

Henry Bros. Electronics, Inc.  
Form 10-Q  
October 18, 2007

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, 2007

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. 05-62411

**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)

Issuer'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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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 issuer's Common Stock, as of the latest practicable date: 5,926,065 shares of common stock, \$.01 par value per share, as of September 30, 2007.

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

	(Unaudited) June 30, 2007	(Audited) December 31, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,258,373	\$ 199,853
Accounts receivable-net of allowance for doubtful accounts	11,952,446	13,628,358
Inventory	1,539,898	1,707,933
Costs in excess of billings and estimated profits	4,590,974	4,643,469
Deferred tax asset	1,349,620	1,155,620
Retainage receivable	1,226,527	1,390,468
Prepaid expenses and income tax receivable	1,095,551	454,801
Other assets	285,963	290,079
<b>Total current assets</b>	<b>23,299,352</b>	<b>23,470,581</b>
Property and equipment - net of accumulated depreciation	2,235,612	2,402,394
Goodwill	3,316,530	3,316,530
Intangible assets - net of accumulated amortization	1,325,886	1,436,414
Deferred tax asset	694,545	594,545
Other assets	150,857	151,145
<b>TOTAL ASSETS</b>	<b>\$ 31,022,782</b>	<b>\$ 31,371,609</b>
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 6,966,889	\$ 5,973,047
Accrued expenses	3,076,580	4,786,203
Accrued taxes	59,576	58,914
Billings in excess of costs and estimated profits	1,431,510	1,167,259
Deferred income	396,460	476,775
Revolving credit line maturing within one year	3,635,897	-
Current portion of long-term debt	475,708	505,028
Deferred tax liability	249,365	249,365
Other current liabilities	401,069	252,881
<b>Total current liabilities</b>	<b>16,693,054</b>	<b>13,469,472</b>
Long-term debt, less current portion	474,793	3,463,236
Deferred tax liability	428,283	428,283
<b>TOTAL LIABILITIES</b>	<b>17,596,130</b>	<b>17,360,991</b>
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, \$.01 par value; 10,000,000 shares authorized; no shares issued	-	-
Common stock, \$.01 par value; 10,000,000 shares authorized; 5,916,065 shares issued and outstanding in 2007 and 2006	59,161	59,161
Additional paid in capital	17,284,205	17,284,205
Deferred compensation	(297,147)	(383,552)
Accumulated deficit	(3,619,567)	(2,949,196)

<b>TOTAL EQUITY</b>	13,426,652	14,010,618
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>	\$ 31,022,782	\$ 31,371,609

The accompanying notes are an integral part of these statements

**HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	<b>Six months ended June 30,</b>		<b>Three months ended June</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>30,</b>
		<b>(Restated)</b>		<b>2006</b>
				<b>(Restated)</b>
Revenue	\$ 24,392,499	\$ 19,284,797	\$ 13,521,198	\$ 10,139,969
Cost of revenue	18,956,044	14,133,828	10,240,919	7,927,175
Gross profit	5,436,455	5,150,969	3,280,279	2,212,794
Operating expenses:				
Selling, general & administrative expenses	6,246,153	5,205,840	2,981,986	2,577,086
Operating (loss) profit	(809,698)	(54,871)	298,293	(364,292)
Interest income	21,273	6,414	14,332	6,234
Other expense	(3,369)	(4,084)	(3,110)	(4,084)
Interest expense	(167,189)	(35,618)	(96,732)	(8,890)
(Loss) income before tax expense	(958,983)	(88,159)	212,783	(371,032)
Tax expense (benefit)	(288,612)	204,153	62,739	22,967
Net (loss) income after taxes	\$ (670,371)	\$ (292,312)	\$ 150,044	\$ (393,999)

**BASIC (LOSS) EARNINGS PER COMMON SHARE:**

Basic (loss) profit per common share	\$ (0.12)	\$ (0.05)	\$ 0.03	\$ (0.07)
Weighted average common shares	5,749,964	5,742,064	5,749,964	5,742,064

