

LRAD Corp  
Form 10-Q  
August 02, 2016

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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**(Mark one)**

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

**For the quarterly period ended June 30, 2016**

**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: 000-24248**

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**LRAD CORPORATION**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

87-0361799  
(I.R.S. Employer  
Identification Number)

16990 Goldentop Rd. Ste. A, San Diego,  
California  
(Address of principal executive offices)

92127  
(Zip Code)

(858) 676-1112

(Registrant's telephone number, including area code)

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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 (§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 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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

The number of shares of Common Stock, \$0.00001 par value, outstanding on July 26, 2016 was 31,798,853.

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****LRAD Corporation****CONDENSED CONSOLIDATED BALANCE SHEETS**

|  | <b>June 30,<br/>2016<br/>(Unaudited)</b> | <b>September<br/>30,<br/>2015</b> |
|--|--|-----------------------------------|
| <b>ASSETS</b>  |  |                                   |
| Current assets:  |  |                                   |
| Cash and cash equivalents  | \$15,546,733                             | \$18,316,103                      |
| Short-term marketable securities   | 2,332,967                                | 1,251,947                         |
| Accounts receivable, less allowance of \$11,018 and \$0, respectively                          | 2,547,420                                | 2,116,323                         |
| Inventories, net   | 5,182,118                                | 4,926,172                         |
| Prepaid expenses and other   | 580,781                                  | 565,666                           |
| Total current assets   | 26,190,019                               | 27,176,211                        |
| Long-term marketable securities  | 2,047,875                                | 3,047,166                         |
| Deferred tax assets  | 9,203,560                                | 8,339,000                         |
| Property and equipment, net  | 506,651                                  | 471,963                           |
| Intangible assets, net   | 59,574                                   | 58,385                            |
| Prepaid expenses and other - noncurrent  | 438,325                                  | 578,938                           |
| Total assets   | \$38,446,004                             | \$39,671,663                      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |  |                                   |
| Current liabilities:   |  |                                   |
| Accounts payable   | \$1,454,255                              | \$703,942                         |
| Accrued liabilities  | 1,899,855                                | 870,555                           |
| Total current liabilities  | 3,354,110                                | 1,574,497                         |
| Other liabilities - noncurrent   | 157,070                                  | 147,954                           |
| Total liabilities  | 3,511,180                                | 1,722,451                         |
| Commitments and contingencies (Note 9)   |  |                                   |
| Stockholders' equity:  |  |                                   |
| Preferred stock, \$0.00001 par value; 5,000,000 shares authorized; none issued and outstanding | -  | -                                 |

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|  |              |              |
|--|--------------|--------------|
| Common stock, \$0.00001 par value; 50,000,000 shares authorized; 31,798,853 and 32,898,461 shares issued and outstanding, respectively | 318          | 329          |
| Additional paid-in capital   | 86,315,868   | 87,608,034   |
| Accumulated deficit  | (51,381,314) | (49,658,850) |
| Accumulated other comprehensive loss   | (48 )        | (301 )       |
| Total stockholders' equity   | 34,934,824   | 37,949,212   |
| Total liabilities and stockholders' equity   | \$38,446,004 | \$39,671,663 |

See accompanying notes

**LRAD Corporation**

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

|  | <b>Three months ended</b> |             | <b>Nine months ended</b> |              |
|--|---------------------------|-------------|--------------------------|--------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>          |              |
|  | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b>  |
| Revenues:  |                           |             |                          |              |
| Product sales  | \$4,753,898               | \$3,256,564 | \$10,657,412             | \$11,655,451 |
| Contract and other                                     | 288,271                   | 249,351     | 808,263                  | 722,122      |
| Total revenues   | 5,042,169                 | 3,505,915   | 11,465,675               | 12,377,573   |
| Cost of revenues                                       | 2,601,731                 | 1,804,905   | 6,095,413                | 6,020,601    |
| Gross profit   | 2,440,438                 | 1,701,010   | 5,370,262                | 6,356,972    |
| Operating expenses:                                    |                           |             |                          |              |
| Selling, general and administrative                    | 1,568,226                 | 1,286,095   | 5,305,012                | 4,154,314    |
| Research and development                               | 632,416                   | 519,991     | 1,791,253                | 1,567,113    |
| Total operating expenses                               | 2,200,642                 | 1,806,086   | 7,096,265                | 5,721,427    |
| Income (loss) from operations                          | 239,796                   | (105,076 )  | (1,726,003 )             | 635,545      |
| Other income   | 30,512                    | 31,863      | 95,469                   | 88,987       |
| Income (loss) from operations before income taxes      | 270,308                   | (73,213 )   | (1,630,534 )             | 724,532      |
| Income tax benefit                                     | (6,614 )                  | (9,266 )    | (862,720 )               | (7,666 )     |
| Net income (loss)                                      | \$276,922                 | \$(63,947 ) | \$(767,814 )             | \$732,198    |
| Net income (loss) per common share - basic and diluted | \$0.01                    | \$(0.00 )   | \$(0.02 )                | \$0.02       |
| Weighted average common shares outstanding:            |                           |             |                          |              |
| Basic  | 31,798,853                | 33,152,714  | 32,028,153               | 33,214,242   |
| Diluted  | 31,861,308                | 33,152,714  | 32,028,153               | 33,738,616   |
| Cash dividends declared per common share               | \$0.01                    | \$-         | \$0.03                   | \$-          |

See accompanying notes

**LRAD Corporation**

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

|  | <b>Three months<br/>ended<br/>June 30,</b> |             | <b>Nine months ended<br/>June 30,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2016</b>                                | <b>2015</b> | <b>2016</b>                           | <b>2015</b> |
| Net income (loss)                                    | \$276,922                                  | \$(63,947)  | \$(767,814)                           | \$732,198   |
| Other comprehensive income, net of tax:              |  |             |                                       |             |
| Unrealized gain on marketable securities, net of tax | 781  | 701         | 252                                   | 397         |
| Other comprehensive income                           | 781  | 701         | 252                                   | 397         |
| Comprehensive income (loss)                          | \$277,703                                  | \$(63,246)  | \$(767,562)                           | \$732,595   |

See accompanying notes

**LRAD Corporation**

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

|  | <b>Nine months ended</b> |              |
|--|--------------------------|--------------|
|  | <b>June 30,</b>          |              |
|  | <b>2016</b>              | <b>2015</b>  |
| <b>Operating Activities:</b>   |                          |              |
| Net (loss) income  | \$(767,814 )             | \$732,198    |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: |                          |              |
| Depreciation and amortization  | 133,844                  | 182,569      |
| Provision for doubtful accounts  | 11,018                   | -            |
| Warranty provision   | 30,610                   | 19,720       |
| Inventory obsolescence   | 1,408                    | 42,286       |
| Share-based compensation   | 456,279                  | 461,717      |
| Deferred income taxes  | (864,560 )               | -            |
| Changes in operating assets and liabilities:   |                          |              |
| Accounts receivable  | (442,115 )               | 1,549,018    |
| Inventories  | (257,354 )               | (1,224,048 ) |
| Prepaid expenses and other   | (15,115 )                | (75,767 )    |
| Prepaid expenses and other - noncurrent  | 140,613                  | 140,614      |
| Accounts payable   | 750,313                  | 570,066      |
| Payroll and related  | 869,999                  | (2,425,472 ) |
| Warranty settlements   | (31,949 )                | (33,260 )    |
| Accrued and other liabilities  | 169,756                  | (562,312 )   |
| Net cash provided by (used in) operating activities                                      | 184,933                  | (622,671 )   |
| <b>Investing Activities:</b>   |                          |              |
| Purchases of marketable securities   | (81,476 )                | (4,741,067 ) |
| Capital expenditures   | (163,521 )               | (273,482 )   |
| Patent costs paid  | (6,200 )                 | (3,385 )     |
| Net cash used in investing activities  | (251,197 )               | (5,017,934 ) |
| <b>Financing Activities:</b>   |                          |              |
| Repurchase of common stock   | (1,748,456 )             | (965,474 )   |
| Proceeds from exercise of stock options  | -                        | 494,834      |
| Common stock cash dividends paid   | (954,650 )               | -            |
| Net cash used in financing activities  | (2,703,106 )             | (470,640 )   |
| Net decrease in cash   | (2,769,370 )             | (6,111,245 ) |
| Cash and cash equivalents, beginning of period   | 18,316,103               | 23,894,744   |



