NAPCO SECURITY SYSTEMS INC
Form 10-Q
November 18, 2008

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

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2008

OR

--- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ TO__________.

Commission File number: 0-10004

NAPCO SECURITY SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

Delaware	11-2277818
(State or other jurisdiction of incorporation of organization)	(IRS Employer Identification Number)
333 Bayview Avenue Amityville, New York	11701
(Address of principal executive offices)	(Zip Code)

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

None
(Former name, former address and former fiscal year if changed from last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes X No ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer Accelerated Filer X

Non-Accelerated Filer _______ Smaller reporting company _______

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes _______ No X _______

Number of shares outstanding of each of the issuer's classes of common stock, as of: NOVEMBER 14, 2008

COMMON STOCK, $.01 PAR VALUE PER SHARE 19,095,713

PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

ASSETS	September 30, 2008 (unaudited)	June 30, 2008
	(in thousands, except share data)	
Current Assets:		
Cash and cash equivalents	$ 4,276	$ 2,765
Accounts receivable, net of reserves	26,479	25,823
Inventories	26,890	19,548
Prepaid expenses and other current assets	1,576	1,121
Deferred income taxes	790	769
Total Current Assets	60,011	50,026
Inventories - non-current, net	8,440	7,724
Property, plant and equipment, net	9,601	8,989
Intangible assets, net	16,039	--
Goodwill, net	10,584	9,686
Other assets	793	298
Total Assets	$ 105,468	$ 76,723
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current portion of long-term debt	$ 3,572	$ --
Accounts payable	5,917	4,857
Accrued expenses	1,980	1,333
Accrued salaries and wages	2,392	2,543
Total Current Liabilities	13,861	8,733
Long-term debt	35,528	12,400
Accrued income taxes	299	294
Deferred income taxes	1,646	1,607
Minority interest in subsidiary	147	147
Total Liabilities	51,481	23,181
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, par value $.01 per share; 40,000,000 shares authorized, 20,095,713 and 20,092,473 shares issued and 19,095,713 and 19,092,473 shares outstanding, respectively	201	201
Additional paid-in capital	13,548	13,424
Retained earnings	45,853	45,532
	59,602	59,157
Less: Treasury Stock, at cost (1,000,000 shares)	(5,615)	(5,615)
Total stockholders' equity	53,987	53,542
Total Liabilities and Stockholders' Equity	$ 105,468	$ 76,723

See accompanying notes to condensed consolidated financial statements.

NAPCO SECURITY SYSTEMS, INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three Months Ended September 30, 2008	2007
	(in thousands, except share and per share data)	
Net sales	$ 17,483	$ 13,876
Cost of sales	11,877	8,652
Gross Profit	5,606	5,224
Selling, general and administrative expenses	4,776	4,421
Operating Income	830	803
Other expense:		
Interest expense, net	315	195
Other expenses, net	79	7
Total Other expenses	394	202
Income Before Minority Interest and Provision for Income Taxes	436	601
Minority interest in loss of subsidiary	42	38
Income Before Provision for Income Taxes	478	639
Provision for income taxes	156	265
Net Income	$ 322	$ 374
Earnings per share:		
Basic	$ 0.02	$ 0.02
Diluted	$ 0.02	$ 0.02

Weighted average number of shares outstanding:		
Basic	19,095,361	19,567,689
Diluted	19,479,269	20,157,065

See accompanying notes to condensed consolidated financial statements.

4

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

	Three Months Ended September 30,	
	2008	2007
	(in thousands)	
Cash Flows from Operating Activities:		
Net income	$ 322	$ 374
Adjustments to reconcile net income to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	378	277
Provision for (Recovery of) doubtful accounts	42	(40)
Change to inventory obsolescence reserve	--	
Deferred income taxes	18	(254)
Non-cash stock based compensation expense	118	59
Changes in operating assets and liabilities, net of acquisition effects:		
Accounts receivable	1,138	3,513
Inventories	(1,317)	(2,491)
Prepaid expenses and other current assets	(354)	16
Other assets	--	(71)
Accounts payable, accrued expenses, accrued salaries and wages, and accrued income taxes	291	500
Net Cash Provided by Operating Activities	636	1,883
Cash Flows Used in Investing Activities:		
Cash used in business acquisition, net of cash acquired of $520	(24,555)	--
Purchases of property, plant and equipment	(115)	(344)
Net Cash Used in Operating Activities	(24,670)	(344)
Cash Flows from Financing Activities:		
Proceeds from exercise of employee stock options	6	--
Proceeds from acquisition financing	25,000	--
Proceeds from long-term debt borrowings	2,200	--

Principal payments on long-term debt	(1,500)	--
Cash paid for deferred financing costs	(161)	--
Cash paid for purchase of treasury stock	--	(1,371)
Net Cash Provided by (Used in) Financing Activities	25,545	(1,371)
Net increase in Cash and Cash Equivalents	1,511	168
Cash and Cash Equivalents, Beginning of Period	2,765	1,748
Cash and Cash Equivalents, End of Period	$ 4,276	$ 1,916
Cash Paid During the Period for:		
Interest	$ 159	$ 186
Income taxes	$ 125	$ --
Non-cash Investing activities:		
Adjustment to Retained earnings relating to adoption of FIN 48	$ --	$ 485
Accrued Business Acquisition costs	$ 295	--
Debt assumed in the acquisition	$ 1,000	--

See accompanying notes to condensed consolidated financial statements.

