

Henry Bros. Electronics, Inc.
Form 10-Q
August 12, 2010

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2010

OR

TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File No. 1-16779

Henry Bros. Electronics, Inc.
(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

22-3690168
(I.R.S. Employer
Identification No.)

17-01 Pollitt Drive
Fair Lawn, New Jersey 07410
(address of principal executive offices) (Zip Code)
Registrant's Telephone number, including area code: (201) 794-6500

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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Non-accelerated filer

Smaller reporting company

(Do not check if a 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

Indicate the number of shares outstanding of each of the Registrant's Common Stock, as of the latest practicable date:

6,050,366 shares of common stock, \$.01 par value per share, as of August 6, 2010.

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Part I Financial Information

Item 1. Financial Statements

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| | June 30, 2010 (unaudited) | December 31, 2009 (audited) |
|---|---------------------------------|-----------------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 1,724,073 | \$ 2,917,046 |
| Accounts receivable-net of allowance for doubtful accounts of \$720,729 at June 30, 2010 and \$712,206 at December 31, 2009 | 12,009,262 | 12,053,139 |
| Inventory | 1,731,602 | 1,245,306 |
| Cost and estimated profit in excess of billing | 7,628,587 | 6,003,533 |
| Deferred tax asset | 1,110,455 | 1,251,443 |
| Retainage receivable | 709,124 | 295,928 |
| Prepaid expenses and income tax receivable | 1,074,868 | 1,423,541 |
| Other assets | 159,666 | 161,479 |
| Total current assets | 26,147,637 | 25,351,415 |
| Property and equipment - net of accumulated depreciation of \$3,967,147 at June 30, 2010 and \$3,564,650 at December 31, 2009 | 2,042,303 | 2,254,054 |
| Goodwill | 3,850,230 | 3,785,480 |
| Intangible assets - net of accumulated amortization of \$1,273,004 at June 30, 2010 and \$1,187,013 at December 31, 2009 | 802,761 | 888,752 |
| Other assets | 358,596 | 412,594 |
| TOTAL ASSETS | \$ 33,201,527 | \$ 32,692,295 |
| LIABILITIES & STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | 6,336,301 | \$ 5,360,471 |
| Accrued expenses | 3,372,421 | 3,507,060 |
| Billing in excess of cost and estimated profit | 1,034,127 | 1,567,874 |
| Deferred income | 207,680 | 136,574 |
| Current portion of long-term debt | 342,884 | 536,552 |
| Other current liabilities | 416,003 | 494,017 |
| Total current liabilities | 11,709,416 | 11,602,548 |
| Long-term debt, less current portion | 4,406,152 | 4,830,517 |
| Deferred tax liability | 519,988 | 318,850 |
| TOTAL LIABILITIES | 16,635,556 | 16,751,915 |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock, \$.01 par value; 2,000,000 shares authorized; no shares issued | - | - |
| | 60,454 | 60,354 |

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| | | |
|---|---------------|---------------|
| Common stock, \$.01 par value; 20,000,000 shares authorized 6,045,366 shares issued and outstanding in 2010 and 6,035,366 in 2009 | | |
| Additional paid in capital | 18,611,588 | 18,437,288 |
| Accumulated deficit | (2,106,071) | (2,557,262) |
| TOTAL EQUITY | 16,565,971 | 15,940,380 |
| TOTAL LIABILITIES & STOCKHOLDERS' EQUITY | \$ 33,201,527 | \$ 32,692,295 |

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | Six months ended June 30, | | Three months ended June 30, | |
|--|---------------------------|---------------|-----------------------------|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | \$ 27,592,292 | \$ 29,280,192 | \$ 15,151,000 | \$ 13,971,980 |
| Cost of revenue | 19,894,834 | 21,168,069 | 11,030,544 | 10,081,871 |
| Gross profit | 7,697,458 | 8,112,123 | 4,120,456 | 3,890,109 |
| Operating expenses: | | | | |
| Selling, general & administrative expenses | 6,762,113 | 7,562,645 | 3,305,055 | 3,691,785 |
| Operating profit | 935,345 | 549,478 | 815,401 | 198,324 |
| Interest income | 56,333 | 9,037 | 14,339 | 2,067 |
| Other income | 4,465 | 15,794 | - | 2,608 |
| Interest expense | (111,785) | (165,407) | (52,808) | (99,706) |
| Income before income tax expense | 884,358 | 408,902 | 776,932 | 103,293 |
| Income tax expense | 433,167 | 187,527 | 383,128 | 48,040 |
| Net income | \$ 451,191 | \$ 221,375 | \$ 393,804 | \$ 55,253 |
| BASIC EARNINGS PER COMMON SHARE: | | | | |
| Basic earnings per common share | \$ 0.07 | \$ 0.04 | \$ 0.07 | \$ 0.01 |
| Weighted average common shares | 6,040,615 | 5,850,048 | 6,043,937 | 5,870,291 |
| DILUTED EARNINGS PER COMMON SHARE: | | | | |
| Diluted earnings per common share | \$ 0.07 | \$ 0.04 | \$ 0.06 | \$ 0.01 |
| Weighted average diluted common shares | 6,203,366 | 6,044,499 | 6,206,688 | 6,064,742 |