Cash and cash equivalents, end of period

\$ 15,546,733 \$ 17,783,499

See accompanying notes

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## **LRAD Corporation**

### **Notes to Condensed Consolidated Financial Statements (Unaudited)**

#### **1. OPERATIONS**

LRAD® Corporation, a Delaware corporation (the “Company”), is engaged in the design, development and commercialization of directed and omnidirectional sound technologies and products. The Company sells its proprietary sound reproduction technologies and products in markets around the world.

#### **2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

##### *General*

The Company’s unaudited condensed consolidated financial statements included herein have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management’s opinion, the accompanying statements reflect adjustments necessary to present fairly the financial position, results of operations, and cash flows for those periods indicated, and contain adequate disclosure to make the information presented not misleading. Adjustments included herein are of a normal, recurring nature unless otherwise disclosed in the footnotes. The condensed consolidated financial statements and notes thereto should be read in conjunction with the Company’s audited financial statements and notes thereto for the year ended September 30, 2015 included in the Company’s Annual Report on Form 10-K, as filed with the SEC on December 3, 2015. Results of operations for interim periods are not necessarily indicative of the results of operations for a full year.

##### *Principles of Consolidation*

The Company has a currently inactive wholly owned subsidiary, LRAD International Corporation, which the Company formed to conduct international marketing, sales and distribution activities. The condensed consolidated financial statements include the accounts of this subsidiary after elimination of intercompany transactions and accounts.

Reclassifications

Where necessary, the prior year's information has been reclassified to conform to the current year presentation.

**3. RECENT ACCOUNTING PRONOUNCEMENTS**

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. This guidance changes how companies account for certain aspects of share-based payments to employees. Among other things, under the new guidance, companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in-capital ("APIC"), but will instead record such items as income tax expense or benefit in the income statement, and APIC pools will be eliminated. Companies will apply this guidance prospectively. Another component of the new guidance allows companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards, whereby forfeitures can be estimated, as required today, or recognized when they occur. If elected, the change to recognize forfeitures when they occur needs to be adopted using a modified retrospective approach. All of the guidance will be effective for the Company in the fiscal year beginning October 1, 2017. Early adoption is permitted. The Company is currently evaluating the impact of this guidance, if any, on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which issued new guidance related to leases that outlines a comprehensive lease accounting model and supersedes the current lease guidance. The new guidance requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new guidance must be adopted using the modified retrospective approach and will be effective for the Company in the fiscal year beginning October 1, 2019. Early adoption is permitted. The Company is currently evaluating the impact of this guidance, if any, on its financial statements and related disclosures.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. The guidance requires an entity to measure inventory at the lower of cost or net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation, rather than the lower of cost or market in the previous guidance. This amendment applies to inventory that is measured using first-in, first-out (FIFO). This amendment is effective for public entities for fiscal years beginning after December 15, 2016, including interim periods within those years. A reporting entity should apply the amendments prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of this guidance, if any, on its consolidated financial statements and related disclosures.



In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. generally accepted accounting principles when it becomes effective. In July 2015, the FASB deferred the effective date of the standard by an additional year; however, it provided companies the option to adopt one year earlier, commensurate with the original effective date. Accordingly, the standard will be effective for the Company in the fiscal year beginning October 1, 2018, with an option to adopt the standard for the fiscal year beginning October 1, 2017. The Company is currently evaluating this standard and has not yet selected a transition method or the effective date on which it plans to adopt the standard, nor has it determined the effect of the standard on its financial statements and related disclosures.

#### **4. FAIR VALUE MEASUREMENTS**

The Company’s financial instruments consist principally of cash equivalents, short and long-term marketable securities, accounts receivable and accounts payable. The fair value of a financial instrument is the amount that would be received in an asset sale or paid to transfer a liability in an orderly transaction between unaffiliated market participants. Assets and liabilities measured at fair value are categorized based on whether or not the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial instruments within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The hierarchy is prioritized into three levels (with Level 3 being the lowest) defined as follows:

**Level 1:** Inputs are based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

**Level 2:** Inputs include quoted prices for similar assets or liabilities in active markets and/or quoted prices for identical or similar assets or liabilities in markets that are not active near the measurement date.

**Level 3:** Inputs include management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument’s valuation.

The fair value of the Company’s cash equivalents and marketable securities was determined based on Level 1 and Level 2 inputs. The Company did not have any marketable securities in the Level 3 category as of June 30, 2016 or September 30, 2015. The Company believes that the recorded values of its other financial instruments approximate their current fair values because of their nature and respective relatively short maturity dates or durations.

Instruments Measured at Fair Value

The following tables present the Company's cash equivalents and marketable securities' costs, gross unrealized gains and losses, and fair value by major security type recorded as cash equivalents or short-term or long-term marketable securities as of June 30, 2016 and September 30, 2015.

|                         | June 30, 2016 |                              |               |                     |                          |                         |
|-------------------------|---------------|------------------------------|---------------|---------------------|--------------------------|-------------------------|
|                         | Cost Basis    | Unrealized<br>Gains/(Losses) | Fair<br>Value | Cash<br>Equivalents | Short-term<br>Securities | Long-term<br>Securities |
| Level 1:                |               |                              |               |                     |                          |                         |
| Money Market Funds      | \$-           | \$ -                         | \$628,206     | \$ 628,206          | \$-                      | \$-                     |
| Level 2:                |               |                              |               |                     |                          |                         |
| Certificates of deposit | \$3,047,164   | \$ -                         | \$3,047,164   | \$ -                | \$999,289                | \$2,047,875             |
| Municipal securities    | 436,012       | 88                           | 436,100       | 55,112              | 380,988                  | -                       |
| Corporate bonds         | 952,827       | (137 )                       | 952,690       | -                   | 952,690                  | -                       |
| Subtotal                | 4,436,003     | (49 )                        | 4,435,954     | 55,112              | 2,332,967                | 2,047,875               |
| Total                   | \$4,436,003   | \$ (49 )                     | \$5,064,160   | \$ 683,318          | \$2,332,967              | \$2,047,875             |