5

NAPCO SECURITY SYSTEMS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1.) Summary of Significant Accounting Policies and Other Disclosures

The accompanying Condensed Consolidated Financial Statements are unaudited. In management's opinion, all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation have been made. The results of operations for the period ended September 30, 2008 are not necessarily indicative of results that may be expected for any other interim period or for the full year.

The unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended June 30, 2008. The accounting policies used in preparing these unaudited Condensed Consolidated Financial Statements are consistent with those described in the June 30, 2008 Consolidated Financial Statements. However, for interim financial statements, inventories are calculated using a gross profit percentage. In addition, the Condensed Consolidated Balance Sheet was derived from the audited financial statements but does not include all disclosures required by Generally Accepted Accounting Principles ("GAAP").

The consolidated financial statements include the accounts of Napco Security Systems, Inc. and all of its wholly-owned subsidiaries, including those of Marks USA, a newly formed subsidiary which acquired substantially all of the assets and certain liabilities of G. Marks Hardware, Inc. ("Marks") acquired on August 18, 2008 . The Company has also consolidated a 51%-owned joint venture. The 49% interest, held by a third party, is reflected as minority interest. All inter-company balances and transactions have been eliminated in consolidation.

The Company has made a number of estimates and assumptions relating to the assets and liabilities, the disclosure of contingent assets and liabilities and the reporting of revenues and expenses to prepare these financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ from those estimates.

Seasonality

The Company's fiscal year begins on July 1 and ends on June 30. Historically, the end users of Napco's products want to install its products prior to the summer; therefore sales of its products 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. To a lesser degree, sales in Europe are also adversely impacted in the Company's first fiscal quarter because of European vacation patterns, i.e., many distributors and installers are closed for the month of August. In addition, demand is affected by the housing and construction markets.

Advertising and Promotional Costs

Advertising and promotional costs are included in "Selling, General and Administrative" expenses in the condensed consolidated statements of income and are expensed as incurred. Advertising expense for the three months ended September 30, 2008 and 2007 was $301,000 and $522,000, respectively.

Research and Development Costs

Research and development costs are included in "Cost of Sales" in the condensed consolidated statements of income and are expensed as incurred. Research and development expense for the three months ended September 30, 2008 and 2007 was $1,312,000 and $1,332,000, respectively.

Business Concentration and Credit Risk

An entity is more vulnerable to concentrations of credit risk if it is exposed to risk of loss greater than it would have had if it mitigated its risk through diversification of customers. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance.

The Company had two customers with accounts receivable balances that aggregated 30% and 34% of the Company's accounts receivable at September 30, 2008 and June 30, 2008, respectively. Sales to neither of these customers exceeded 10% of net sales in any of the past three fiscal years.

Allowance for Doubtful Accounts

In the ordinary course of business, the Company has established a reserve for doubtful accounts and customer deductions in the amount of $408,000 and $405,000 as of September 30, 2008 and June 30, 2008, respectively. The Company's 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 trends.

Stock Options

During the three months ended September 30, 2008 the Company granted 100,000 stock options under its 2002 Employee Incentive Stock Option Plan. These grants have an exercise price of $4.25, a fair value of approximately $198,000 and vest over a two-year period from the date of grant. There were no options granted under its 2000 Non-employee Incentive Stock Option Plan. There were 3,240 options exercised, with proceeds of approximately $6,000, under the 2002 Employee Incentive Stock Option Plan and no exercises under the 2000 Non-employee Incentive Stock Option Plan during the three months ended September 30, 2008.

Intangible Assets

Under the Statement of Accounting Standards ("SFAS") No.142, "Goodwill and Other Intangible Assets", all goodwill and certain intangible assets determined to have indefinite lives will not be amortized but will be tested for impairment at least annually. Intangible assets other than goodwill will be amortized over their useful lives and reviewed for impairment at least annually or more often whenever there is an indication that the carrying amount may not be recovered.

The Company's acquisition of substantially all of the assets and certain liabilities of Marks included intangible assets with a fair value of $16,100,000 on the date of acquisition. In accordance with the requirements of SFAS No. 141, "Business Combinations", the Company recorded the estimated value of $9,800,000 related to the customer relationships, $340,000 related to a non-compete agreement and $6,300,000 related to the Marks trade name within intangible assets. The remaining excess of the purchase price of $897,000 was assigned to Goodwill. In accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets", the intangible assets will be amortized over their estimated useful lives of twenty years (customer relationships) and seven years (non-compete agreement). The Marks USA trade name was deemed to have an indefinite life. The goodwill recorded as a result of the acquisition is deductible for Federal and New York State income tax purposes over a period of 15 years.

Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board ("FASB") issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company's adoption of SFAS No. 161 is not expected to have a material effect on its condensed consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13." This FSP amends SFAS No. 157 to exclude certain leasing transactions accounted for under previously existing accounting guidance. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination, regardless of whether those assets and liabilities are related to leases.