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the six months ended June 30, | |
|---|--------------------------------------|---------------------|
| | 2010 (unaudited) | 2009 (unaudited) |
| Cash flows from operating activities: | | |
| Net income | \$ 451,191 | \$ 221,375 |
| Adjustments to reconcile net income from operations to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 505,408 | 459,098 |
| Bad debt expense | 77,281 | 159,979 |
| Provision for obsolete inventory | 1,226 | - |
| Stock option expense | 132,500 | 193,000 |
| Deferred income taxes | 342,126 | 232,177 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (33,404) | 1,270,740 |
| Inventory | (486,296) | (40,214) |
| Costs in excess of billings and estimated profits | (1,625,054) | 2,065,552 |
| Retainage receivable | (413,197) | 471,990 |
| Other assets | 55,811 | (32,757) |
| Prepaid expenses and income tax receivable | 348,673 | (466,057) |
| Accounts payable | 975,830 | (3,052,553) |
| Accrued expenses | (134,639) | (1,183,517) |
| Billings in excess of costs and estimated profits | (533,747) | (572,394) |
| Deferred income | 71,106 | (65,231) |
| Other liabilities | (78,014) | 239,502 |
| Net cash used in operating activities | (343,199) | (99,310) |
| Cash flows from investing activities: | | |
| Purchase of businesses, net of cash acquired | (25,000) | (37,500) |
| Purchase of property and equipment | (120,767) | (196,576) |
| Net cash used in investing activities | (145,767) | (234,076) |
| Cash flows from financing activities: | | |
| Proceeds from exercising of stock options - net of fees | - | 185,069 |
| Borrowings under revolving loan agreement | 2,200,000 | 1,900,000 |
| Repayments under revolving agreement | (2,600,000) | - |
| Payments of bank loans | - | (103,410) |
| Net repayments of other debt | (150,482) | (271,869) |
| Payments of equipment financing | (153,525) | (139,038) |
| Net cash (used in) provided by financing activities | (704,007) | 1,570,752 |
| (Decrease) increase in cash and cash equivalents | (1,192,973) | 1,237,366 |
| Cash and cash equivalents - beginning of period | 2,917,046 | 27,704 |
| Cash and cash equivalents - end of period | \$ 1,724,073 | \$ 1,265,070 |
| Supplemental disclosure of cash flow information: | | |
| Amount paid for the period for: | | |
| Interest | \$ 111,785 | \$ 144,508 |
| Taxes | 66,400 | 698,083 |

Non-cash investing and financing activities:

| | | |
|---|--------|---------|
| Equipment financed | 86,897 | 268,844 |
| Issuance of stock to acquire businesses | 39,750 | 79,250 |

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONCS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

| | Common Stock par value \$0.01 | | Additional Paid-in Capital | Accumulated Deficit | Total |
|---|----------------------------------|-----------|----------------------------------|------------------------|---------------|
| | Shares | Amount | | | |
| Balance at December 31, 2009 (audited) | 6,035,366 | \$ 60,354 | \$ 18,437,288 | \$ (2,557,262) | \$ 15,940,380 |
| Shares issued in connection with the acquisition of CIS Security Systems | 10,000 | 100 | 41,800 | - | 41,900 |
| Amortization of value assigned to stock option grants | - | - | 132,500 | - | 132,500 |
| Net income | - | - | - | 451,191 | 451,191 |
| Balance at June 30, 2010 (unaudited) | 6,045,366 | \$ 60,454 | \$ 18,611,588 | \$ (2,106,071) | \$ 16,565,971 |

See accompanying notes to the condensed consolidated financial statements.

HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS (UNAUDITED)

1. Description of Business and Basis of Presentation

Interim Financial Statements:

The information presented as of June 30, 2010 and for the three and six month periods ended June 30, 2010 and 2009 are unaudited, and reflect all adjustments (consisting only of normal recurring adjustments) which Henry Bros. Electronics, Inc. and its Subsidiaries (the "Company" or "HBE") considers necessary for the fair presentation of the Company's financial position as of June 30, 2010, the results of its operations for the three and six month periods ended June 30, 2010 and 2009, and cash flows and changes in stockholders' equity for the six month period ended June 30, 2010. The Company's December 31, 2009 balance sheet information was derived from the audited consolidated financial statements for the year ended December 31, 2009, which are included as part of the Company's Annual Report on Form 10-K.

The condensed consolidated financial statements included herein have been prepared in accordance with U.S. generally accepted accounting principles and the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, 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. It is suggested that these condensed financial statements be read in conjunction with the Company's financial statements and notes thereto included in the Company's latest shareholders' annual report.

As of June 30, 2010, there have been no material changes to any of the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Description of Business:

Henry Bros. Electronics, Inc. is an established player in the electronic physical security industry, specializing in integrated security systems, and emergency preparedness.

HBE provides products and services to customers in the public and private sectors. Customers include transit authorities, seaports, airports, universities, office-buildings, hospitals and airlines. Each of the Company's segments markets its products and services nationwide with an emphasis in Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia.

The company operates through two primary operating segments:

1. Security Systems Integration
2. Specialty Product and Services

The Security Systems Integration business operates under the name Henry Bros. Electronics, Inc. and its approach to client service is core to all of its businesses. At the beginning of each new client relationship, HBE designates one member of its professional staff as the client service contact. This individual is the point person for communications between the client and HBE and often acts as the client's project manager for all of its security needs, which ensures that clients receive the best possible security solution to meet its needs. The Company derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

The Specialty Products and Services segment includes three separate businesses:

1. Evacuation planning
2. Mobile digital recording
3. Airorlite Communications

The Evacuation Planning business operates under the Diversified Security Solutions, Inc. name and works with managers of high-rise office buildings to analyze their specific facilities' needs with emergency preparedness plans. This division provides demonstrations, training and recommendations to clients; develops emergency plans and procedures; and communicates building strategy to the tenants to increase building community unity, awareness and confidence.

