market System®
(Symbol–"NSSC")

Directors

Richard L. Soloway
Chairman, President and CEO

Paul Stephen Beeber
Attorney

Kevin S. Buchel
Executive Vice President of
Operations and CFO
and Treasurer

Rick Lazio, Esq.
Senior Vice President
of alliantgroup LP

Donna A. Soloway
Security Industry Publicist

Robert A. Ungar, Esq.
President of
Robert A. Ungar Associates, Inc.
Lobbying, Media and
Fire Service Industry

Andrew J. Wilder
Partner of
GR Reid Associates LLP
(Certified Public Accountants)

Primary Bank

HSBC Bank USA
534 Broadhollow Road
Melville, NY 11747

Investor Relations

Copies of the Company's Annual Report, Forms 10-K and 10-Q and other information filed with the Securities and Exchange Commission may be obtained directly from the Corporation by contacting:

NAPCO
Security Technologies, Inc.
333 Bayview Avenue
Amityville, NY 11701
Attention: Corporate Secretary

Independent Accountants

Baker Tilly US, LLP
125 Baylis Road
Melville, NY 11747

Legal Counsel

Forman & Shapiro LLP
1345 Avenue of the Americas
New York, NY 10105

Transfer Agent

Continental Stock
Transfer & Trust Co.
1 State Street
New York, NY 10004

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