In February 2008, the FASB issued FSP No. FAS 157-2, "Effective Date of FASB Statement No. 157". This FSP delays the effective date of SFAS No. 157, "Fair Value Measurements", for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP.

In October 2008, the FASB issued FSP No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP 157-3"). FSP 157-3 classified the application of SFAS No. 157 in an inactive market. It demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued. The implementation of FSP 157-3 did not have a material effect on the Company's condensed consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP SFAS 142-3"). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, Business Combinations, and other U.S. GAAP principles. FSP SFAS 142-3 is effective for fiscal years beginning after December 31, 2008. The adoption of FSP SFAS 142-3 is effective July 1, 2009 and is not expected to have a material effect on the Company's condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) replaces SFAS No. 141, "Business Combinations," however, it retains the fundamental requirements of the former Statement that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business. SFAS No. 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. Among other requirements, SFAS No. 141(R) requires the acquiring entity in a business combination to recognize the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree at their acquisition-date fair values, with limited exceptions; acquisition-related costs generally will be expensed as incurred. SFAS No. 141(R) requires certain financial statement disclosures to enable users to evaluate and understand the nature and financial effects of the business combination. SFAS No. 141(R) must be applied prospectively to business combinations that are consummated beginning in the Company's fiscal 2010. The Company's adoption of SFAS No. 141(R) is not expected to have a material effect on its condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51" ("SFAS No. 160") to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Among other requirements, SFAS No. 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is to be reported as a separate component of equity in the consolidated financial statements. SFAS No. 160 also requires consolidated net income to include the amounts attributable to both the parent and the non-controlling interest and to disclose those amounts on the face of the consolidated statement of income. SFAS No. 160 must be applied prospectively for fiscal years, and interim periods within those fiscal years, beginning in the Company's fiscal 2010, except for the presentation and disclosure requirements, which will be applied retrospectively for all periods. The Company's adoption of SFAS No. 160 is not expected to have a material effect on its condensed consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Most of the provisions of this Statement apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", applies to all entities with available-for-sale and trading securities. Some requirements apply differently to entities that do not report net income. SFAS No. 159 became effective for the Company in its fiscal year ending June 30, 2009. The Company's adoption of SFAS No. 159 did not have a material effect on its condensed consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS No. 157 provides guidance for using fair value to measure assets and liabilities. In addition, this statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Where applicable, this statement simplifies and codifies related guidance within generally accepted accounting principles. SFAS No. 157 became effective for the Company in its fiscal year ending June 30, 2009. The Company's adoption of SFAS No. 159 did not have a material effect on its condensed consolidated financial statements.

Reclassification.

Certain expenses in Cost of sales for fiscal 2008 have been reclassified to Selling, general and administrative expenses to conform with the current years presentation.

2.) Stock-based Compensation

The Company has established two share incentive programs as discussed in more detail in the Consolidated Financial Statements and related notes contained in the Company's annual report on Form 10-K for the year ended June 30, 2008. The Company accounts for its stock options and share units granted in accordance with SFAS No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)") which requires that all stock-based compensation must be recognized as an expense in the financial statements and that cost be measured at the fair market value of the award. SFAS No. 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows. Stock-based compensation costs of $118,000 and $59,000 were recognized in three months ended September 30, 2008 and 2007, respectively. Unearned stock-based compensation cost was $532,000 as of September 30, 2008.

The fair values of stock options granted during the three months ended September 30, 2008 were estimated on the date of grant using the Black-Scholes option pricing model that used the following weighted average assumptions:

Expected life in years	5
Risk-free interest rates	3.07%
Volatility	49.86%
Dividend yield	0%

3.) Inventories

For interim financial statements, inventories are calculated using a gross profit percentage. The Company regularly reviews parts and finished goods inventories on hand and, when necessary, records a reserve for excess or obsolete inventories. As of September 30, 2008 and June 30, 2008, the balance in this reserve amounted to $1,432,000 and $1,200,000, respectively. The Company also regularly reviews the period over which its inventories will be converted to sales. Any inventories expected to convert to sales beyond 12 months from the balance sheet date are classified as non-current.

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

	September 30, 2008	June 30, 2008
Component parts	$ 19,230	$ 12,924
Work-in-process	4,804	4,114
Finished product	11,296	10,234
	$ 35,330	$ 27,272
Classification of inventories, net of reserves:		
Current	$ 26,890	$ 19,548
Non-current	8,440	7,724
	$ 35,330	$ 27,272

4.) Earnings Per Common Share

The Company follows the provisions of SFAS No. 128, "Earnings Per Share". In accordance with SFAS No. 128, earnings per common share amounts ("Basic EPS") were computed by dividing earnings by the weighted average number of common shares outstanding for the period. Earnings per common share amounts, assuming dilution ("Diluted EPS"), were computed by reflecting the potential dilution from the exercise of stock options. SFAS No. 128

requires the presentation of both Basic EPS and Diluted EPS on the face of the condensed consolidated statements of income.