The Mobile Digital Recording business operates under the name Viscom Products, Inc. and has developed an integrated standard solution for the deployment of mobile digital recorders on municipal buses and trains.

The Airorlite Communications business provides specialized communications product design, development and engineering related to RF transmission.

HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS (UNAUDITED) – (continued)

The table below shows the sales percentages by geographic location for the following periods:

| | Six months ended June 30, | |
|---------------------|---------------------------|------|
| | 2010 | 2009 |
| New Jersey/New York | 50% | 47% |
| California | 19% | 20% |
| Texas | 8% | 4% |
| Arizona | 5% | 8% |
| Colorado | 7% | 12% |
| Virginia / Maryland | 7% | 8% |
| Integration segment | 96% | 99% |
| Specialty segment | 5% | 2% |
| Inter-segment | -1% | -1% |
| Total revenue | 100% | 100% |

2. Summary of Significant Accounting Policies:

Principles of Consolidation:

The condensed consolidated financial statements include the accounts of the Company. Acquisitions are recorded as of the purchase date, and are included in the consolidated financial statements from the date of acquisition. All material intercompany transactions have been eliminated in consolidation.

Use of Estimates:

The preparation of financial statements, in conformity with generally accepted accounting principles in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and costs relating to security integration systems projects and service agreements are particularly affected by management's estimates. The contract sale price and estimated costs are based upon the facts and circumstances known at the time of the proposal. Estimates for the costs to complete the contract are periodically updated during the performance of the contract. Unpredictable events can occur during the performance of the contract that can increase the costs and reduce the estimated gross profit. Change orders to record additional costs may not be approved or can become subject to long negotiations with the customer and can result in concessions by the Company. Considerable judgments are made during the performance of the contract that affects the Company's revenue recognition and cost accruals that may have a significant impact on the results of operations reported by the Company.

Fair Value of Financial Instruments:

The carrying amounts of the Company's financial instruments, which include cash equivalents, accounts receivable, accounts payable, accrued expenses, short and long-term debt, approximate their fair values as of June 30, 2010.

Recently Issued Accounting Pronouncements:

In May 2009, the FASB issued guidance now codified as FASB ASC Topic 855, "Subsequent Events," which establishes general standards of accounting for, and disclosures of, events that occur after the balance sheet date but before financial statements are issued. This pronouncement is effective for interim or fiscal periods ending after June 15, 2009. The adoption of this pronouncement did not have a material impact on our consolidated financial position, results of operations or cash flows. However, the provisions of FASB ASC Topic 855 resulted in additional disclosures with respect to subsequent events. In February 2010, an update to accounting guidance was issued which eliminates the disclosure of the date through which subsequent events have been evaluated. This update was effective immediately. The adoption of this amendment did not have a significant effect on our financial statements.

HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS (UNAUDITED) – (continued)

3. Earnings Per Share

The computation of basic earnings per share is based upon the weighted average number of shares of common stock outstanding during the period. When applicable, the computation of diluted earnings per share includes the dilutive effects of common stock equivalents, less the shares that may be repurchased with the funds received from their exercise and the effect of adding back unrecognized future stock compensation expense. Potentially dilutive common stock equivalents include shares issuable upon exercise of options. Contingent shares are excluded from basic earnings per share.

4. Stock Based Compensation

For the three months ended June 30, 2010 and 2009, the Company charged \$72,500 and \$133,000, respectively, to operations for stock based compensation expense. For the six months ended June 30, 2010 and 2009, the Company charged \$132,500 and \$193,000, respectively, to operations for stock based compensation expense. A modification to a stock option, previously issued to an executive officer, extending the term for one year, resulted in an expense in the second quarter of 2009, equal to the net increase in the fair value of the modified stock option of \$49,000.

A summary of stock option activity for the six months ended June 30, 2010 under the Company's various Stock Option Plans' follows:

| | Number of Shares | | Weighted Average Exercise Price | |
|--------------------------------|------------------|-------------|---------------------------------|-------------|
| | Outstanding | Exercisable | Outstanding | Exercisable |
| December 31, 2009 (audited) | 997,799 | 628,866 | \$ 4.96 | \$ 5.17 |
| Granted at market | 113,000 | | 3.86 | |
| Exercised | - | | - | |
| Forfeited or expired | (110,300) | | 7.01 | |
| June 30, 2010 (unaudited) | 1,000,499 | 555,788 | \$ 4.61 | \$ 4.77 |

Stock based compensation is being amortized over the vesting period of up to five years. The fair value of the Company's stock option awards was estimated assuming no expected dividends and the following weighted-average assumptions for the six months ended June 30, 2010 follows:

| | |
|--|---------|
| Expected Life (years) | 5.86 |
| Expected volatility | 50.6% |
| Risk-free interest rates | 1.9% |
| Dividend yield | - |
| Weighted-average grant-date fair value | \$ 1.67 |

There were 113,000 options issued during the six month period ending June 30,2010

5. Costs and Billings on Uncompleted Contracts

Costs and billing on uncompleted contracts consisted of the following:

| | June 30, 2010 | December 31, 2009 |
|--|------------------|----------------------|
| Cost and estimated profit on uncompleted contracts | \$ 37,357,461 | \$ 46,259,927 |
| Billing on uncompleted contracts | 30,763,001 | 41,824,268 |
| | \$ 6,594,460 | \$ 4,435,659 |

