KOSS CORP
Form 10-Q
October 27, 2017
Index

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 EXCHANGE ACT OF 1934
for the quarterly period ended September 30, 2017

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 0-3295

KOSS CORPORATION
(Exact Name of Registrant as Specified in its Charter)

DELAWARE	39-1168275
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4129 North Port Washington Avenue, Milwaukee, Wisconsin	53212
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (414) 964-5000

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 þ No o

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Index

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

At October 23, 2017, there were 7,382,706 shares outstanding of the registrant’s common stock.

Index

KOSS CORPORATION
FORM 10-Q
September 30, 2017

INDEX

Index

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

KOSS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2017	June 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 241,148	$ 432,283
Accounts receivable, less allowance for doubtful accounts of $53,626 and $55,872, respectively	3,965,214	3,931,541
Inventories	8,371,937	8,345,343
Prepaid expenses and other current assets	332,629	206,395
Income taxes receivable	67,607	32,814
Total current assets	12,978,535	12,948,376
Equipment and leasehold improvements, net	1,433,974	1,408,091
Other assets:		
Deferred income taxes	2,986,999	3,042,257
Cash surrender value of life insurance	6,328,047	6,024,929
Total other assets	9,315,046	9,067,186
Total assets	$ 23,727,555	$ 23,423,653
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,433,391	$ 2,243,110
Accrued liabilities	1,155,487	1,149,395
Total current liabilities	3,588,878	3,392,505
Long-term liabilities:		
Deferred compensation	2,302,824	2,294,418
Other liabilities	163,000	164,418
Total long-term liabilities	2,465,824	2,458,836
Total liabilities	6,054,702	5,851,341
Stockholders' equity:		
Common stock, $0.005 par value, authorized 20,000,000 shares; issued and outstanding 7,382,706 shares	36,914	36,914
Paid in capital	5,503,751	5,420,710
Retained earnings	12,132,188	12,114,688
Total stockholders' equity	17,672,853	17,572,312

Total liabilities and stockholders' equity	$ 23,727,555	$ 23,423,653

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

Index

KOSS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended September 30	
	2017	2016
Net sales	$6,066,630	$6,348,706
Cost of goods sold	4,392,676	4,406,447
Gross profit	1,673,954	1,942,259
Selling, general and administrative expenses	1,647,706	1,775,771
Unauthorized transaction related (recoveries) costs, net	(14,409)	37,500
Interest expense	2,692	846
Income before income tax provision	37,965	128,142
Income tax provision	20,465	43,931
Net income	$17,500	$84,211
Income per common share:		
Basic	$—	$0.01
Diluted	$—	$0.01

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

5

Index

KOSS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended September 30	
	2017	2016
Operating activities:		
Net income	$17,500	$84,211
Adjustments to reconcile net income to net cash provided by operating activities:		
(Recovery of) provision for doubtful accounts	(3,653)	705
Depreciation of equipment and leasehold improvements	131,359	123,837
Stock-based compensation expense	83,041	88,523
Deferred income taxes	55,258	66,990
Change in cash surrender value of life insurance	(172,382)	(181,176)
Change in deferred compensation accrual	45,906	38,777
Deferred compensation paid	(37,500)	(37,500)
Net changes in operating assets and liabilities (see note 10)	(22,686)	(121,922)
Cash provided by operating activities	96,843	62,445
Investing activities:		
Purchase of equipment and leasehold improvements	(157,242)	(206,309)
Life insurance premiums paid	(130,736)	(131,608)
Cash (used in) investing activities	(287,978)	(337,917)
Net (decrease) in cash and cash equivalents	(191,135)	(275,472)
Cash and cash equivalents at beginning of period	432,283	735,393
Cash and cash equivalents at end of period	$241,148	$459,921

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

Index

KOSS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2017
(Unaudited)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated balance sheet of Koss Corporation (the "Company") as of June 30, 2017, has been derived from audited financial statements. The unaudited condensed consolidated financial statements presented herein are based on interim amounts. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made. The operating results for the three months ended September 30, 2017, are not necessarily indicative of the operating results that may be experienced for the full fiscal year ending June 30, 2018.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Registrant’s Annual Report on Form 10-K for the fiscal year ended June 30, 2017.

2. NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09 (Topic 606), Revenue from Contracts with Customers. This new standard supersedes nearly all existing revenue recognition guidance and provides a five-step analysis to determine when and how revenue is recognized. The underlying principle is to recognize revenue when promised goods or services transfer to the customer. The amount of revenue recognized is to reflect the consideration expected to be received for those goods or services. The new standard also requires additional disclosures about the nature, amount, timing and uncertainty of revenues and cash flows arising from customer contracts. The standard permits the use of either the retrospective or cumulative effect transition method. The Company will adopt the new standard in the first quarter of fiscal 2019 and anticipates using the retrospective method.

The Company has begun the assessment of the new standard through review of customer contracts and identification of what performance obligations exist. The preliminary results of our assessment indicate that the Company does not expect a material impact on its consolidated financial statements. The Company is continuing its assessment and may identify other impacts.