A reconciliation between the numerators and denominators of the Basic and Diluted EPS computations for earnings is as follows (in thousands except per share data):

	Three months ended September 30, 2008		
	Net Income (numerator)	Shares (denominator)	Per Share Amounts
Basic EPS			
Net income, as reported	$ 322	19,095	$ 0.02
Effect of dilutive securities			
Employee Stock Options	$ -	384	$ -
Diluted EPS			
Net income, as reported and assumed option exercises	$ 322	19,479	$ 0.02

9

397,000 options to purchase shares of common stock in the three months ended September 30, 2008 were excluded in the computation of Diluted EPS because the exercise prices were in excess of the average market price for this period and their inclusion would be anti-dilutive.

	Three months ended September 30, 2007		
	Net Income (numerator)	Shares (denominator)	Per Share Amounts
Basic EPS			
Net income, as reported	$ 374	19,568	$ 0.02
Effect of dilutive securities			
Employee Stock Options	$ -	589	$ -
Diluted EPS			
Net income, as reported and assumed option exercises	$ 374	20,157	$ 0.02

62,000 options to purchase shares of common stock in the three months ended September 30, 2007 were excluded in the computation of Diluted EPS because the exercise prices were in excess of the average market price for this period and their inclusion would be anti-dilutive.

Option activity during the three months ended September 30, 2008 is summarized as follows:

	Options	Weighted Average Exercise Price
Outstanding at July 1, 2008	1,323,480	$ 2.89

Granted	100,000	4.25
Cancelled	--	--
Exercised	(3,240)	(1.90)
Outstanding at September 30, 2008	1,420,240	2.99
Exercisable at September 30, 2008	1,199,281	

5.) Acquisition of Business

On August 18, 2008, the Company acquired substantially all of the assets and business of G. Marks Hardware, Inc. ("Marks") for $25.2 million, the repayment of $1 million of bank debt and the assumption of current liabilities as described more fully in the Asset Purchase Agreement. As such, the operations of Marks have been included in the Company's Statement of Income for the period August 18, 2008 to September 30, 2008. The Marks business involves the manufacturing and distribution of door-locking devices. The Company completed this acquisition at a price in excess of the value of the net identifiable assets because it believes that the combination of the two companies offers the potential for manufacturing and operational synergies as the Company combines the Marks operations and production into its own door-locking operations and production structure. The Company funded the acquisition with a term loan from its lenders as described in Note 6.

The acquisition described above was accounted for as a purchase and was valued based on management's estimate of the fair value of the assets acquired and liabilities assumed. The estimates of fair value are preliminary and subject to adjustment for a period of up to one year from the date of acquisition. Based on the Company's evaluation, the allocation of the purchase price for the acquisition was as follows (in thousands):

Assets Acquired:	
Cash	$ 520
Accounts receivable	1,836
Inventory	6,740
Prepaid expenses and other current assets	112
Property and equipment	801
Other assets	340
Goodwill	897
Intangible assets	16,100
	27,346
Less: Liabilities Assumed:	
Line of credit borrowings outstanding	1,000
Accounts payable	637
Accrued expenses	339
	1,976
Total consideration (including acquisition Costs of $197)	$ 25,370

In accordance with the requirements of SFAS No. 141, "Business Combinations", the Company recorded the estimated value of $9,800,000 related to the customer relationships, $340,000 related to a non-compete agreement and $6,300,000 related to the Marks trade name within intangible assets and the excess of the purchase price over the fair value of the acquired assets of $897,000 was assigned to Goodwill. In accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets", the intangible assets will be amortized over their estimated useful lives of twenty years (customer relationships) and seven years (non-compete agreement). The weighted average amortization period of these assets is 19.6 years. The Marks trade name was deemed to have an indefinite life. The goodwill recorded as a result of the acquisition is deductible for Federal and New York State income tax purposes over a period of 15 years.

Unaudited pro-forma consolidated financial information is presented below as if the acquisition had occurred as of the first day of the earliest period presented. Results have been adjusted to account for: (1) the initial $25,000,000 cash borrowing and related interest expense under the term loan, (2) cash used to repay $1,000,000 in assumed bank debt at closing of the purchase transaction, (3) deferred financing costs and related amortization associated with the term loan, (4) additional salary and employee stock option expense for employees not previously included in salary expense, and (5) amortization expense of acquired intangible assets. The pro-forma information presented below does not purport to present what actual results would have been if the acquisition had occurred at the beginning of such periods, nor does the information project results for any future period. The unaudited pro-forma consolidated financial information should be read in conjunction with the historical financial information included in other reports and documents filed with the United Stated Securities and Exchange Commission.