Included in accompanying Balance Sheets under the following captions:

| | June 30, 2010 | December 31, 2009 |
|--|------------------|----------------------|
| Cost and estimated profit in excess of billing | \$ 7,628,587 | \$ 6,003,533 |
| Billing in excess of cost and estimated profit | 1,034,127 | 1,567,874 |
| | \$ 6,594,460 | \$ 4,435,659 |

HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS (UNAUDITED) – (continued)

6. Long-Term Debt

On June 30, 2005, the Company entered into a loan agreement (the “Loan Agreement”) with TD Bank, N.A. pursuant to which TD Bank extended a \$4 million two-year credit facility (the “Revolving Loan”), to the Company and refinanced \$1 million of existing indebtedness to TD Bank into a five year term loan (the “Term Loan”).

On October 6, 2008, the Company executed its fourth amendment to the Revolving Loan with TD Bank, increasing its line of credit from \$4 million to \$8 million. The Revolving Loan is subject to certain borrowing base limitations. On August 10, 2010 the term of the Revolving Loan was extended to June 30, 2012. Advances under the Revolving Loan may be used to finance working capital and acquisitions. Interest is paid monthly in arrears at TD Bank’s prime rate, subject to a minimum floor rate of 4.0% effective November 11, 2009 as part of the extension of the Revolving Loan. TD Bank has a first priority security interest on the Company’s accounts receivable and inventory.

The Company is required to maintain certain financial and reporting covenants and is restricted from paying dividends under the terms of the Loan Agreement.

Long-term debt included the following balances:

| | June 30, 2010 | December 31, 2009 |
|--|------------------|----------------------|
| Revolving line at the prime rate of interest, subject to a minimum floor rate of 4.0% effective November 11, 2009. Expires June 30, 2012 | \$ 3,935,898 | \$ 4,335,898 |
| Corporate insurance financed at 5.99% payable in monthly installments thru September 01, 2010 | 43,259 | 194,665 |
| Capitalized lease obligations due in monthly installments, with interest ranging from 6.4% to 12.7% | 769,879 | 836,506 |
| | 4,749,036 | 5,367,069 |
| Less: Current Portion | (342,884) | (536,552) |
| | \$ 4,406,152 | \$ 4,830,517 |

The weighted average interest rate on the Revolving Loan was 4.0% and 3.35% for the six months ended June 30, 2010 and the year ended December 31, 2009, respectively.

7. Income Taxes

The effective income tax rate for the three months and six months ended June 30, 2010 was 49.3% and 49.0%, respectively, compared with an effective income tax rate of 46.5% and 45.9% for the three months and six months ended June 30, 2009, respectively. Income tax expense for interim reporting is based on an annual effective income tax rate forecast, which includes estimates and assumptions that could change during the year. The differences between the effective income tax rate and the U.S. federal statutory rate of 34% principally result from state and local taxes, and differences between the book and tax treatment of certain items, such as incentive stock options.

The effective income tax rate for the three months and six months ended June 30, 2010 has not been impacted by any material discrete items. As of June 30, 2010 the Company has \$51,053 of unrecognized income tax benefits, all of

which would impact the Company's effective tax rate if recognized. There have been no significant changes during the six months ended June 30, 2010.

8. STOCKHOLDERS' EQUITY

In connection with the acquisition of all the capital stock of CIS Security Systems Corp. ("CIS") on October 2, 2006, the Company issued an aggregate of 20,000 shares of its common stock, valued at \$67,200. The Company issued an additional 60,000 shares during 2009, 2008 and 2007, and 10,000 shares during the first six months of 2010 of its restricted common stock to CIS's selling shareholder after CIS met certain performance targets. The issuance of the shares of restricted stock in connection with the aforementioned acquisition was made in reliance upon the exemption provided in section 4(2) of the Securities Act of 1933, as amended. In addition, the selling shareholder may earn an additional 10,000 shares of the Company's common stock if CIS achieves certain performance targets through December 2011.

HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS (UNAUDITED) – (continued)

9. Segment Data

Selected information by business segment is presented in the following tables:

| | For the six months ended June 30, | | For the three months ended June 30, | |
|-------------------------------|-----------------------------------|----------------------|-------------------------------------|----------------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | | | | |
| Integration | \$ 26,525,407 | \$ 28,886,728 | \$ 14,856,929 | \$ 13,897,082 |
| Specialty | 1,336,188 | 661,464 | 563,374 | 342,898 |
| Inter-segment | (269,303) | (268,000) | (269,303) | (268,000) |
| Total revenue | \$ 27,592,292 | \$ 29,280,192 | \$ 15,151,000 | \$ 13,971,980 |
| Operating Profit | | | | |
| Integration | \$ 2,300,932 | \$ 2,328,801 | \$ 1,533,341 | \$ 1,136,925 |
| Specialty | 419,718 | 66,743 | 152,597 | 2,847 |
| Corporate | (1,785,305) | (1,846,066) | (870,537) | (941,448) |
| Total operating profit | \$ 935,345 | \$ 549,478 | \$ 815,401 | \$ 198,324 |

Selected balance sheet information by business segment is presented in the following table as of:

| | June 30, 2010 | December 31, 2009 |
|----------------------|----------------------|----------------------|
| Total Assets: | | |
| Integration | 29,007,081 | \$ 27,309,364 |
| Specialty | 1,126,359 | 1,454,812 |
| Corporate | 3,068,087 | 3,928,119 |
| Total assets | \$ 33,201,527 | \$ 32,692,295 |

10. Contingent Liabilities

From time to time, the Company is subject to various claims with respect to matters arising out of the normal course of business. In management's opinion, none of these claims is likely to have a material effect on the Company's consolidated financial statements.