**DILUTED (LOSS) EARNINGS PER COMMON SHARE:**

Diluted (loss) profit per common share:	\$ (0.12)	\$ (0.05)	\$ 0.03	\$ (0.07)
Weighted average diluted common shares	5,749,964	5,905,784	5,749,964	5,905,556

The accompanying notes are an integral part of these statements

**HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Six months ended	
	June 30,	
	2007	2006 (Restated)
Cash flows from operating activities:		
Net (loss) income	\$ (670,371)	\$ (292,312)
Adjustments to reconcile net (loss) income from operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	394,101	336,558
Bad debt expense	110,465	82,664
Provision for obsolete inventory	55,000	30,000
Stock option expense	86,405	106,805
Deferred income taxes	(294,000)	(36,404)
Changes in operating assets and liabilities:		
Accounts receivable	1,565,448	347,029
Inventories	113,034	(92,165)
Costs in excess of billings and estimated profits	52,494	(65,751)
Retainage receivable	163,940	(622,432)
Other assets	4,115	(123,136)
Prepaid expenses and income tax receivable	(640,749)	(298,839)
Accounts payable	993,841	(1,234,643)
Accrued expenses	(1,709,621)	(45,977)
Billings in excess of cost and estimated profits	264,251	297,068
Deferred income	(80,315)	(46,202)
Other Liabilities	148,189	269,865
Net cash provided by (used in) operating activities	556,227	(1,387,872)
Cash flows from investing activities:		
Purchase of property and equipment	(74,367)	(61,326)
Net cash used in investing activities	(74,367)	(61,326)
Cash flows from financing activities:		
Proceeds from issuance of common stock - net of fees		30,999
Net proceeds and (payments) from revolving bank lines	788,000	-
Payments of bank loans	(101,675)	(56,035)
Net repayments of other debt	(47,404)	(5,759)
Capitalized lease payments	(62,262)	(56,269)
Net Cash provided by (used in) financing activities	576,659	(87,064)
Increase (decrease) in cash and cash equivalents	1,058,519	(1,536,262)
Cash and cash equivalents - beginning of period	199,854	2,177,686
Cash and cash equivalents - end of period	\$ 1,258,373	\$ 641,424
Supplemental disclosure of cash flow information:		
Amount paid for the period for:		
Interest	\$ 164,697	\$ 35,340
Taxes	\$ 175,500	319,113
Non-cash investing and financing activities:		
Equipment financed	\$ 42,425	90,812

The accompanying notes are an integral part of these statements

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

	<b>Common Stock</b>		<b>Additional</b>	<b>Deferred</b>	<b>Retained</b>	<b>Total</b>
	<b>par value \$.01</b>	<b>10,000,000</b>				
	<b>Shares</b>	<b>Amount</b>	<b>Capital</b>	<b>ensation</b>		
Balance at December 31, 2005 (Corrected)	5,889,399	\$ 58,894	\$ 16,956,008	\$ (342,878)	\$ (689,058)	\$ 15,982,966
Employee stock options exercised	6,666	67	30,930			30,997
Value of stock option grants			66,551	(66,551)		-
Amortization of value assigned to stock option grants				106,805		106,805
Net loss June 30, 2006					(292,312)	(292,312)
Balance at June 30, 2006	5,896,065	58,961	17,053,489	(302,624)	(981,370)	15,828,456
Balance at December 31, 2006	5,916,065	\$ 59,161	\$ 17,284,205	\$ (383,552)	\$ (2,949,196)	\$ 14,010,618
Amortization of value assigned to stock option grants				86,405		86,405
Net loss June 30, 2007					(670,371)	(670,371)
Balance at June 30, 2007	5,916,065	\$ 59,161	\$ 17,284,205	\$ (297,147)	\$ (3,619,567)	\$ 13,426,652

The accompanying notes are an integral part of these statements



**HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS (UNAUDITED)****1. Basis of Presentation**

Henry Bros. Electronics, Inc., (the Company) and its subsidiaries, are divided into two business segments Security System Integration ( Integration ) and Specialty Products and Services ( Specialty ). The Integration segment provides cradle to grave services for a wide variety of security, communications and control systems. The Company specializes in turn-key systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. Through the Specialty Products and Services segment we provide emergency preparedness programs, mobile digital recording solutions and specialized radio frequency communication equipment and integration. Each of the Company's segments markets nationwide with an emphasis in the Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia metropolitan areas. Customers are primarily medium and large businesses and governmental agencies. The Company derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