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|                         | September 30, 2015 |                              |               |                     |                          |                         |
|-------------------------|--------------------|------------------------------|---------------|---------------------|--------------------------|-------------------------|
|                         | Cost Basis         | Unrealized<br>Gains/(Losses) | Fair<br>Value | Cash<br>Equivalents | Short-term<br>Securities | Long-term<br>Securities |
| Level 1:                |                    |                              |               |                     |                          |                         |
| Money Market Funds      | \$301,193          | \$ -                         | \$301,193     | \$ 301,193          | \$-                      | \$-                     |
| Level 2:                |                    |                              |               |                     |                          |                         |
| Certificates of deposit | 3,296,238          | -                            | 3,296,238     | -                   | 249,072                  | 3,047,166               |
| Municipal securities    | 654,205            | 293                          | 654,498       | 160,058             | 494,440                  | -                       |
| Corporate bonds         | 509,029            | (594 )                       | 508,435       | -                   | 508,435                  | -                       |
| Subtotal                | 4,459,472          | (301 )                       | 4,459,171     | 160,058             | 1,251,947                | 3,047,166               |
| Total                   | \$4,760,665        | \$ (301 )                    | \$4,760,364   | \$ 461,251          | \$1,251,947              | \$3,047,166             |

## 5. INVENTORIES

Inventories consisted of the following:

|                          | June 30,<br>2016 | September<br>30,<br>2015 |
|--------------------------|------------------|--------------------------|
| Raw materials            | \$4,510,534      | \$4,562,535              |
| Finished goods           | 932,878          | 763,227                  |
| Work in process          | 160,292          | 20,588                   |
| Inventories, gross       | 5,603,704        | 5,346,350                |
| Reserve for obsolescence | (421,586 )       | (420,178 )               |
| Inventories, net         | \$5,182,118      | \$4,926,172              |

## 6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

|  | June 30,<br>2016 | September<br>30,<br>2015 |
|--|------------------|--------------------------|
|--|------------------|--------------------------|

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|                                |             |             |
|--------------------------------|-------------|-------------|
| Machinery and equipment        | \$958,072   | \$940,289   |
| Office furniture and equipment | 1,004,269   | 877,011     |
| Leasehold improvements         | 71,738      | 67,913      |
| Property and equipment, gross  | 2,034,079   | 1,885,213   |
| Accumulated depreciation       | (1,527,428) | (1,413,250) |
| Property and equipment, net    | \$506,651   | \$471,963   |

**Nine months ended**

**June 30,**

**2016      2015**

|                      |           |           |
|----------------------|-----------|-----------|
| Depreciation expense | \$128,833 | \$178,179 |
|----------------------|-----------|-----------|



**7. ACCRUED LIABILITIES AND OTHER LIABILITIES—NONCURRENT**

Accrued liabilities consisted of the following:

|                        | <b>June 30,<br/>2016</b> | <b>September<br/>30,<br/>2015</b> |
|------------------------|--------------------------|-----------------------------------|
| Payroll and related    | \$1,200,915              | \$ 330,916                        |
| Deferred revenue       | 339,095                  | 51,345                            |
| Warranty reserve       | 261,328                  | 289,660                           |
| Accrued contract costs | 98,517                   | 197,034                           |
| Other                  | -                        | 1,600                             |
| Total                  | \$1,899,855              | \$ 870,555                        |

Other liabilities - noncurrent consisted of the following:

|                   |           |            |
|-------------------|-----------|------------|
| Deferred rent     | \$104,119 | \$ 121,996 |
| Extended warranty | 52,951    | 25,958     |
| Total             | \$157,070 | \$ 147,954 |

*Payroll and related*

Payroll and related consists primarily of accrued payroll, benefits and related taxes for a Separation Agreement entered into with the Company's CEO during the quarter ended March 31, 2016, as well as vacation, sales commissions, and payroll for the two week period ended June 30, 2016.

*Deferred Revenue*

Deferred revenue consists primarily of prepayments from customers in advance of product shipment as well as revenue for shipments to customers that can't be recognized due to shipping terms.

*Warranty Reserve*

Changes in the warranty reserve and extended warranty were as follows:

|                      | <b>Three month ended</b> |             | <b>Nine months ended</b> |             |
|----------------------|--------------------------|-------------|--------------------------|-------------|
|                      | <b>June 30,</b>          |             | <b>June 30,</b>          |             |
|                      | <b>2016</b>              | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Beginning balance    | \$ 317,822               | \$ 327,236  | \$ 315,618               | \$ 314,311  |
| Warranty provision   | 4,307                    | (20,954 )   | 30,610                   | 19,720      |
| Warranty settlements | (7,850 )                 | (5,511 )    | (31,949 )                | (33,260 )   |
| Ending balance       | \$ 314,279               | \$ 300,771  | \$ 314,279               | \$ 300,771  |

|                             | <b>June 30,</b> | <b>September</b> | <b>June 30,</b> | <b>September</b> |
|-----------------------------|-----------------|------------------|-----------------|------------------|
|                             | <b>2016</b>     | <b>30,</b>       | <b>2016</b>     | <b>30,</b>       |
|                             |                 | <b>2015</b>      |                 | <b>2015</b>      |
| Short-term warranty reserve | \$ 261,328      | \$ 289,660       | \$ 261,328      | \$ 289,660       |
| Long-term warranty reserve  | 52,951          | 25,958           | 52,951          | 25,958           |
| Total warranty reserve      | \$ 314,279      | \$ 315,618       | \$ 314,279      | \$ 315,618       |

*Accrued contract costs*

We have contracted with a third party service provider to administer the required services under the terms of a repair and maintenance agreement with a foreign military. This payment is made in arrears each year.

**8. INCOME TAXES**

At June 30, 2016, the Company had federal net operating losses (“NOLs”) and related state NOLs. The Company released \$8,339,000 of its valuation allowance against its deferred tax assets in the quarter ended September 30, 2015 as it determined that it was more likely than not that those assets would be realized. The Company continues to maintain a valuation allowance of \$12,175,000 as the Company believes that the negative evidence that it will be able to recover these net deferred tax assets outweighs the positive evidence.

The Company recorded an income tax benefit of \$862,720 and income tax expense of \$1,600, reflecting effective tax rates of 52.9% and 0.2% for the nine months ended June 30, 2016 and 2015, respectively. The nine months ended June 30, 2015 also included a \$9,266 income tax benefit adjustment from the year ended September 30, 2014. The change in the effective tax rate in the nine months ended June 30, 2016, compared to the same period in the prior year, is primarily due to the partial release of our valuation allowance in the prior year, resulting in current year tax benefit.

ASC 740, *Accounting for Uncertainty in Income Taxes*, requires the Company to recognize in its consolidated financial statements uncertainties in tax positions taken that may not be sustained upon examination by the taxing authorities. If interest or penalties are assessed, the Company would recognize these charges as income tax expense. The Company has not recorded any income tax expense or benefit for uncertain tax positions.

## **9. COMMITMENTS AND CONTINGENCIES**

### *Litigation*

The Company may at times be involved in litigation in the ordinary course of business. The Company will, from time to time, when appropriate in management's estimation, record adequate reserves in the Company's consolidated financial statements for pending litigation. Currently, there are no pending material legal proceedings to which the Company is a party or to which any of its property is subject.