The unaudited pro-forma consolidated financial information for the three months ended September 30, 2008 and 2007 is as follows:

	Three months ended September 30, 2008	2007
	(in thousands, except per share data)	
Pro-forma:		
Net sales	$ 20,002	$ 20,277
Net income	$ 416	$ 566
Net income (loss) per share:		
Basic	$ 0.02	$ 0.03
Diluted	$ 0.02	$ 0.03
Weighted average number of shares:		
Basic	19,095,361	19,567,689
Diluted	19,479,269	20,157,055

6.) Long Term Debt

On August 18, 2008, the Company and its banks amended and restated the existing $25,000,000 revolving credit agreement. The amended facility is

$50,000,000 and provides for a $25,000,000 revolving credit line as well as a $25,000,000 term portion of which the entire $25,000,000 was utilized to finance the asset purchase agreement as described in Note 5. The amended revolving credit agreement and term loan is secured by all the accounts receivable, inventory, the Company's headquarters in Amityville, New York and certain other assets of Napco Security Systems, Inc. and the common stock of three of the Company's subsidiaries. The agreements bear interest at either the Prime Rate or an alternate rate based on LIBOR as described in the agreement. The August amendment extended the revolving credit agreement to August 2012. Any outstanding borrowings are to be repaid or refinanced on or before that time. As of September 30, 2008 there was $14,100,000 outstanding under the revolving credit facility with an interest rate of 4.6% and $25,000,000 outstanding under the term loan with an interest rate of 5.0%. The term loan is to be repaid in 19 quarterly installments of $893,000 each commencing in December 2008 and a final payment of $8,033,000 due in August 2013. The agreements contain various restrictions and covenants including, among others, restrictions on payment of dividends, restrictions on borrowings and compliance with certain financial ratios, as defined in the agreement. As of September 30, 2008 the Company was in violation of the certain financial covenants for which it has received the appropriate waiver from its banks. In addition, the Company's revolving credit line was amended to $20,000,000 from $25,000,000.

7.) Geographical Data

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

The Company observes the provisions of SFAS No. 131. The following represents selected consolidated geographical data for the three months ended September 30, 2008 and 2007 (in thousands):

	Three Months ended September 30, 2008	Three Months ended September 30, 2007
Sales to external customers(1):		
Domestic	$ 15,427	$ 11,573
Foreign	2,056	2,303
Total Net Sales	$ 17,483	$ 13,876

	As of September 30, 2008	As of June 30, 2008
Identifiable assets:		

United States	$ 77,792	$ 50,056
Dominican Republic (2)	21,237	19,841
Other foreign countries	6,439	6,826
Total Identifiable Assets	$ 105,468	$ 76,723

(1) All of the Company's sales occur in the United States and are shipped primarily from the Company's facilities in the United States and United Kingdom. There were no sales into any one foreign country in excess of 10% of Net Sales.
(2) Consists primarily of inventories ($16,291,000 and $14,754,000) and fixed assets ($4,873,000 and $4,970,000) located at the Company's principal manufacturing facility in the Dominican Republic as of September 30, 2008 and June 30, 2008, respectively.

8.) Commitments and Contingencies

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. In August 2008, the Company entered into a lease for the building where Marks has maintained its operations. The lease provides for an annual base rent of $288,750 plus maintenance and real estate taxes, expires in August 2009 and provides for two annual extensions thereafter at similar terms and conditions. The Company intends to move the Marks operations into its facilities after constructing extensions of approximately 35,000 square feet. To date, the Company does not have estimates for the cost of this move or the related construction. The Marks business involves the manufacturing and distribution of door-locking devices.

9.) Income Taxes

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

The Company does not expect that our unrecognized tax benefits will significantly change within the next twelve months. We file a consolidated U.S. income tax return and tax returns in certain state and local and foreign jurisdictions. There are no current tax examinations in progress. Accordingly, as of September 30, 2008, we remain subject to examination in all tax jurisdictions for all relevant jurisdictional statutes.

The Company adopted the provisions of FIN 48 as of July 1, 2007. The Company has identified its U.S. Federal income tax return and its State return in New York as its major tax jurisdictions. During the three months ending September 30, 2008 the Company increased its reserve for uncertain income tax positions by $5,000. As a result, as of September 30, 2008 the Company has a long-term accrued income tax liability of $ 299,000.

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

Napco Security Systems, Inc.
Management's Discussion and Analysis of Financial Condition and Results of Operations

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

Overview

The Company is a diversified manufacturer of security products, encompassing intrusion and fire alarms, building access control systems and electronic locking devices. These products are used for commercial, residential, institutional, industrial and governmental applications, and are sold worldwide principally to independent distributors, dealers and installers of security equipment. International sales accounted for approximately 12% and 17% of our revenues for the three months ended September 30, 2008 and 2007, respectively.

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

On August 18, 2008, the Company acquired substantially all of the assets and business of G. Marks Hardware, Inc. ("Marks") for $25.2 million, the repayment of $1 million of bank debt and the assumption of certain current liabilities. The Company also entered into a lease for the building where Marks has maintained its operations. The lease provides for an annual base rent of $288,750 plus maintenance and real estate taxes, expires in August 2009 and provides for two annual extensions thereafter. The Company intends to move the

Marks operations into its facilities after constructing extensions of approximately 35,000 square feet. To date, the Company does not have estimates for the cost of this move or the related construction. The Marks business involves the manufacturing and distribution of door-locking devices.

The security products market is characterized by constant incremental innovation in product design and manufacturing technologies. Generally, the Company devotes 7-8% of revenues to research and development (R&D) on an annual basis. Products resulting from our R&D investments in fiscal 2008 did not contribute materially to revenue during this fiscal year, but should benefit the Company over future years. In general, the new products introduced by the Company are initially shipped in limited quantities, and increase over time. Prices and manufacturing costs tend to decline over time as products and technologies mature.