11. Related Party Transactions

Richard D. Rockwell, a member of the Board of Directors since November 2007, has been Owner and Chairman of Professional Security Technologies LLC, a full service security systems integrator since 1996. The Company had revenues from PST of \$45,558 and \$15,590 for the three months ended June 30, 2010 and 2009, respectively and had revenues from PST of \$63,148 and \$73,765 for the six months ended June 30, 2010 and 2009, respectively. These revenues were principally related to the sale of equipment. There was a balance of \$84,983 and \$39,192 in accounts receivable as of June 30, 2010 and December 31, 2009, respectively.

12. Subsequent Events:

In August 2010, the Company agreed to purchase certain assets of Professional Security Technologies LLC ("PST") consisting principally of a customer list of existing and targeted potential PST customers ("PST Customers") and PST's assignment of its rights under an existing dealer agreement with a national equipment supplier pursuant to which the Company will be authorized to sell Supplier's products ("Supplier Products"). PST is a New Jersey limited liability company owned by the Company's Chairman of the Board of Directors. In addition, the Company agreed to hire certain PST employees. The total consideration being paid to PST for the assets is as follows:

1. 150,000 shares of the Company's common stock, 75,000 of which will be delivered at closing. The remaining 75,000 shares will be held in escrow subject to delivery as described in point 3 below.
2. Payment of five (5%) percent of the net cash proceeds received by the Company, during the period commencing on July 1, 2010 and ending on December 31, 2012, in connection with (a) sales to PST customers (including sales of Supplier Products) and (b) sales of Supplier Products to the Company's other customers.
3. 75,000 shares of the Company's common stock when the aggregate revenue from the sales described above, during the period commencing on July 1, 2010 and ending on December 31, 2012, equal \$8,000,000; provided, however, such shares will be released, prior to reaching the revenue target, in the event there is a change in control of the Company prior to December 31, 2012.

This transaction will be accounted for under the purchase method of accounting. The purchase price payable at closing and the contingent consideration will be recorded as an identifiable intangible asset and goodwill.

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

OVERVIEW

Henry Bros. Electronics, Inc. is an established player in the electronic physical security industry, specializing in integrated security systems, and emergency preparedness.

HBE provides products and services to customers in the public and private sectors. Customers include transit authorities, seaports, airports, universities, office-buildings, hospitals and airlines. Each of the Company's segments markets its products and services nationwide with an emphasis in Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia.

The company operates through two primary operating segments:

1. Security Systems Integration
2. Specialty Product and Services

The Security Systems Integration business operates under the name Henry Bros. Electronics, Inc. and its approach to client service is core to all of its businesses. At the beginning of each new client relationship, HBE designates one member of its professional staff as the client service contact. This individual is the point person for communications between the client and HBE and often acts as the client's project manager for all of its security needs, which ensures that clients receive the best possible security solution to meet its needs. The Company derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

The Specialty Products and Services segment includes three separate businesses:

1. Evacuation planning
2. Mobile digital recording
3. Airorlite Communications

The Evacuation Planning business operates under the Diversified Security Solutions, Inc. name and works with managers of high-rise office buildings to analyze their specific facilities' needs with emergency preparedness plans. This division provides demonstrations, training and recommendations to clients; develops emergency plans and procedures; and communicates building strategy to the tenants to increase building community unity, awareness and confidence.

The Mobile Digital Recording business operates under the name Viscom Products, Inc. and has developed an integrated standard solution for the deployment of mobile digital recorders on municipal buses and trains.

The Airorlite Communications business provides specialized communications product design, development and engineering related to RF transmission.

OUR VISION AND STRATEGY

Our vision is to maintain our leadership position in security technology. We intend to do this in part by:

- Providing advice on product selection and system design;
- Examining and thoroughly testing each security product as it would be set up for use in our customers' facilities; and,
- Using only systems and components that are reliable and efficient to use.

In addition to growing the business organically, we are opportunistically open to the possibility of pursuing the strategic acquisition of synergistic integrators and specialty products and service companies. To finance our acquisitions, we have used a combination of internally generated cash, the sale of Company common stock and bank debt. We currently have an \$8 million revolving credit facility, subject to certain borrowing base limitations, with TD Bank. Borrowings under the revolving credit facility were \$3,935,898 at June 30, 2010. It is our expectation and intent to use cash and to incur additional debt as appropriate to finance future working capital and acquisitions. Additionally, to fund future acquisitions we would consider the issuance of subordinated debt, the sale of equity securities, or the sale of existing Company assets.

TRENDS

Booked orders increased 110.8% to \$34,785,752 in the second quarter of 2010, as compared to \$16,500,960 same quarter of 2009. Booked orders increased 75.5% to \$49,570,775 in the first six months of 2010, as compared to \$28,241,723 in the first six months of 2009.

The Company's backlog of \$50,000,277 at June 30, 2010 increased 120.6% from the June 30, 2009 backlog of \$22,662,774. The principal drivers of this increase were increase bookings in our New Jersey / New York, Texas and California operations.