### *Bonus Plan*

The Company has an incentive bonus plan for fiscal year 2016 designed to motivate its employees to achieve the Company's financial objectives. All of the Company's employees are entitled to participate in the incentive plan. Target Bonus Amounts ("Target") vary based on a percentage of the employee's base salary which range from 10% to 50% of base salary and a bonus payment may be made at three levels, including at 50% of Target, at 100% of Target and at 200% of Target, depending upon the achievement by the Company of specified earnings per share goals. Included in such calculation is the cost of the incentive plan. For purposes of the earnings per share calculation, the number of shares outstanding will be held constant as of October 1, 2015. During the nine months ended June 30, 2016 and 2015, the Company accrued \$0 and \$323,098, respectively, for bonuses and related payroll tax expenses in connection with the bonus plans.

## **10. SHARE-BASED COMPENSATION**

*Stock Option Plans*

At June 30, 2016, the Company had two equity incentive plans. The 2005 Equity Incentive Plan (“2005 Equity Plan”) was terminated with respect to new grants in March 2015, but remains in effect for grants issued prior to that time. The 2015 Equity Incentive Plan (“2015 Equity Plan”) was approved by the Company’s Board of Directors on January 19, 2015 and by the Company’s stockholders on March 18, 2015. The 2015 Equity Plan authorizes for issuance as stock options, restricted stock, stock appreciation rights, restricted stock units and performance awards, an aggregate of 5,000,000 new shares of common stock to employees, directors, advisors or consultants. At June 30, 2016, there were options outstanding covering 2,537,419 and 813,750 shares of common stock under the 2005 Equity Plan and 2015 Equity Plan, respectively.

*Stock Option Activity*

The following table summarizes information about stock option activity during the nine months ended June 30, 2016:

|                             | <b>Number<br/>of Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
|-----------------------------|-----------------------------|--|
| Outstanding October 1, 2015 | 2,852,419                   | \$ 2.35  |
| Granted                     | 725,000                     | \$ 1.82  |
| Forfeited/expired           | (226,250 )                  | \$ 2.25  |
| Outstanding June 30, 2016   | 3,351,169                   | \$ 2.24  |
| Exercisable June 30, 2016   | 2,780,311                   | \$ 2.30  |

Options outstanding are exercisable at prices ranging from \$0.93 to \$3.17 and expire over the period from 2020 to 2023 with an average life of 5.5 years. The aggregate intrinsic value of options outstanding and exercisable at June 30, 2016 was \$198,578 and \$160,699, respectively.

*Share-Based Compensation*

The Company recorded share-based compensation expense and classified it in the condensed consolidated statements of operations as follows:

|                                     | <b>Three months ended</b> |             | <b>Nine months ended</b> |             |
|-------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                     | <b>June 30,</b>           |             | <b>June 30,</b>          |             |
|                                     | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Cost of revenues                    | \$6,157                   | \$7,024     | \$17,895                 | \$18,695    |
| Selling, general and administrative | 115,864                   | 119,653     | 362,224                  | 350,099     |
| Research and development            | 26,001                    | 26,186      | 76,160                   | 92,923      |
| Total                               | \$148,022                 | \$152,863   | \$456,279                | \$461,717   |

The employee stock options granted in the nine months ended June 30, 2016 and 2015 had a weighted-average estimated fair value of \$0.62 per share and \$1.13 per share, respectively, using the Black-Scholes option pricing model with the following weighted-average assumptions (annualized percentages):

|                         | <b>Nine months ended</b> |       |             |       |
|-------------------------|--------------------------|-------|-------------|-------|
|                         | <b>June 30,</b>          |       | <b>2015</b> |       |
|                         | <b>2016</b>              |       |             |       |
| Volatility              | 49.0%                    | -     | 52.0%       | 62.0% |
| Risk-free interest rate | 1.1%                     | -     | 1.7%        | 1.6%  |
| Forfeiture rate         |                          | 10.0% |             | 10.0% |
| Dividend yield          | 2.2%                     | -     | 2.7%        | 0.0%  |
| Expected life in years  | 3.2                      | -     | 4.6         | 3.2   |

The Company declared its first dividend in the quarter ended December 31, 2015, so dividend yield assumptions were added to the valuation of options granted based on the expected annual yield. Expected volatility is based on the historical volatility of the Company's common stock over the period commensurate with the expected life of the options. The risk-free interest rate is based on rates published by the Federal Reserve Board. The expected life is based on observed and expected time to post-vesting exercise. The expected forfeiture rate is based on past experience and employee retention data. Forfeitures are estimated at the time of the grant and revised in subsequent periods if actual forfeitures differ from those estimates or if the Company updates its estimated forfeiture rate. Such amounts will be recorded as a cumulative adjustment in the period in which the estimate is changed.

Since the Company has an NOL carryforward as of June 30, 2016, no excess tax benefit for the tax deductions related to share-based awards was recognized for the nine months ended June 30, 2016 and 2015. As of June 30, 2016, there

was approximately \$600,000 of total unrecognized compensation cost related to non-vested share-based employee compensation arrangements. The cost is expected to be recognized over a weighted-average period of 1.4 years.

## 11. STOCKHOLDERS' EQUITY

### *Summary*

The following table summarizes changes in the components of stockholders' equity during the nine months ended June 30, 2016:

|                                  | <b>Common Stock<br/>Shares</b> | <b>Common Stock<br/>Amount</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Total<br/>Stockholders'<br/>Equity</b> |
|----------------------------------|--------------------------------|--------------------------------|---|------------------------------|---|---|
| Balances, September 30, 2015     | 32,898,461                     | \$ 329                         | \$87,608,034                              | \$(49,658,850)               | \$ (301 )   | \$ 37,949,212                             |
| Share-based compensation expense | -                              | -                              | 456,279                                   | -                            | -   | 456,279                                   |
| Repurchase of common stock       | (1,099,608 )                   | (11 )                          | (1,748,445 )                              | -                            | -   | (1,748,456 )                              |
| Common stock cash dividends      | -                              | -                              | -   | (954,650 )                   | -   | (954,650 )                                |
| Other comprehensive income       | -                              | -                              | -   | -                            | 253   | 253                                       |
| Net loss                         | -                              | -                              | -   | (767,814 )                   | -   | (767,814 )                                |
| Balances, June 30, 2016          | 31,798,853                     | \$ 318                         | \$86,315,868                              | \$(51,381,314)               | \$ (48 )  | \$ 34,934,824                             |

### *Share Buyback Program*

The Board of Directors approved a share buyback program in 2013 under which the Company was authorized to repurchase up to \$4 million of its outstanding common shares. This program expired on December 31, 2015 and in December 2015, the Board of Directors approved a new buyback program for calendar year 2016 under which the Company is authorized to repurchase up to \$4 million of its outstanding common shares. During the nine months ended June 30, 2016, 1,099,608 shares were repurchased for \$1,748,456 under these two programs.

*Dividends*

On December 3, 2015, the Company announced a cash dividend of \$0.01 per share on the Company's common stock, payable on January 29, 2016 to stockholders of record on January 15, 2016. On February 4, 2016, the Company announced a cash dividend of \$0.01 per share on the Company's common stock, payable on March 30, 2016 to stockholders of record on March 15, 2016. On May 10, 2016, the Company announced a cash dividend of \$0.01 per share on the Company's common stock, payable on June 30, 2016 to stockholders of record on June 15, 2016. Dividends charged to retained earnings in the three and nine months ended June 30, 2016 were \$317,989 and \$954,650, respectively. There were no dividends declared in the prior year periods.

