

September 14, 2011

Market Outperform / Speculative Risk

Cost-controls boost earnings, betting on new products

#### MARKET DATA Intraday - 9/14/2011

Price	2.78
Exchange	NASDAQ
Target Price	\$3.10
52 Wk Hi - Low	3.02 - 1.55
EV(MM)	73.8
Market Cap(MM)	53.1
Shares Out (MM)	19.1
Public Mkt Float (MM)	12.1
Avg. Daily Vol	16,728

#### BALANCE SHEET METRICS

Cash (MM)	3.1
LTD (MM)	\$0.0
Total Debt/Total Equity	67.11%
Debt/Capital	NA
Price/Book Value	1.5x
Book Value/Share	1.86

#### EARNINGS DATA (\$)

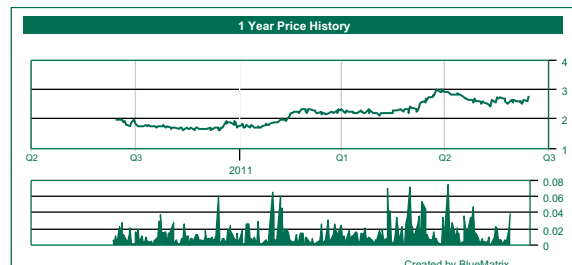
FY - Jun	2010A	2011A	2012E
Q1 (Sep)	(0.10)	(0.06)	--
Q2 (Dec)	(0.05)	0.01	--
Q3 (Mar)	(0.10)	0.04	--
Q4 (Jun)	(0.10)	0.07	--
Full Year EPS	(0.34)	0.06	0.15

#### VALUATION METRICS

Price/Earnings	NM	46.3x	18.5x
Y/Y EPS Growth	NM	NM	150.0%

#### INDICES

DJIA	11,141.3
SP-500	1,177.9
NASDAQ	2,238.2
Russell 2000	696.4



**4QFY11 results:** During the fourth quarter of fiscal 2011, Napco (NSSC, Market Outperform) revenues were up 0.3% Y/Y and 17% Q/Q to \$20.7 million, below our estimates of \$21.8 million. The June quarter is a seasonally strong quarter for the company as compared to the previous quarters. Revenue growth was strong in intrusion and door locking products. Net income came in at \$1.4 million (EPS \$0.07), ahead of our estimates of \$0.9 million (EPS \$0.05), driven by margin expansions and significant reduction in SGA expenses. On an annual basis, revenues grew 5% to \$71.4 million and net income was at \$1.12 million as compared to loss of \$6.5 million. Cash & cash equivalents declined to \$3.07 million as compared to \$3.6 million in the last quarter.

#### Margin expansion

For the fourth consecutive quarter, gross margins expanded due to favorable sales mix. GM improved by 300 basis points Q/Q to 31.3%. SGA expenses declined 17% Q/Q to \$4.0 million, benefiting from Marks consolidation. Consequently, operating margins more than doubled to 9.9% compared to 3.7% in the last quarter.

#### New product launches to drive future growth

Management is very optimistic on its next product launch, *Starlink Wireless*, a GSM communicator that delivers two way uploading and downloading of alarm reporting without using fixed telephone lines. Revenues from these new products are expected to ramp up in 2012-13. We believe that revenue from these new products will not only drive additional recurring revenues but also help Napco reduce volatility of the revenues generated by the seasonal and cyclical nature of its business.

#### Debt repayment

During the quarter, the company repaid debt of \$1.83 million, bringing down the total debt to \$23.7 million compared to \$29.8 million in June, 2010. Management intends to repay all the debt in the next two years and consequently we expect the interest expense to trend lower in the upcoming quarters.

#### Key Takeaway

The compelling need for security has expanded the market opportunity for security products, especially high-security applications in the network and video surveillance domains. We believe that the company is well positioned to capitalize on this opportunity with the launch of new products with recurring revenue streams, as well as products with higher profit margins. Napco's operating income is trending higher primarily due to increase in sales and improved efficiencies brought in by Marks integration. As the company moves into a seasonally strong quarter, we see revenues and net income to accelerate faster.

Our 1QFY12 revenue and net income estimates are \$16mm and \$(0.66)mm. For fiscal year 2012, we expect revenue and net income of \$78.5mm and \$3.6mm, respectively.

Our DCF based price target assumes terminal revenue growth and EBITDA margins of 10%.