Given the above change in 2010 backlog, our revenue forecast for 2010 is currently expected to fall within a range of \$70 million to \$75 million, from the previously disclosed range of \$60 million to \$65 million. In addition, we currently anticipate our overall average operating margins for our business to be in the range of 5.0% to 6.0% from the previously disclosed range of 4.0% to 5.0% for the year ended December 31, 2010, as compared to an operating loss of 1.3% in 2009 and an operating profit of 5.0% in 2008.

There are several factors impacting operating margins, including levels of competition for a particular project and the size of the project. As a significant amount of our costs are relatively fixed, such as labor costs, increases or decreases in revenues can have a significant impact on operating margins. The Company continually monitors costs and pursues various cost control measures and sales initiatives to improve operating margins.

In February 2008, the Company entered into a subcontractor agreement with Global Security & Engineering Solutions, a division of L-3 Services, Inc. (the "L-3 Contract") pursuant to which L-3 would issue task orders under its Indefinite Quantity Firm Fixed Price Contract with the U.S. Marine Corp Systems Command to deliver a Tactical Video Capture System ("TVCS"). TVCS is used for real-time visualization and situational awareness while Marine units are conducting military operations in urban terrain training exercises. The performance period of the contract is three years. In the first half of 2010, the revenue recognized under this contract represented \$2.1 million, compared to \$4.0 million in the first half of 2009. There were outstanding task orders included in our backlog of approximately \$2.1 million at June 30, 2010.

Three Months Ended June 30, 2010 compared to June 30, 2009

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(Unaudited)

Three months ended June 30,

| | 2010 | 2009 | % change |
|--|---------------|---------------|----------|
| Revenue | \$ 15,151,000 | \$ 13,971,980 | 8.4% |
| Cost of revenue | 11,030,544 | 10,081,871 | 9.4% |
| Gross profit | 4,120,456 | 3,890,109 | 5.9% |
| Operating expenses: | | | |
| Selling, general & administrative expenses | 3,305,055 | 3,691,785 | -10.5% |
| Operating profit | 815,401 | 198,324 | 311.1% |
| Interest income | 14,339 | 2,067 | 593.7% |
| Other income | - | 2,608 | -100.0% |
| Interest expense | (52,808) | (99,706) | -47.0% |
| Income before income tax expense | 776,932 | 103,293 | 652.2% |
| Income tax expense | 383,128 | 48,040 | 697.5% |
| Net income | \$ 393,804 | \$ 55,253 | 612.7% |

Revenue - Revenue for the three months ended June 30, 2010 was \$15,151,000, representing an increase of \$1,179,020 or 8.4%, as compared to revenue of \$13,971,980 for the three months ended June 30, 2009. Our California, New Jersey/New York and Texas operations each experienced significant revenue increases in the second quarter of 2010 compared with the second quarter of 2009. Although the overall market continues to be very price competitive as a result of the slowly recovering U.S. economy, a significant amount of the increase in revenue in the second quarter of 2010 relates to revenue driven from the public sector transportation vertical market. Partially offsetting these increases were declines in revenues recognized under the L-3 Contract, as well as declines in our Colorado and Arizona operations. The wind down of a large project in our Colorado operation in 2009 that did not repeat in 2010 was a significant contributor for the decline in that operation. The L-3 Contract generated \$1.2 million lower revenue in the second quarter of 2010 compared to the same period in 2009. Revenues under the L-3 Contract slowed in 2010 due to the government adopting the Unified Facilities Criteria (“UFC”) in the first quarter of 2010. The UFC called for enhancing existing installation drawing packages prior to construction approval. Currently, two sites are in progress and four additional sites are scheduled to begin in the second half of 2010.

Cost of Revenue and Gross Profit - Cost of revenue for the three months ended June 30, 2010 was \$11,030,544, as compared to \$10,081,871 for the three months ended June 30, 2009. Gross profit for the three months ended June 30, 2010 was \$4,120,456 as compared to gross profit of \$3,890,109 for the three months ended June 30, 2009. The gross profit margin for the three months ended June 30, 2010 was 27.2 % as compared to 27.8% for the three months ended June 30, 2009. The increase in gross profit dollars was directly related to the higher revenues discussed above. Although California, Texas and Arizona’s gross profit as a percent of revenue (“gross profit margin”) increased in the second quarter of 2010 compared to the second quarter of 2009, the gross profit margin in our Colorado, Mid-Atlantic, and New Jersey/New York operations each decreased in this same comparable period. The lower gross profit margin was attributable to the pricing pressures of a highly competitive market. These pressures more than offset the cost containment and efficiency improvement efforts implemented throughout the Company in order to lessen the negative impact of the slowly recovering U.S. economy. In addition, the gross profit dollars and margins were lower under the L-3 contract for those reasons discussed in “Revenue” above. Partially offsetting the declines was increased gross profit dollars and margin from our Airorlite operations.

Selling, General and Administrative Expenses - Selling, general and administrative expense was \$3,305,055 for the three months ended June 30, 2010 as compared to \$3,691,785 for the three months ended June 30, 2009. This decrease of \$386,730 or 10.5% was mainly attributable to lower personnel costs, lower facility costs and overall cost containment reflecting management’s efforts to lessen the negative impact of the protracted credit freeze and economic downturn.