**12. INCOME (LOSS) PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share:

|  | <b>Three months ended<br/>June 30,</b> |             | <b>Nine months ended<br/>June 30,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2016</b>                            | <b>2015</b> | <b>2016</b>                           | <b>2015</b> |
| <b>Numerator:</b>  |  |             |                                       |             |
| Income (loss) available to common stockholders   | \$276,922                              | \$(63,947)  | \$(767,814)                           | \$732,198   |
| <b>Denominator:</b>  |  |             |                                       |             |
| Weighted average common shares outstanding   | 31,798,853                             | 33,152,714  | 32,028,153                            | 33,214,242  |
| Assumed exercise of dilutive options and warrants  | 62,455                                 | -           | -                                     | 524,374     |
| Weighted average dilutive shares outstanding   | 31,861,308                             | 33,152,714  | 32,028,153                            | 33,738,616  |
| Basic income (loss) per common share   | \$0.01                                 | \$(0.00)    | \$(0.02)                              | \$0.02      |
| Diluted income (loss) per common share   | \$0.01                                 | \$(0.00)    | \$(0.02)                              | \$0.02      |
| Potentially dilutive securities outstanding at period end excluded from the diluted computation as the inclusion would have been antidilutive: |  |             |                                       |             |
| Options  | 2,348,083                              | 1,405,250   | 2,895,669                             | 1,405,250   |
| Warrants   | -                                      | 1,627,945   | -                                     | 1,627,945   |
| Total  | 2,348,083                              | 3,033,195   | 2,895,669                             | 3,033,195   |

**13. MAJOR CUSTOMERS**

For the three months ended June 30, 2016, revenues from three customers accounted for 22%, 19% and 15% of total revenues, and for the nine months ended June 30, 2016, there were no customers accounting for more than 10% of revenues. At June 30, 2016, accounts receivable from two customers accounted for 39% and 30% of total accounts receivable, respectively, with no other single customer accounting for more than 10% of the accounts receivable balance.

For the three months ended June 30, 2015, revenues from three customers accounted for 18%, 13% and 11% of total revenues, respectively, and for the nine months ended June 30, 2015, revenues from three customers accounted for 16%, 13% and 12% of total revenues, respectively, with no other single customer accounting for more than 10% of revenues. At June 30, 2015, accounts receivable from two customers accounted for 36% and 18% of total accounts receivable, respectively, with no other single customer accounting for more than 10% of the accounts receivable balance.

#### **14. UNUSUAL AND INFREQUENT EXPENSES**

The Company incurred expenses of \$61,385 and \$897,157 during the three and nine months ended June 30, 2016 which were unusual in nature and infrequent in occurrence. These expenses included legal and consulting costs resulting from a proxy contest initiated by a stockholder of the Company, severance and related benefit and tax expenses in accordance with a Separation Agreement and General Release related to the June 30, 2016 departure of the Company's chief executive officer (CEO), and recruiting costs related to the search for a new CEO.



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

The discussion and analysis set forth below should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related notes included under Item 1 of this Quarterly Report on Form 10-Q, together with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended September 30, 2015.

### **Forward Looking Statements**

*This report contains certain statements of a forward-looking nature relating to future events or future performance. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and similar expressions or variations of such words are intended to identify forward-looking statements, but are not the only means of identifying forward-looking statements. Prospective investors are cautioned that such statements are only predictions and actual events or results may differ materially. In evaluating such statements, prospective investors should specifically consider various factors identified in this report and any matters set forth under Part I, Item 1A (Risk Factors) of our Annual Report on Form 10-K, which could cause actual results to differ materially from those indicated by such forward-looking statements.*

### **Overview**

Our Company develops and delivers highly intelligible, directed Long Range Acoustic Devices® ("LRAD®") that beam, focus and control sound over short and long distances. By placing sound only where needed, we not only enhance many typical speaker applications, but we offer novel sound applications that conventional speakers cannot achieve.

Our LRAD-X® product line offers a variety of directed sound products, which use focused acoustic output to clearly transmit critical information, instructions and warnings over long distances. The LRAD-X product line features clear voice intelligibility and meets the military's stringent environmental requirements in a number of packages and form factors, from our hand held LRAD 100X to our LRAD 2000X unit, which communicates up to 5,500 meters. Through the use of powerful voice commands, prerecorded messages in multiple languages, and warning tones, our LRAD-X products are designed to create large safety zones while determining the intent and influencing the behavior of an intruder. We continue to expand our LRAD-X product line to provide a complete range of systems and accessories to meet a broad range of diverse applications including fixed and mobile military deployments, maritime security, critical infrastructure and perimeter security, commercial security, border and homeland security, law enforcement and emergency responder communications, asset protection and wildlife preservation and control. Our LRAD-X products have been competitively selected over other commercially available systems by the United States military and by several international militaries.

Building on the success of our LRAD-X directional technology, in 2012 we launched our first omnidirectional product, the LRAD 360X. Unlike the existing siren based systems in the market, the LRAD 360X is designed with the same characteristics as our directed products - highly intelligible voice broadcasts and the ability to communicate and alert over long distances. Since the LRAD 360X product launch, we have developed our ONE VOICE® omnidirectional mass communication product line, which includes a mobile, fully-integrated, trailer-mounted mass communication system, and other enhancements to provide a more fully integrated solution for municipalities, military bases, airports, college/business campuses, etc. We expect that the ONE VOICE product line will allow us to expand our business opportunities into the large and growing worldwide emergency warning and mass notification market. Through increased focus and investment in domestic and international sales and marketing activities, we have pioneered a new global market, selling our directional LRAD-X long-range acoustic hailing devices (“AHDs”) and advanced ONE VOICE omnidirectional mass notification systems into over 70 countries.

Revenues in the third fiscal quarter ended June 30, 2016, were \$5.0 million, an increase from \$3.5 million in the third fiscal quarter of 2015. The increase in revenues resulted from two large shipments into Southeast Asia – \$1.1 million for public safety and \$760,000 for navy vessels – as well as diverse shipments across a number of markets, including police, border and perimeter security, oil and gas, prisons, U.S. and foreign military and military vehicles. While we continue to experience delays in projects in both U.S. and international markets due to various reasons, we saw some improvement during our third fiscal quarter. We are aggressively pursuing these opportunities to try to bring them to closure. Based on the timing of budget cycles, as well as financial issues and military conflict in certain areas of the world, delays in awarding contracts often occur, resulting in uneven quarterly revenues. Demand for our products remains strong and we continue to build awareness and interest in our LRAD-X and ONE VOICE mass notification products throughout the world. On a quarter over quarter basis, our revenues are expected to remain uneven. Gross profit increased compared to the same quarter in the prior year as a result of higher revenues and fixed overhead absorption, partially offset by lower product margin due to product mix. Operating expenses increased by 21.8% from \$1.8 million to \$2.2 million in the quarter ended June 30, 2016, primarily due to increased salaries, benefits and consultants, recruiting expenses related to the CEO search and commissions due to increased revenues. We reported a net income of \$277,000 for the quarter, or \$0.01 per diluted share, compared to a net loss of \$64,000, or \$0.00 per share for the same quarter in the prior year.