3. UNAUTHORIZED TRANSACTION RELATED COSTS AND RECOVERIES

In December 2009, the Company learned of significant unauthorized transactions as previously reported. The Company has ongoing costs and recoveries associated with the unauthorized transactions. For the three months ended September 30, 2016, the costs incurred were for legal fees related to claims initiated against third parties (see Note 13). For the three months ended September 30, 2017 and 2016, the costs and recoveries were as follows:

	Three Months Ended September 30	
	2017	2016

Legal fees incurred	$—	$37,500
Proceeds from asset forfeitures	(14,409)	—
Unauthorized transaction related (recoveries) costs, net	$(14,409)	$37,500

4. INVENTORIES

7

Index

The components of inventories were as follows:

	September 30, 2017	June 30, 2017
Raw materials	$ 2,848,202	$ 2,900,499
Work-in process	2,603	—
Finished goods	7,978,627	7,895,561
	10,829,432	10,796,060
Allowance for obsolete inventory	(2,457,495)	(2,450,717)
Total inventories	$ 8,371,937	$ 8,345,343

5. INCOME TAXES

The Company files income tax returns in the United States federal jurisdiction and in several state jurisdictions. The Company's federal tax returns for tax years beginning July 1, 2013 or later are open. For states in which the Company files state income tax returns, the statute of limitations is generally open for tax years ended June 30, 2013 and forward. For the three months ended September 30, 2017, the Company recorded an income tax expense of $20,465, compared to income tax expense of $43,931 for the three months ended September 30, 2016.

The Company does not believe it has any unrecognized tax benefits as of September 30, 2017 and as of June 30, 2017. Any changes to the Company's unrecognized tax benefits as of September 30, 2017, if recognized, would impact the effective tax rate.

6. CREDIT FACILITY

On May 12, 2010, the Company entered into a secured credit facility ("Credit Agreement") with JPMorgan Chase Bank, N.A. ("Lender"). The Credit Agreement provided for an $8,000,000 revolving secured credit facility with interest rates either ranging from 0.0% to 0.75% over the Lender's most recently publicly announced prime rate or 2.0% to 3.0% over LIBOR, depending on the Company's leverage ratio. The Company pays a fee of 0.3% to 0.45% for unused amounts committed in the credit facility. On May 31, 2016, the Credit Agreement was amended to extend the expiration to July 31, 2018, and to amend certain financial covenants. On June 29, 2017, the Credit Agreement was amended to reduce the facility to $4,000,000 and to eliminate the financial covenants. In addition to the revolving loans, the Credit Agreement also provides that the Company may, from time to time, request the Lender to issue letters of credit for the benefit of the Company of up to a sublimit of $2,000,000 and subject to certain other limitations. The loan may be used only for general corporate purposes of the Company. The Company and the Lender also entered into the Pledge and Security Agreement dated May 12, 2010, under which the Company granted the Lender a security interest in substantially all of the Company's assets in connection with the Company's obligations under the Credit Agreement. The Company is currently in compliance with all covenants related to the Credit Facility. As of September 30, 2017 and June 30, 2017, there were no outstanding borrowings on the facility.

The Company incurs interest expense primarily related to its secured credit facility. Interest expense was $2,692 and $846 for the three months ended September 30, 2017 and 2016, respectively.

Index

7. ACCRUED LIABILITIES

Accrued liabilities were as follows:

	September 30, 2017	June 30, 2017
Cooperative advertising and promotion allowances	$ 336,986	$415,050
Product warranty obligations	214,230	220,541
Customer credit balances	183,941	21,175
Current deferred compensation	150,000	150,000
Accrued returns	46,364	53,915
Interest	1,932	—
Employee benefits	50,442	54,074
Legal and professional fees	40,000	86,500
Management bonuses and profit-sharing	3,527	—
Sales commissions and bonuses	53,433	83,654
Other	74,632	64,486
Total accrued liabilities	$ 1,155,487	$1,149,395

8. INCOME PER COMMON AND COMMON STOCK EQUIVALENT SHARE

Basic income per share is computed based on the weighted-average number of common shares outstanding. The weighted-average number of common shares outstanding was 7,382,706 for the periods ended September 30, 2017 and 2016. When dilutive, stock options are included in income per share as share equivalents using the treasury stock method. For the periods ended September 30, 2017 and 2016, there were no common stock equivalents related to stock option grants that were included in the computation of the weighted-average number of shares outstanding for diluted income per share. Shares issuable upon the exercise of outstanding options of 2,395,000 and 2,365,000 were excluded from the diluted weighted-average common shares outstanding for the periods ended September 30, 2017 and 2016, respectively, as they would be anti-dilutive.

9. STOCK OPTIONS

The Company recognizes stock-based compensation expense for options granted under both the 1990 Flexible Incentive Plan and the 2012 Omnibus Incentive Plan. The stock-based compensation relates to stock options granted to employees, non-employee directors and non-employee consultants. In the three months ended September 30, 2017, options to purchase 490,000 shares were granted under the 2012 Omnibus Incentive Plan at a weighted average exercise price of $1.89. In the three months ended September 30, 2016, options to purchase 485,000 shares were granted under the 2012 Omnibus Incentive Plan at a weighted average exercise price of $2.33. Stock-based compensation expense during the three months ended September 30, 2017 was