Economic and Other Factors

The post-September 11 era has generally been characterized by increased demand for electronic security products and services. The Company believes the security equipment market is likely to continue to exhibit growth, particularly in industrial sectors, due to ongoing concerns over the adequacy of security safeguards. The Company's business is also affected by the housing markets.

Seasonality

The Company's fiscal year begins on July 1 and ends on June 30. Historically, the end users of Napco's products want to install its products prior to the summer; therefore sales of its products 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. To a lesser degree, sales in Europe are also adversely impacted in the Company's first fiscal quarter because of European vacation patterns, i.e., many distributors and installers are closed for the month of August. In addition, demand is affected by the housing and construction markets. Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be subjective and complex, and consequently actual results could differ from those estimates. Our most critical accounting policies relate to revenue recognition; concentration of credit risk; inventories; intangible assets; goodwill; and income taxes.

Revenue Recognition

Revenues from merchandise sales are recorded at the time the product is shipped or delivered to the customer pursuant to the terms of sale. We report our sales levels on a net sales basis, which is computed by deducting from gross sales the amount of actual returns received and an amount established for anticipated returns and other allowances.

Our sales return accrual is a subjective critical estimate that has a direct impact on reported net sales and income. This accrual is calculated based on a history of gross sales and actual sales returns, as well as management's estimate of anticipated returns and allowances. As a percentage of gross sales, sales returns, rebates and allowances were 7% and 4% for the three months ended

September 30, 2008 and 2007, respectively.

Concentration of Credit Risk

An entity is more vulnerable to concentrations of credit risk if it is exposed to risk of loss greater than it would have had if it mitigated its risk through diversification of customers. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance.

The Company had two customers with accounts receivable balances that aggregated 30% and 34% of the Company's accounts receivable at September 30, 2008 and June 30, 2008, respectively. Sales to neither of these customers exceeded 10% of net sales in any of the past three fiscal years.

In the ordinary course of business, we have established a reserve for doubtful accounts and customer deductions in the amount of $408,000 and $405,000 as of September 30, 2008 and June 30, 2008, 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 trends.

Inventories

Inventories are valued at the lower of cost or fair market value, with cost being determined on the first-in, first-out (FIFO) method. The reported net value of inventory includes finished saleable products, work-in-process and raw materials that will be sold or used in future periods. Inventory costs include raw materials, direct labor and overhead. The Company's overhead expenses are applied based, in part, upon estimates of the proportion of those expenses that are related to procuring and storing raw materials as compared to the manufacture and assembly of finished products. These proportions, the method of their application, and the resulting overhead included in ending inventory, are based in part on subjective estimates and approximations and actual results could differ from those estimates.

In addition, the Company records an inventory obsolescence reserve, which represents the difference between the cost of the inventory and its estimated market value, based on various product sales projections. The balance in this reserve was $1,432,000 and $1,200,000 as of September 30, 2008 and June 30, 2008, respectively. 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.

Goodwill and Other Intangible Assets

The Company accounts for Goodwill in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. These statements established accounting and reporting standards for acquired goodwill and other intangible assets. Specifically, the standards address how acquired intangible assets should be accounted for both at the time of acquisition and after they have been recognized in the financial statements. In accordance with SFAS No. 142, intangible assets, including purchased goodwill, must be evaluated for impairment. Those intangible assets that are classified as goodwill or as other intangibles with indefinite lives are not amortized.

Impairment testing is performed in two steps: (i) the Company determines impairment by comparing the fair value of a reporting unit with its carrying value, and (ii) if there is an impairment, the Company measures the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. The Company has performed its annual impairment evaluation required by this standard and determined that its goodwill is not impaired.

The Company's acquisition of substantially all of the assets and certain liabilities of Marks included intangible assets with a fair value of $16,100,000 on the date of acquisition. In accordance with the requirements of SFAS No. 141, "Business Combinations", the Company recorded the estimated value of $9,800,000 related to the customer relationships, $340,000 related to a non-compete agreement and $6,300,000 related to the Marks trade name within intangible assets and Goodwill of $897,000 subject to further adjustment. In accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets", the intangible assets will be amortized over their estimated useful lives of twenty years (customer relationships) and seven years (non-compete agreement). The Marks USA trade name was deemed to have an indefinite life. The goodwill recorded as a result of the acquisition is deductible for Federal and New York State income tax purposes over a period of 15 years.

15

Income Taxes

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

We do not expect that our unrecognized tax benefits will significantly change within the next twelve months. We file a consolidated U.S. income tax return and tax returns in certain state and local and foreign jurisdictions. There are no current tax examinations in progress. Accordingly, as of September 30, 2008, we remain subject to examination in all tax jurisdictions for all relevant jurisdictional statutes.