## Overall Business Outlook

Our product line-up continues to gain worldwide awareness and recognition through media exposure, trade show participations, product demonstrations and word of mouth as a result of positive responses and increased acceptance of our products. We believe we have a solid global brand, technology and product foundation with our LRAD-X directed product line, which we have expanded over the years to service new markets and customers for greater business growth. We have launched a line of omnidirectional products targeted to meet the needs of the large and growing mass notification market. We believe that we have strong market opportunities for our directional and omnidirectional product offerings within the global government and military sector, as well as increasing commercial applications as a result of continued threats to governments, commerce and law enforcement, and in wildlife preservation and control applications. We intend to continue expanding our international mass notification business, particularly in the Middle East, Europe and Asia where we believe there are greater market opportunities for our omnidirectional products. Our selling network has expanded through the addition of marketing and business development personnel as well as continuing to improve and increase our relationships with key integrators and sales representatives within the United States and in a number of worldwide locations. However, we may continue to face challenges in fiscal 2016 and 2017 due to continuing economic and geopolitical conditions in some international regions, as well as the upcoming U.S. presidential election. We anticipate continued U.S. Military spending uncertainty due to ongoing defense budget delays and spending reductions. We continue to pursue large business opportunities, but it is difficult to anticipate how long it will take to close these opportunities, or if they will ever ultimately come to fruition. It is also difficult to determine whether our omnidirectional product will be accepted as a viable solution in the mass notification market, which includes a number of large, well-known competitors.

## Critical Accounting Policies

We have identified a number of accounting policies as critical to our business operations and the understanding of our results of operations. These are described in our consolidated financial statements located in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended September 30, 2015. The impact and any associated risks related to these policies on our business operations is discussed below and throughout Management's Discussion and Analysis of Financial Condition and Results of Operations when such policies affect our reported and expected financial results.

The methods, estimates and judgments we use in applying our accounting policies, in conformity with generally accepted accounting principles in the U.S., have a significant impact on the results we report in our financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. The estimates affect the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.



**Comparison of Results of Operations for the Three Months Ended June 30, 2016 and 2015****Revenues**

The following table sets forth for the periods indicated certain items of our condensed consolidated statements of operations expressed in dollars and as a percentage of net revenues. The financial information and the discussion below should be read in conjunction with the condensed consolidated financial statements and notes contained in this report.

|  | Three months ended<br>June 30, 2016 |                          | June 30, 2015 |                          | Fav(Unfav)  |         |
|--|-------------------------------------|--------------------------|---------------|--------------------------|-------------|---------|
|  | Amount                              | % of<br>Total<br>Revenue | Amount        | % of<br>Total<br>Revenue | Amount      | %       |
| Revenues:  |                                     |                          |               |                          |             |         |
| Product sales  | \$4,753,898                         | 94.3 %                   | \$3,256,564   | 92.9 %                   | \$1,497,334 | 46.0 %  |
| Contract and other                                   | 288,271                             | 5.7 %                    | 249,351       | 7.1 %                    | 38,920      | 15.6 %  |
|  | 5,042,169                           | 100.0 %                  | 3,505,915     | 100.0 %                  | 1,536,254   | 43.8 %  |
| Cost of revenues                                     | 2,601,731                           | 51.6 %                   | 1,804,905     | 51.5 %                   | (796,826 )  | (44.1%) |
| Gross profit   | 2,440,438                           | 48.4 %                   | 1,701,010     | 48.5 %                   | 739,428     | 43.5 %  |
| Operating Expenses:                                  |                                     |                          |               |                          |             |         |
| Selling, general and administrative                  | 1,568,226                           | 31.1 %                   | 1,286,095     | 36.7 %                   | (282,131 )  | (21.9%) |
| Research and development                             | 632,416                             | 12.5 %                   | 519,991       | 14.8 %                   | (112,425 )  | (21.6%) |
|  | 2,200,642                           | 43.6 %                   | 1,806,086     | 51.5 %                   | (394,556 )  | (21.8%) |
| Income (loss) from operations                        | 239,796                             | 4.8 %                    | (105,076 )    | (3.0%)                   | 344,872     | 328.2 % |
| Other Income   | 30,512                              | 0.6 %                    | 31,863        | 0.9 %                    | (1,351 )    | (4.2% ) |
| Income (loss) from operations before<br>income taxes | 270,308                             | 5.4 %                    | (73,213 )     | (2.1%)                   | 343,521     | 469.2 % |
| Income tax benefit                                   | (6,614 )                            | (0.1%)                   | (9,266 )      | (0.3%)                   | (2,652 )    | 28.6 %  |
| Net income (loss)                                    | \$276,922                           | 5.5 %                    | \$(63,947 )   | (1.8%)                   | \$340,869   | 533.0 % |

Revenues increased in the current quarter compared to the prior year due partially to the timing of customer orders and shipments. The receipt of orders will often be uneven due to the timing of approvals or budgets. Revenues during the quarter were very diverse, selling into 31 countries and into various markets, including police, border and perimeter security, oil and gas, prisons, U.S. and foreign military and military vehicles. We delivered a \$1.1 million public safety order and a \$760,000 order for navy vessels into Southeast Asia during the quarter. At June 30, 2016, we had

aggregate deferred revenue of \$339,095 for prepayments from customers in advance of product shipment.

### ***Gross Profit***

The increase in gross profit in the quarter was primarily due to the increase in revenue and increased absorption of our fixed overhead costs, partially offset by lower product margins.

Our products have varying gross margins, so product sales mix will materially affect gross profits. In addition, our margins vary based on the sales channels through which our products are sold in a given period. We continue to implement product updates and changes, including raw material and component changes that may impact product costs. With such product updates and changes we have limited warranty cost experience and estimated future warranty costs can impact our gross margins. We do not believe that historical gross profit margins should be relied upon as an indicator of future gross profit margins.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased by \$83,749 for salaries, benefits and consultants, primarily for business development personnel, \$79,448 for recruiting expenses, primarily for a CEO search, \$66,514 for increased commission expense, \$28,972 for increased marketing expenses, and \$23,448 of other increases.

We incurred non-cash share-based compensation expenses allocated to selling, general and administrative expenses in the three months ended June 30, 2016 and 2015 of \$115,864 and \$119,653, respectively.

We may expend additional resources on the marketing and selling of our products in future periods as we identify ways to optimize potential opportunities. Commission expenses will fluctuate based on the nature of our sales.

### ***Research and Development Expenses***

Research and development expenses increased compared to the prior year primarily due to \$64,132 for increased staffing and benefits, \$44,953 for development and testing expenses, and \$3,340 of other expenses.



Included in research and development expenses for the three months ended June 30, 2016 and 2015 was \$26,001 and \$26,186 of non-cash share-based compensation costs, respectively.

Research and development costs vary period to period due to the timing of projects, the availability of funds for research and development and the timing and extent of the use of outside consulting, design and development firms. We continually improve our product offerings and we have further expanded our product line in 2016 with new products, customizations and enhancements. Based on current plans, we expect research and development costs to continue in the current fiscal year on a basis comparable to the prior year.

### *Net Income*

The increase in net income was primarily due to the increase in revenues, partially offset by an increase in operating expenses. We recognized an income tax benefit of \$6,614 during the quarter ended June 30, 2016, compared to a benefit of \$9,266 in the same quarter of the prior year from prior year tax adjustments.