The table below shows the sales percentages by geographic location for the six months ended June 30, 2007 and 2006:

	<b>2007</b>	<b>2006</b>
New Jersey/New York	42%	47%
California	24%	30%
Texas	5%	3%
Arizona	4%	7%
Colorado	8%	12%
Virginia/Washington DC	12%	-
Integration Segment	96%	99%
Specialty Segment	5%	6%
Inter-segment	-	-5%
Total	100%	100%

In addition to the New Jersey headquarters location, other sales and service facilities are located near the Dallas Fort Worth Airport, Phoenix Arizona Airport, Denver and Colorado Springs, Colorado, Fullerton, California, Washington DC, and New York City.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the six month period ended June 30, 2007, are not necessarily indicative of the results that may be expected for the full year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-K for the fiscal period ended December 31, 2006.

As discussed in Item 4 on this Quarterly Report on Form 10-Q and as disclosed in the Company's Annual Report on Form 10-K for the fiscal period ended December 31, 2006, certain quarterly information in 2006 has been restated. The impact on the condensed consolidated operations for the three and six months ended June 30, 2006 follows:



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

	<b>Three months ended</b>	<b>Six months ended</b>
	<b>June 30, 2006</b>	
<b>As Reported:</b>		
Revenue	\$ 10,030,118	\$ 19,185,196
Gross profit	2,564,036	5,559,741
Net income	30,001	255,688
<b>Earnings per share:</b>		
Basic	\$ 0.01	\$ 0.04
Diluted	0.01	0.04
<b>As Restated:</b>		
Revenue	\$ 10,139,969	\$ 19,284,797
Gross profit	2,212,794	5,150,969
Net loss	(393,999)	(292,312)
<b>Loss per share:</b>		
Basic	\$ (0.07)	\$ (0.05)
Diluted	(0.07)	(0.05)

**2. Net Income 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. The computation of diluted earnings per share includes the dilutive effects of common stock equivalents of options and warrants, 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 securities are not included in earnings per share for the six months ended June 30, 2007, as their inclusion would be anti-dilutive.

**3. Stock Based Compensation**

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123(R) (FAS-123(R)), *Share-Based Payment*, which is a revision of Statement of Financial Accounting Standards No. 123 (FAS-123), *Accounting for Stock-Based Compensation*.

FAS-123(R) eliminates accounting for share-based compensation transactions using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25 (APB-25), *Accounting for Stock Issued to Employees*, and requires instead that such transactions be accounted for using a fair-value-based method. The Company has elected to adopt the provisions of FAS-123(R) effective January 1, 2006, under the modified prospective transition method, in which compensation cost was

**HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS (UNAUDITED) (continued)**

recognized beginning with the effective date (a) based on the requirements of FAS-123R for all share-based payments granted after the effective date and (b) based on the requirements of FAS-123R for all awards granted to employees prior to the effective date of FAS-123R that remain unvested on the effective date.

As permitted under FAS-123, the Company elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for stock-based awards to employees through December 31, 2005. Accordingly, compensation cost for stock options and nonvested stock grants was measured as the excess, if any, of the market price of the Company's common stock at the date of grant over the exercise price.

With the adoption of FAS-123(R), the Company elected to amortize stock-based compensation for awards granted on or after the adoption of FAS-123R on January 1, 2006, on a straight-line basis over the requisite service (vesting) period for the entire award. For awards granted prior to January 1, 2006, compensation costs are amortized in a manner consistent with Financial Accounting Standards Board Interpretation No. 28 (FIN-28), *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. This is the same manner applied in the pro forma disclosures under FAS-123. Accordingly, the fair value of all options granted on and after January 1, 2003 is to be charged against income over the vesting period. For the three months ended June 30, 2007 and 2006 the Company charged \$56,250 and \$79,987, respectively, and for the six months ended June 30, 2007 and 2006 the Company charged \$113,775 and \$129,869, respectively, to operations for those options granted subsequent to January 1, 2003. Those issued prior to adoption are accounted for under the intrinsic value method in accordance with APB No. 25. The Company adopted the perspective method as permitted by SFAS No. 148 on January 1, 2003.