Interest Income – Interest income for the three months ended June 30, 2010 was \$14,339 as compared to \$2,067 for the three months ended June 30, 2009. This increase was attributable to higher average cash balances during the three month period ended June 30, 2010 versus the same period in the prior year.

Interest Expense - Interest expense for the three months ended June 30, 2010 was \$52,808 as compared to \$99,706 for the three months ended June 30, 2009. The decrease is due to the average outstanding revolving debt balance being \$2,444,505 lower in the three month period ended June 30, 2010 versus that in the three months ended June 30, 2009.

Tax Expense – The Company recognized income tax expense for the three months ended June 30, 2010 of \$383,128, based upon income before income taxes of \$776,932, compared with income tax expense of \$48,040 for the three months ended June 30, 2009, based upon income before income taxes of \$103,293. Income tax expense for interim reporting is based on an annual effective income tax rate forecast, which includes estimates and assumptions that could change during the year. The differences between the effective income tax rate and the U.S. federal statutory rate of 34% principally result from state and local taxes, and differences between the book and tax treatment of certain

items, such as incentive stock options. The effective income tax rate for the three months ended June 30, 2010 was 49.3%, compared to an effective income tax rate of 46.5% for the three months ended June 30, 2009.

Net Income - As a result of the above noted factors our net income was \$393,804 for the three months ended June 30, 2010, compared to net income of \$55,253 for the three months ended June 30, 2009. This resulted in diluted income per share of \$0.06 on weighted average diluted common shares outstanding of 6,206,688 for the three months ended June 30, 2010, as compared to diluted earnings per share of \$0.01 on weighted average diluted common shares outstanding of 6,064,742 for the three month period ended June 30, 2009.

Six Months Ended June 30, 2010 compared to June 30, 2009

| | (Unaudited) | | |
|--|---------------------------|---------------|----------|
| | Six months ended June 30, | | |
| | 2010 | 2009 | % change |
| Revenue | \$ 27,592,292 | \$ 29,280,192 | -5.8% |
| Cost of revenue | 19,894,834 | 21,168,069 | -6.0% |
| Gross profit | 7,697,458 | 8,112,123 | -5.1% |
| Operating expenses: | | | |
| Selling, general & administrative expenses | 6,762,113 | 7,562,645 | -10.6% |
| Operating profit | 935,345 | 549,478 | 70.2% |
| Interest income | 56,333 | 9,037 | 523.4% |
| Other income | 4,465 | 15,794 | -71.7% |
| Interest expense | (111,785) | (165,407) | -32.4% |
| Income before income tax expense | 884,358 | 408,902 | 116.3% |
| Income tax expense | 433,167 | 187,527 | 131.0% |
| Net income | \$ 451,191 | \$ 221,375 | 103.8% |

Revenue - Revenue for the six months ended June 30, 2010 was \$27,592,292, representing a decrease of \$1,687,900 or 5.8%, as compared to revenue of \$29,280,192 for the six months ended June 30, 2009. While our Texas, New Jersey/New York and California operations each experienced significant revenue increases in the first half of 2010 compared with the first half of 2009, the overall market continues to be very price competitive as a result of the slowly recovering U.S. economy, which contributed to revenue declines in our Colorado, Arizona and Mid-Atlantic operations. The wind down of a large project in our Colorado operation in 2009 that did not repeat in 2010 was a significant contributor to the decline in that operation. The L-3 Contract generated \$1.9 million lower revenue in the first half of 2010 compared to the same period in 2009. Revenues under the L-3 Contract slowed in 2010 due to the government adopting the Unified Facilities Criteria (“UFC”) in the first quarter of 2010. The UFC called for enhancing existing installation drawing packages prior to construction approval. Currently, two sites are in progress and four additional sites are scheduled to begin in the second half of 2010.

Cost of Revenue and Gross Profit - Cost of revenue for the six months ended June 30, 2010 was \$19,894,834, as compared to \$21,168,069 for the six months ended June 30, 2009. Gross profit for the six months ended June 30, 2010 was \$7,697,458 as compared to gross profit of \$8,112,123 for the six months ended June 30, 2009. The gross profit margin for the six months ended June 30, 2010 was 27.9% as compared to 27.7% for the six months ended June 30, 2009. The decrease in gross profit dollars was directly related to the lower revenues discussed above. In addition, all operations in the Integration segment, except for the California Banking operation, experienced a lower gross profit as a percent of revenue (“gross profit margin”) in the second half of 2010 compared to the second half of 2009. The lower gross profit margin was attributable to the pricing pressures of a highly competitive market. These pressures more than offset the cost containment and efficiency improvement efforts implemented throughout the Company in order to lessen the negative impact of the slowly recovering U.S. economy. In addition, the gross profit dollars and margins were lower under the L-3 contract for those reasons discussed in “Revenue” above. Partially offsetting the declines was increased gross profit dollars and margin from our Airorlite operations.

Selling, General and Administrative Expenses - Selling, general and administrative expense was \$6,762,113 for the six months ended June 30, 2010 as compared to \$7,562,645 for the six months ended June 30, 2009. This decrease of \$800,532 or 10.6% was mainly attributable to lower personnel costs, lower facility costs and overall cost containment reflecting management’s efforts to lessen the negative impact of the protracted credit freeze and economic downturn.

Interest Income – Interest income for the six months ended June 30, 2010 was \$56,333 as compared to \$9,037 for the six months ended June 30, 2009. This increase was attributable to interest earned on an income tax refund and higher average cash balances during the six month period ended June 30, 2010 versus the same period in the prior year.