Results of Operations

	Three months ended September 30, (dollars in thousands)		
	2008	2007	% Increase/

			(decrease)
Net sales	$ 17,483	$ 13,876	26.0%
Gross profit	5,606	5,224	7.3%
Gross profit as a % of net sales	32.1%	37.6%	(5.5)%
Selling, general and administrative	4,776	4,421	8.0%
Selling, general and administrative as a percentage of net sales	27.3%	31.9%	(4.6)%
Operating income	830	803	3.4%
Interest expense, net	315	195	61.5%
Other expense	79	7	1,028.6%
Minority interest in net loss of subsidiary, net	42	38	10.5%
Provision for income taxes	156	265	(41.1)%
Net income	322	374	(13.9)%

Sales for the three months ended September 30, 2008 increased by approximately 26% to $17,483,000 as compared to $13,876,000 for the same period a year ago. The increase in sales for the three months ended September 30, 2008 was primarily the result of the six weeks of net sales added from the Marks acquisition as well as a 2% increase in the Company's other product lines. This 2% increase was primarily due to increases in the Company's door locking and access control products as partially offset by decreased sales of intrusion products.

The Company's gross profit for the three months ended September 30, 2008 increased to $5,606,000 or 32.1% of sales as compared to $5,224,000 or 37.6% of sales for the same period a year ago. The increase in Gross profit in dollars for the three months was primarily due to the addition of the Gross profit of Marks ($1,057,000) resulting from the acquisition on August 18, 2008 as partially offset by a decrease in Gross profit in the Company's other products.

Selling, general and administrative expenses for the three months ended September 30, 2008 increased by $355,000 to $4,776,000, or 27.3% of sales, as compared to $4,421,000, or 31.9% of sales a year ago. The increase in dollars for the three months ended September 30, 2008 was due primarily to the additional expenses relating to Marks ($454,000) as partially offset by a decrease in tradeshow expenses due to a major tradeshow occurring in October 2008 ($199,000). This tradeshow occurred in September 2007 and was therefore included in Selling, general and administrative expense for the first quarter of fiscal 2008. The decrease in Selling, general and administrative expenses as a percentage of net sales was due to the timing of this tradeshow as well as Marks having lower Selling, general and administrative expenses as a percentage of sales as compared to rest of the Company.

16

Interest expense, net for the three months ended September 30, 2008 increased by $120,000 to $315,000 as compared to $195,000 for the same period a year ago. The increase in interest expense for the three months resulted primarily from the increase in the Company's average outstanding debt, which was due to the $25,000,000 of bank financing utilized for the Marks acquisition.

The Company's provision for income taxes for the three months ended September 30, 2008 decreased by $109,000 to $156,000 as compared to $265,000 for the same period a year ago. The decrease in provision for income taxes for the three months resulted primarily from the Company's corporate restructuring during the quarter ended December 31, 2007. As a result, the Company's effective rate for

for income tax was 32.6% for the three months ended September 30, 2008, which reflected the effect of this restructuring and 41.5% for the three months ended September 30, 2007, which did not.

Net income decreased by $52,000 to $322,000 or $0.02 per diluted share for the three months ended September 30, 2008 as compared to $374,000 or $0.02 per diluted share for the same period a year ago. The decrease for the three months ended September 30, 2008 was primarily due to the decrease in gross profit as a percentage of sales as discussed above as partially offset by the additional net income generated from the Marks acquisition ($240) as well as the lower effective tax rate relating to the Company's corporate restructuring described above.

Liquidity and Capital Resources

During the three months ended September 30, 2008 the Company utilized all of its cash from operations and additional borrowings to complete the Marks acquisition ($26,173,000, which includes payment of the $1,000,000 of assumed debt), purchase inventory ($1,317,000) and property, plant and equipment ($115,000). The Company's management believes that current working capital, 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.

Accounts Receivable at September 30, 2008 increased $656,000 to $26,479,000 as compared to $25,823,000 at June 30, 2008. This increase is primarily the result of Marks acquisition ($2,540,000) as partially offset by the lower sales volume during the quarter ended September 30, 2008 as compared to the quarter ended June 30, 2008, which is typically the Company's highest.

Inventories at September 30, 2008 increased by $8,058,000 to $35,330,000 as compared to $27,272,000 at June 30, 2008. This increase was primarily the result of the Marks acquisition ($5,774,000) as well as the Company level-loading its production schedule in anticipation of its historical sales cycle where a larger portion of the Company's sales occur in the latter fiscal quarters as compared to the earlier quarters. The Company initiated several steps in order to reduce inventory levels in fiscal 2008 and expects to continue them in fiscal 2009.

On August 18, 2008, the Company and its banks amended and restated the existing $25,000,000 revolving credit agreement. The amended facility is $50,000,000 and provides for a $25,000,000 revolving credit line as well as a $25,000,000 term portion of which the entire $25,000,000 was utilized to finance the asset purchase agreement as described in Note 12. The amended revolving credit agreement and term loan is secured by all the accounts receivable, inventory, the Company's headquarters in Amityville, New York and certain other assets of Napco Security Systems, Inc. and the common stock of three of the Company's subsidiaries. The agreements bear interest at either the Prime Rate or an alternate rate based on LIBOR as described in the agreement. The August amendment extended the revolving credit agreement to August 2012. Any outstanding borrowings are to be repaid or refinanced on or before that time. As of September 30, 2008 there was $14,100,000 outstanding under the revolving credit facility with an interest rate of 4.6% and $25,000,000 outstanding under the term loan with an interest rate of 5.0%. The term loan is to be repaid in 19 quarterly installments of $893,000 each commencing in December 2008 and a final payment of $8,033,000 due in August 2013. The agreements contain various restrictions and covenants including, among others, restrictions on payment of dividends, restrictions on borrowings and compliance with certain financial ratios, as defined in the agreement. As of September 30, 2008 the Company was in violation of the covenant relating to the ratio of Funded Debt to EBITDA for which it has received the appropriate waiver from its banks. In addition, the Company's revolving credit line was amended to $20,000,000 from $25,000,000 in November 2008.