**Napco Security Technologies, Inc.**

## Income Statement

FYE: Jun	Sep-09	Dec-09	Mar-10	Jun-10	FY2010	Sep-10	Dec-10	Mar-11	Jun-11	FY2011	Sep-11	Dec-11	Mar-12	Jun-12	FY2012E
(\$ in million, except per share data)	<b>1Q10</b>	<b>2Q10</b>	<b>3Q10</b>	<b>4Q10</b>		<b>1Q11</b>	<b>2Q11</b>	<b>3Q11</b>	<b>4Q11</b>		<b>1Q12E</b>	<b>2Q12E</b>	<b>3Q12E</b>	<b>4Q12E</b>	
<b>Total Revenue</b>	<b>14.5</b>	<b>16.6</b>	<b>16.0</b>	<b>20.6</b>	<b>67.8</b>	<b>15.3</b>	<b>17.6</b>	<b>17.8</b>	<b>20.7</b>	<b>71.4</b>	<b>16.0</b>	<b>18.7</b>	<b>20.4</b>	<b>23.4</b>	<b>78.5</b>
Cost of Goods Sold	(11.1)	(12.6)	(11.9)	(17.6)	(53.2)	(11.9)	(12.9)	(12.2)	(14.2)	(51.3)	(12.2)	(13.6)	(14.5)	(15.7)	(55.9)
SG&A	(4.7)	(4.4)	(5.0)	(4.7)	(18.8)	(4.1)	(4.2)	(4.9)	(4.0)	(17.2)	(4.2)	(4.3)	(4.5)	(4.8)	(17.8)
Restructuring & Impairment	-	-	(0.9)	-	(0.9)	-	-	-	(0.4)	(0.4)	-	-	-	-	-
Operating Income	(1.4)	(0.4)	(1.8)	(1.7)	(5.2)	(0.7)	0.5	0.7	2.0	2.5	(0.4)	0.8	1.4	2.9	4.8
Interest Income (Expense)	(0.6)	(0.6)	(0.6)	(0.6)	(2.4)	(0.6)	(0.4)	(0.3)	(0.3)	(1.7)	(0.3)	(0.3)	(0.3)	(0.3)	(1.2)
Other income (Expense)	(0.0)	0.0	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	-	(0.0)	-	-	-	-	-
Minority Interest	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pretax Income	(1.9)	(1.0)	(2.4)	(2.3)	(7.6)	(1.3)	0.1	0.3	1.7	0.8	(0.7)	0.5	1.1	2.6	3.6
Provision for Income Taxes	0.1	0.1	0.5	0.4	1.1	0.2	0.1	0.4	(0.3)	0.3	0.1	(0.1)	(0.2)	(0.5)	(0.7)
Net Income	(1.8)	(0.9)	(1.9)	(1.9)	(6.5)	(1.1)	0.2	0.70	1.40	1.12	(0.53)	0.4	0.89	2.10	2.9
<b>EPS</b>	<b>\$ (0.10)</b>	<b>\$ (0.05)</b>	<b>\$ (0.10)</b>	<b>\$ (0.10)</b>	<b>\$ (0.34)</b>	<b>\$ (0.06)</b>	<b>\$ 0.01</b>	<b>\$ 0.04</b>	<b>\$ 0.07</b>	<b>\$ 0.06</b>	<b>\$ (0.03)</b>	<b>\$ 0.02</b>	<b>\$ 0.05</b>	<b>\$ 0.11</b>	<b>\$ 0.15</b>
Shares Outstanding	19.1	19.1	19.1	19.1	19.1	19.1	19.1	19.2	19.3	19.2	19.4	19.5	19.6	19.7	19.5
<b>Margin Analysis</b>															
Gross Margin	23.1%	24.0%	25.9%	14.7%	21.4%	22.3%	26.6%	31.0%	31.3%	28.2%	24.0%	27.5%	29.0%	33.0%	28.8%
SG&A	32.4%	26.5%	31.1%	23.0%	27.8%	27.0%	23.6%	27.3%	19.5%	24.1%	26.3%	23.0%	22.1%	20.5%	22.7%
Operating Margin	-9.4%	-2.5%	-10.9%	-8.2%	-7.7%	-4.7%	3.0%	3.7%	9.9%	3.5%	-2.3%	4.5%	6.9%	12.5%	6.1%
Pretax Margin	-13.4%	-5.8%	-14.7%	-11.2%	-11.2%	-8.6%	0.6%	1.8%	8.3%	1.1%	-4.1%	2.9%	5.5%	11.2%	4.6%
Tax Rate	6.2%	6.3%	20.8%	17.8%	14.3%	14.4%	-48.1%	-119.9%	18.0%	38.9%	20.0%	20.0%	20.0%	20.0%	20.0%
Net Margin	-12.6%	-5.5%	-11.6%	-9.2%	-9.6%	-7.4%	0.9%	3.9%	6.8%	1.6%	-3.3%	2.3%	4.4%	9.0%	3.7%
<b>Ann. Growth Analysis</b>															
Revenues	-17%	-13%	14%	9%	-3%	6%	6%	11%	0.3%	5%	4%	6%	15%	13%	10%
Gross Profit	-28%	-26%	298%	-19%	-8%	-3%	11%	20%	112%	31%	7%	3%	-7%	5%	2%
Operating Income	-263%	-154%	-67%	-85%	-65%	-47%	-230%	-138%	-220%	-148%	-50%	59%	116%	43%	92%
Net Income	-665%	-375%	-63%	-79%	-51%	-38%	-117%	-137%	-174%	-117%	-53%	176%	28%	50%	158%
<b>Seq. Growth Analysis</b>															
Revenues	-24%	15%	-4%	29%		-19%	15%	1%	17%		-23%	17%	9%	15%	
Gross Profit	26%	4%	8%	-43%		52%	19%	17%	1%		-23%	15%	5%	14%	
Operating Income	-88%	-70%	327%	-3%		-94%	-174%	24%	211%		-118%	-334%	68%	106%	
Net Income	-80%	-50%	104%	2%		-87%	-114%	343%	102%		-138%	-182%	106%	135%	