### **Comparison of Results of Operations for the Nine Months Ended June 30, 2016 and 2015**

#### *Revenues*

The following table sets forth for the periods indicated certain items of our condensed consolidated statements of operations expressed in dollars and as a percentage of net revenues. The financial information and the discussion below should be read in conjunction with the condensed consolidated financial statements and notes contained in this report.

|                    | <b>Nine months ended<br/>June 30, 2016</b> |                                    | <b>June 30, 2015</b> |                                    | <b>Fav(Unfav)</b> |          |
|--------------------|--|------------------------------------|----------------------|------------------------------------|-------------------|----------|
|                    | <b>Amount</b>                              | <b>% of<br/>Total<br/>Revenues</b> | <b>Amount</b>        | <b>% of<br/>Total<br/>Revenues</b> | <b>Amount</b>     | <b>%</b> |
| Revenues:          |  |                                    |                      |                                    |                   |          |
| Product sales      | \$10,657,412                               | 93.0                               | % \$11,655,451       | 94.2                               | % \$(998,039 )    | (8.6% )  |
| Contract and other | 808,263                                    | 7.0                                | % 722,122            | 5.8                                | % 86,141          | 11.9 %   |
| Total revenues     | 11,465,675                                 | 100.0                              | % 12,377,573         | 100.0                              | % (911,898 )      | (7.4% )  |



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|  |              |          |   |           |         |   |               |          |
|--|--------------|----------|---|-----------|---------|---|---------------|----------|
| Cost of revenues   | 6,095,413    | 53.2     | % | 6,020,601 | 48.6    | % | (74,812 )     | (1.2% )  |
| Gross profit   | 5,370,262    | 46.8     | % | 6,356,972 | 51.4    | % | (986,710 )    | (15.5% ) |
| Operating expenses:  |              |          |   |           |         |   |               |          |
| Selling, general and administrative                          | 5,305,012    | 46.3     | % | 4,154,314 | 33.6    | % | (1,150,698)   | (27.7% ) |
| Research and development                                     | 1,791,253    | 15.6     | % | 1,567,113 | 12.7    | % | (224,140 )    | (14.3% ) |
| Total operating expenses                                     | 7,096,265    | 61.9     | % | 5,721,427 | 46.3    | % | (1,374,838)   | (24.0% ) |
| (Loss) income from operations                                | (1,726,003 ) | (15.0% ) |   | 635,545   | 5.1     | % | (2,361,548)   | (371.6%) |
| Other income   | 95,469       | 0.8      | % | 88,987    | 0.7     | % | 6,482         | 7.3 %    |
| (Loss) income from continuing operations before income taxes | (1,630,534 ) | (14.2% ) |   | 724,532   | 5.8     | % | (2,355,066)   | (325.0%) |
| Income tax benefit   | (862,720 )   | (7.5% )  |   | (7,666 )  | (0.1% ) |   | 855,054       | na       |
| Net (loss) income  | \$(767,814 ) | (6.7% )  |   | \$732,198 | 5.9     | % | \$(1,500,012) | (204.9%) |

Revenues decreased in the first nine months of 2016, compared to the prior year due to the timing of customer orders and delays in awarding contracts. The receipt of orders will often be uneven due to the timing of approvals or budgets. While we continue to experience delays in projects in both U.S. and international markets due to various reasons, our third fiscal quarter showed signs of improvement. Shipments during the first nine months included a wide variety of applications including global public safety, border and perimeter security, energy companies, mass notification, oil and gas, prisons, U.S. and foreign military and military vehicles. At June 30, 2016, we had aggregate deferred revenue of \$339,095 for prepayments from customers in advance of product shipment.

**Gross Profit**

The decrease in gross profit in the year was primarily due to the decrease in revenue, lower product margins as a result of product mix, and lower absorption of our fixed overhead costs.

Our products have varying gross margins, so product sales mix will materially affect gross profits. In addition, our margins vary based on the sales channels through which our products are sold in a given period. We continue to implement product updates and changes, including raw material and component changes that may impact product costs. With such product updates and changes, we have limited warranty cost experience and estimated future warranty costs can impact our gross margins. We do not believe that historical gross profit margins should be relied upon as an indicator of future gross profit margins.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses included one-time expenses of \$897,157 related to our response to and settlement of a proxy contest initiated by one of our stockholders, severance costs related to the departure of our CEO, and recruiting costs related to the search for a new CEO. In addition, expenses increased by \$334,331 for salaries, benefits and consultants, primarily for business development and marketing personnel additions, \$56,644 for marketing and trade shows and \$80,899 of other increases. These expenses were partially offset by a \$218,333 reduction for bonus accrual compared to the prior year.

We incurred non-cash share-based compensation expenses allocated to selling, general and administrative expenses in the nine months ended June 30, 2016 and 2015 of \$362,224 and \$350,099, respectively.

We may expend additional resources on the marketing and selling of our products in future periods as we identify ways to optimize potential opportunities. Commission expenses will fluctuate based on the nature of our sales.

### ***Research and Development Expenses***

Research and development expenses increased compared to the prior year primarily due to \$241,377 for increased staffing and benefits, \$43,414 for development and testing expenses and \$35,818 for depreciation, partially offset by a \$76,558 reduction for bonus accrual, \$16,763 for non-cash share based compensation expense and \$3,148 of other expense.

Included in research and development expenses for the nine months ended June 30, 2016 and 2015 was \$76,160 and \$92,923 of non-cash share-based compensation costs, respectively.

Research and development costs vary period to period due to the timing of projects, the availability of funds for research and development and the timing and extent of the use of outside consulting, design and development firms. We continually improve our product offerings and we have further expanded our product line in fiscal 2016 with new products, customizations and enhancements. Based on current plans, we expect research and development costs to continue in the current fiscal year on a basis comparable to the prior year.

### ***Net Income***

The decrease in net income was primarily due to the decrease in revenues and the one-time expenses related to a proxy contest and settlement, and severance and recruiting costs related to the departure of our CEO. In the nine months ended June 30, 2016, we recognized a tax benefit of \$862,720, compared to a benefit of \$7,666 for the same period of the prior year.

### ***Liquidity and Capital Resources***

Cash and cash equivalents at June 30, 2016 was \$15,546,733, compared to \$18,316,103 at September 30, 2015. During the nine months ended June 30, 2016, the Company used \$1,748,456 for the repurchase of common stock and \$954,650 for the payment of cash dividends. Other than cash and expected future cash flows from operating activities in subsequent periods, we have no unused sources of liquidity at this time.

Principal factors that could affect our liquidity include:

- ability to meet sales projections;
- government spending levels;
- introduction of competing technologies;
- product mix and effect on margins;
- ability to reduce current inventory levels;
- product acceptance in new markets;

- value of shares repurchased; and

- value of dividends declared.

Principal factors that could affect our ability to obtain cash from external sources include:

- volatility in the capital markets; and

- market price and trading volume of our common stock.

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Based on our current cash position, and assuming currently planned expenditures and level of operations, we believe we have sufficient capital to fund operations for the next twelve months. However, we operate in a rapidly evolving and unpredictable business environment that may change the timing or amount of expected future cash receipts and expenditures. Accordingly, there can be no assurance that we may not be required to raise additional funds through the sale of equity or debt securities or from credit facilities. Additional capital, if needed, may not be available on satisfactory terms, or at all.