Interest Expense - Interest expense for the six months ended June 30, 2010 was \$111,785 as compared to \$165,407 for the six months ended June 30, 2009. The decrease is due to the average outstanding revolving debt balance being \$1,852,762 lower in the six month period ended June 30, 2010 versus that in the six months ended June 30, 2009.

Tax Expense – The Company recognized income tax expense for the six months ended June 30, 2010 of \$433,167, based upon income before income taxes of \$884,358, compared with income tax expense of \$187,527 for the six months ended June 30, 2009, based upon income before income taxes of \$408,902. Income tax expense for interim reporting is based on an annual effective income tax rate forecast, which includes estimates and assumptions that could change during the year. The differences between the effective income tax rate and the U.S. federal statutory rate of 34% principally result from state and local taxes, and differences between the book and tax treatment of certain items, such as incentive stock options. The effective income tax rate for the six months ended June 30, 2010 was 49.0%, compared to an effective income tax rate of 45.9% for the six months ended June 30, 2009.

Net Income - As a result of the above noted factors our net income was \$451,191 for the six months ended June 30, 2010, compared to net income of \$221,375 for the six months ended June 30, 2009. This resulted in diluted income per share of \$0.07 on weighted average diluted common shares outstanding of 6,203,366 for the six months ended June 30, 2010, as compared to diluted earnings per share of \$0.04 on weighted average diluted common shares outstanding of 6,044,499 for the six month period ended June 30, 2009.

Liquidity and Capital Resources

As of June 30, 2010, we had cash and cash equivalents of \$1,724,073. Our net current assets were \$14,438,221 at June 30, 2010 versus \$13,748,867 at December 31, 2009. Total debt at June 30, 2010 was \$4,749,036 compared to the December 31, 2009 balance of \$5,367,069.

Cash used in operating activities was \$343,199 during the six months ended June 30, 2010. The most significant use of cash resulted from a net increase in costs in excess of billings and estimated profits of \$1,625,054, as well as an increase in inventory and retainage receivable of \$486,296 and \$413,197, respectively. Partially offsetting this was a provider of cash resulting from an increase in accounts payable and prepaid expenses and income tax receivable of \$975,830 and \$348,673, respectively.

Cash used in investing activities was \$145,767, comprised of \$120,767 for the purchase of property and equipment and \$25,000 of earn-out payments associated with the CIS acquisition.

Cash used in financing activities was \$704,007, all of which represents the net repayments of bank loans and other debt.

Borrowings under the revolving credit facility were \$3,935,898 at June 30, 2010 and were \$4,335,898 at December 31, 2009. On October 6, 2008, the Company executed an amendment to its revolving credit agreement with TD Bank, increasing its line of credit from \$4 million to \$8 million. On August 10, 2010 the term of the revolving credit agreement was extended to June 30, 2012. As part of this extension, interest will continue be paid monthly in arrears at TD Bank's prime rate, however, interest will now be subject to a minimum floor rate of 4.0%. The Company is required to maintain certain financial and reporting covenants and restrictions on dividend payments under the terms of the Loan Agreement with TB Bank, N.A. (See Note 6 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q).

Critical Accounting Policies and Estimates

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10-K for year ended December 31, 2009. Some of these policies require management to make estimates and assumptions that may affect the reported amounts in the Company's financial statements.

Forward Looking Statements

When used in this discussion, the words "believes", "anticipates", "contemplated", "expects", or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, the ability to control costs and expenses, significant variations in recognized revenue due to customer caused delays in installations, cancellations of contracts by our customers, and general economic conditions which could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements that may be made to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We have one revolving credit facility for which the interest rate on outstanding borrowings is variable and is based upon the prime rate of interest, subject to a minimum floor rate of 4.0%. At June 30, 2010, there was \$3,935,898 outstanding under this credit facility.

Our business is impacted by the health of the U.S economy. Current economic conditions have caused a decline in business spending which has adversely affected our business and financial performance and our operating results. Accordingly, our business and financial performance has been adversely affected by current economic conditions, and any future deterioration of economic conditions, could cause a further reduction in the availability of credit in the capital markets to our customers.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer, Chief Operating Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of June 30, 2010. Based on such evaluation, such officers have concluded that, as of June 30, 2010, the Company's disclosure controls and procedures are effective.

(b) Changes in Internal Control Over Financial Reporting

During the three months ended June 30, 2010, management did not identify any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II - Other Information

Item 1. Legal Proceedings

We know of no material litigation or proceeding, pending or threatened, to which we are or may become a party.

Item 6. Exhibits

| Number | Description |
|--------|---|
| 31.1 | Rule 13a-14(a) 15d-14(a) Certification of Chief Executive Officer |
| 31.2 | Rule 13a-14(a) 15d-14(a) Certification of Chief Operating Officer |
| 31.3 | Rule 13a-14(a) 15d-14(a) Certification of Chief Financial Officer |
| 32 | Section 1350 Certification |

In accordance with the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto authorized.

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.

Henry Bros. Electronics, Inc.
(Registrant)

Date: August 11, 2010

By: /s/ JAMES E. HENRY

James E. Henry

Vice Chairman, Chief Executive Officer,
Treasurer and Director

Date: August 11, 2010

By: /s/ BRIAN REACH

Brian Reach

President, Chief Operating Officer,
Secretary and Director

Date: August 11, 2010

By: /s/ JOHN P. HOPKINS

John P. Hopkins

Chief Financial Officer