Source: Company Reports and Rodman &amp; Renshaw Estimates

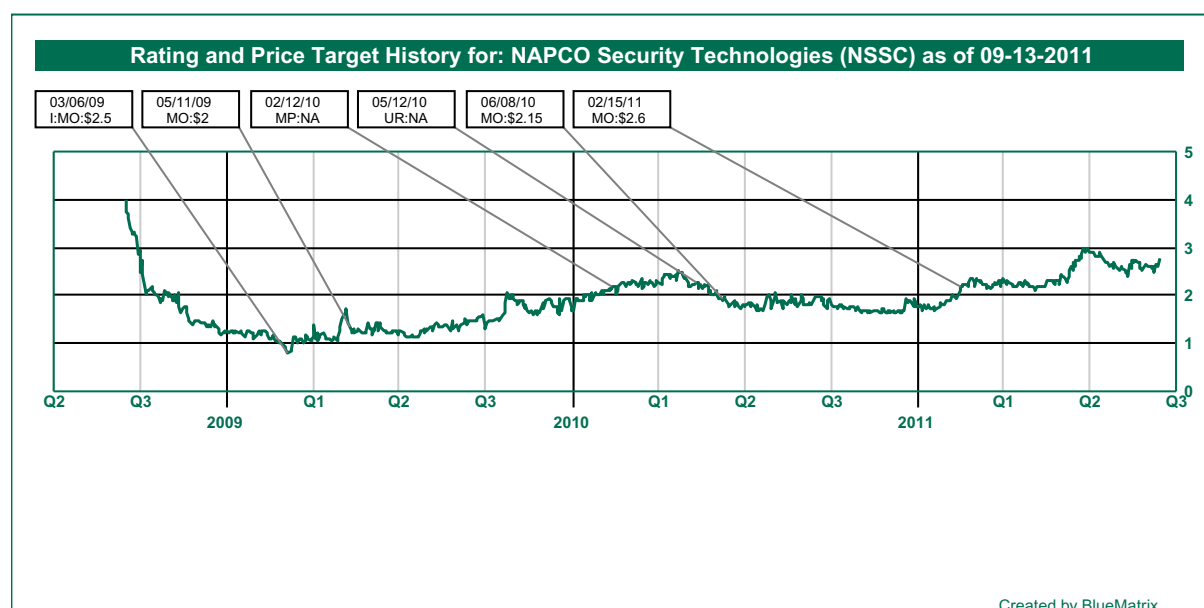
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### RETURN ASSESSMENT

- **Market Outperform (Buy):** The common stock of the company is expected to outperform a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
- **Market Perform (Hold):** The common stock of the company is expected to mimic the performance of a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
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- **Speculative -** The common stock risk level is significantly greater than market risk. The stock price of these equities is exceptionally volatile.
- **Aggressive -** The common stock risk level is materially higher than market level risk. The stock price is typically more volatile than the general market.
- **Moderate -** The common stock is moderately risky, or equivalent to stock market risk. The stock price volatility is typically in-line with movements in the general market.



### RATING SUMMARY

Distribution of Ratings Table				
Rating	Count	Percent	IB Serv./Past 12 Mos	
			Count	Percent
Market Outperform(MO)	154	62.60%	37	24.03%
Market Perform(MP)	62	25.20%	8	12.90%
Market Underperform(MU)	6	2.40%	0	0.00%
Under Review(UR)	24	9.80%	3	12.50%
Total	246	100%	48	100%

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