### *Cash Flows*

Our cash flows from operating, investing and financing activities, as reflected in the consolidated statements of cash flows, are summarized in the table below:

|                             | <b>Nine Months Ended</b> |              |
|-----------------------------|--------------------------|--------------|
|                             | <b>June 30,</b>          |              |
|                             | <b>2016</b>              | <b>2015</b>  |
| Cash provided by (used in): |                          |              |
| Operating activities        | \$ 184,933               | \$(622,671 ) |
| Investing activities        | (251,197 )               | (5,017,934)  |
| Financing activities        | (2,703,106)              | (470,640 )   |

### *Operating Activities*

Net loss of \$767,814 for the nine months ended June 30, 2016 was increased by \$231,401 of non-cash items that included deferred income taxes, share-based compensation, depreciation and amortization, warranty provision, provision for doubtful accounts and inventory obsolescence. Cash provided by operating activities in the current year reflected an increase in payroll and related of \$869,999, primarily for payroll costs related to the separation agreement with the Company CEO and other payroll expenses for June 30, 2016 that were not paid until July 1, 2016. It also reflected an increase in accounts payable of \$750,313, accrued and other liabilities of \$169,756 for increased deferred revenue for customer prepayments, and decreased prepaid expenses and other – noncurrent of \$140,613. Cash used in operating activities included an increase in accounts receivable of \$442,115, an increase in inventories of \$257,354, an increase in prepaid expenses and other of \$15,115 and warranty settlements of \$31,949. Net income of \$732,198 for the nine months ended June 30, 2015 was adjusted for \$706,292 of non-cash items that include share-based compensation expense, depreciation and amortization, warranty provision and inventory obsolescence. Cash provided by operating activities in the prior year reflected a decrease in accounts receivable of \$1,549,018 due to collections from a high year-end balance, an increase in accounts payable of \$570,066, and a decrease in prepaid expenses and other – noncurrent of \$140,614. Cash used in operating activities included a decrease in payroll and related of \$2,425,472, primarily for the payment of bonuses earned in fiscal 2014, increased inventories of \$1,224,048 based on our current sales forecast, a decrease in accrued and other liabilities of \$562,312 from a reduction of prepayments from customers, increased prepaid expenses and other of \$75,767 and \$33,260 for warranty settlements.

We had accounts receivable of \$2,547,420 at June 30, 2016, compared to \$2,116,323 at September 30, 2015. The level of trade accounts receivable at June 30, 2016 represented approximately 46 days of revenues compared to 44 days of revenues at September 30, 2015. Terms with individual customers vary greatly. We typically require thirty-day terms from our customers if credit is approved. Our receivables can vary dramatically due to overall sales volume, quarterly variations in sales, timing of shipments to and receipts from large customers, payment terms, and the timing of contract payments.

At June 30, 2016 and September 30, 2015, our working capital was \$22,835,909 and \$25,601,714, respectively. The reduction in working capital was primarily due to use of \$1,748,456 to repurchase common shares, \$954,650 for cash dividends paid, \$897,157 for one-time expenses related to a proxy contest initiated by a stockholder of the Company, severance costs paid to our CEO on June 30, 2016 and recruiting costs related to the search for a new CEO, offset by a transfer of \$999,291 of investments from long-term to short-term.

#### *Investing Activities*

In the nine months ended June 30, 2016, we increased our holding of short and long-term marketable securities by \$81,476, compared to \$4,741,067 purchased in the nine months ended June 30, 2015.

We also use cash in investing activities primarily for the purchase of tooling, computer equipment and software, and investment in new or existing patents. Cash used in investing activities for equipment and patents was \$163,521 and \$273,482 for the nine months ended June 30, 2016 and 2015, respectively. We anticipate some additional expenditure for equipment and patents during the balance of fiscal year 2016.

### *Financing Activities*

In the nine months ended June 30, 2016 and 2015, we used \$1,748,456 and \$965,474 for the repurchase of common stock. In the nine months ended June 30, 2016 and 2015, we received \$0 and \$494,834, respectively, from the exercise of stock options.

On December 3, 2015, we announced a cash dividend of \$0.01 per share on our common stock, payable on January 29, 2016 to stockholders of record as of the close of business on January 15, 2016. On February 4, 2016, we announced a cash dividend of \$0.01 per share on our common stock, payable on March 30, 2016 to stockholders of record as of the close of business on March 15, 2016. On May 10, 2016, the Company announced a cash dividend of \$0.01 per share on the Company's common stock, payable on June 30, 2016 to stockholders of record on June 15, 2016. We paid a total of \$954,650 in dividends during the nine months ended June 30, 2016, compared to \$0 in the nine months ended June 30, 2015.

### **Recent Accounting Pronouncements**

New pronouncements issued for future implementation are discussed in Note 3, Recent Accounting Pronouncements, to our consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

#### *Interest Rate Risk*

The Company's interest income is sensitive to fluctuations in the general level of U.S. interest rates. Changes in U.S. interest rates affect the interest earned on the Company's cash. The Company's exposure to market risk for changes in interest rates is minimal as a result of maintaining cash in savings accounts. The Company currently does not have any debt that could be subject to interest fluctuation or market risk.

#### *Foreign Currency Risk*

We consider our direct exposure to foreign exchange rate fluctuations to be minimal. Currently, all sales to customers and all arrangements with third-party manufacturers, with one exception, provide for pricing and payment in U.S. dollars, and, therefore, are not subject to exchange rate fluctuations. Increases in the value of the U.S. dollar relative to other currencies could make our products more expensive, which could negatively impact our ability to compete. Conversely, decreases in the value of the U.S. dollar relative to other currencies could result in our suppliers raising their prices to continue doing business with us. Fluctuations in currency exchange rates could affect our business in the future.

#### **Item 4. Controls and Procedures.**

We are required to maintain disclosure controls and procedures designed to ensure that material information related to us, including our consolidated subsidiaries, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms.

#### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of our disclosure controls and procedures as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2016.

#### **Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting during our fiscal quarter ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Our process for evaluating controls and procedures is continuous and encompasses constant improvement of the design and effectiveness of established controls and procedures and the remediation of any deficiencies, which may be identified during this process.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.





## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

We may at times be involved in litigation in the ordinary course of business. We will also, from time to time, when appropriate in management's estimation, record adequate reserves in our consolidated financial statements for pending litigation. Currently, there are no pending material legal proceedings to which the Company is a party or to which any of its property is subject.

### **Item 1A. Risk Factors.**

As a Smaller Reporting Company as defined by Rule 12b-2 of the Exchange Act and in item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this item.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None

### **Item 3. Defaults Upon Senior Securities.**

None.

### **Item 4. Mine Safety Disclosures.**

Not Applicable.

### **Item 5. Other Information.**

None.

**Item 6. Exhibits.**

31.1 Certification of Richard S. Danforth, Principal Executive Officer, pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*

31.2 Certification of Katherine H. McDermott, Principal Financial Officer, pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Richard S. Danforth, Principal Executive Officer and Katherine H. McDermott, Principal Financial Officer.\*

101.INS XBRL Instance Document\*

101.SCH XBRL Taxonomy Extension Schema Document\*

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document\*

101.DEF XBRL Taxonomy Extension Definition Linkbase Document\*

101.LAB XBRL Taxonomy Extension Label Linkbase Document\*

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document\*

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\*Filed concurrently herewith.

**SIGNATURES**

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

LRAD CORPORATION

Date: August 2, 2016 By: /s/ KATHERINE H. MCDERMOTT  
**Katherine H. McDermott, Chief Financial Officer**  
**(Principal Financial Officer)**