As of September 30, 2008 the Company had no material commitments for capital expenditures or inventory purchases other than purchase orders issued in the normal course of business.

ITEM 3: Quantitative and Qualitative Disclosures About Market Risk

The Company's principal financial instrument is long-term debt (consisting of a revolving credit facility and term loan) that provides for interest at the prime rate or an alternate rate based on LIBOR as described in the agreement. The Company is affected by market risk exposure primarily through the effect of changes in interest rates on amounts payable by the Company under this credit facility. At September 30, 2008, an aggregate principal amount of approximately $39,100,000 was outstanding under the Company's credit facility with a weighted average interest rate of approximately 4.9%. If principal amounts outstanding under the Company's credit facility remained at this level for an entire year and the prime rate increased or decreased, respectively, by 1% the Company would pay or save, respectively, an additional $391,000 in interest that year.

A significant number of foreign sales transactions by the Company are denominated in U.S. dollars. As such, the Company has shifted foreign currency exposure onto many of 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. In addition, the Company transacts certain sales in Europe in British Pounds Sterling, therefore exposing itself to a certain amount of foreign currency risk. Management believes that the amount of this exposure is immaterial. We are also exposed to foreign currency risk relative to expenses incurred in Dominican Pesos ("RD$"), the local currency of the Company's production facility in the Dominican Republic. The result of a 10% strengthening in the U.S. dollar to our RD$ expenses would result in an annual decrease in income from operations of approximately $314,000.

ITEM 4: Controls and Procedures

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

At the conclusion of the period ended September 30, 2008, 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 in alerting them in a timely manner to information relating to the Company required to be disclosed in this report except as follows:

Management's review over it's internal controls at the conclusion of fiscal 2008 identified conditions which they deemed to be material weaknesses, (as defined by standards established by the SEC and the Public Company Accounting Oversight Board) with respect to certain of our inventory valuation methods both at year-end and relating to the Gross profit method used to calculate Gross profit and Inventories for interim reporting purposes. Management has informed it's independent auditors and the Audit Committee that it has corrected its method of calculating its gross profit and inventory for interim reporting by including a more comprehensive review of changes within the business and accounting for those changes where appropriate. The Company has also initiated a review of the ways in which we can more accurately cost its inventory for year-end reporting and will continue to monitor the effectiveness of these actions and will make any other changes or take such additional actions as management determines to be appropriate. Management expects to complete the actions relating to the year-end inventory valuation during fiscal 2009.

During the first quarter of fiscal 2009, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting except for the procedure described above which has corrected the weakness relating to interim Gross profit and inventory calculations.

18

PART II: OTHER INFORMATION

Item 1A. Risk Factors

Information regarding the Company's Risk Factors are set forth in the Company's Annual Report on Form 10-K for the year ended June 30, 2008. There have been no material changes in the risk factors previously disclosed in the Company's Form 10-K for the year ended June 30, 2008 during the three months ended September 30, 2008 except as follows:

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. If these conditions deteriorate, our business, results of operations or financial condition could be materially adversely affected. In addition, since October 2008, the U.S. and international financial markets have taken a significant loss and continue to be very volatile. In the event that the downturn in the U.S. or international financial markets is prolonged, our revenue levels could be materially adversely affected. If the current worldwide economic downturn continues, many of our current or potential future customers may experience serious cash flow problems and as a result may, modify, delay or cancel purchases of our products. Additionally, customers may not be able to pay, or may delay payment of, accounts receivable that are owed to us. Furthermore, the current downturn and market instability makes it difficult for us to forecast our revenues.

Our Business Could Be Materially Adversely Affected by the Integration of Marks into Our Existing Operations

Our business is dependent on the orderly, effective integration of the acquired Marks business, technologies, product lines and employees into our organization. If this integration is unsuccessful, our business may be materially adversely affected.

Item 6. Exhibits

31.1	Certification Pursuant to Rule 13a-14(a)/15d-14(a) of Richard L. Soloway, Chairman of the Board and President
31.2	Certification Pursuant to Rule 13a-14(a)/15d-14(a) of Kevin S. Buchel, Senior Vice President of Operations and Finance
32.1	Section 1350 Certifications

SIGNATURES

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

November 17, 2008

NAPCO SECURITY SYSTEMS, INC
(Registrant)

By: /S/ RICHARD L. SOLOWAY

Richard L. Soloway
Chairman of the Board of Directors, President and Secretary
(Chief Executive Officer)

By: /S/ KEVIN S. BUCHEL

Kevin S. Buchel
Senior Vice President of Operations and Finance and Treasurer
(Principal Financial and Accounting Officer)