**4. Long-Term Debt**

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

Advances under the Revolving Loan may be used to finance working capital and acquisitions. Interest is paid monthly in arrears at TD Banknorth's prime rate (8.25% at June 30, 2007 and December 31, 2006) through May 1, 2008, when all amounts outstanding under the Revolving loan is due. The Revolving Loan was originally due May 1, 2007; however, in December 2006 TD Banknorth provided the Company a one year extension.

The Term Loan provides for the payment of sixty equal monthly installments of principal and interest in the amount of \$19,729.65 commencing July 30, 2005 and continuing thru June 30, 2010. Interest under the Term Loan is 6.75% .

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

The Company is required to maintain certain financial and reporting covenants and is restricted from paying dividends under the terms of the Loan Agreement. The Company was not in compliance with certain of these bank covenants at March 31, 2007, June 30 and December 31, 2006. TD Banknorth provided the Company with a waiver associated with the bank covenants in default on October 11, 2007. As a condition of the waiver, the Company agreed to grant TD Banknorth a first security interest on its accounts receivable.

Long-term debt included of the following balances:

	<b>(Unaudited)</b> <b>June 30,</b> <b>2007</b>	<b>(Audited)</b> <b>December 31,</b> <b>2006</b>
Term loan at 6.75% interest payable in monthly installments of \$19,730 thru June 30, 2010	\$ 429,447	\$ 531,122
Revolving line at the prime rate of interest, payable in monthly installments thru May 1, 2008	3,635,897	2,847,897
Corporate insurance financed at 8.49% in monthly installments thru October 1, 2007	41,462	162,397
Capitized lease obligations due in monthly installments, with interest ranging from 6.4% to 11.7%	379,894	399,731
Other miscellaneous debt	99,699	27,117
	4,586,399	3,968,264
Less: Current Portion	(475,708)	(505,028)
Less: Revolving credit line maturing within one year	3,635,897	-
	\$ 474,793	\$ 3,463,236

The weighted average prime interest rate for the three months ended June 30, 2007 and 2006 were 8.25% and 7.83%, respectively and for the six months ended June 30, 2007 and 2006 were 8.25% and 7.63%, respectively.

**5. Segment Data**

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

	<b>Three months ended June</b>		<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Revenue</b>				
Total Integration	\$ 12,693,742	\$ 9,543,173	\$ 23,337,516	\$ 18,529,284
Specialty Products and Services	915,894	256,553	1,143,421	891,263
Inter-segment	(88,438)	340,243	(88,438)	(135,750)
Total Revenue	\$ 13,521,198	\$ 10,139,969	\$ 24,392,499	\$ 19,284,797
<b>Operating Profit</b>				
Total Integration	\$ 841,662	\$ 381,617	\$ 562,046	\$ 1,033,489
Specialty Products and Services	80,537	(306,359)	(78,972)	(322,362)
Corporate	(623,906)	(439,550)	(1,292,772)	(765,998)
Total Operating Profit	\$ 298,293	\$ (364,292)	\$ (809,698)	\$ (54,871)

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

	<b>June 30, 2007</b>		<b>December 31, 2006</b>
<b>Total Assets</b>			
Total Integration	23,549,253	\$	28,209,608
Specialty Products and Services	2,905,988		2,146,308
Corporate	4,567,541		1,015,693
Total Assets	31,022,782	\$	31,371,609

## 6. 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 financial statements.

**HENRY BROS. ELECTRONICS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS (UNAUDITED) (continued)**

**7. Recently Issued Accounting Pronouncements**

The Company does not anticipate the adoption of recently issued accounting pronouncements to have a significant impact on the Company's results of operations, financial position or cash flows.

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

### OVERVIEW

We are an established leader in the electronic physical security industry, specializing in integrated security systems and emergency preparedness.

### 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;
- Using only systems and components that are reliable and efficient to use.

In addition to growing the business organically, we have been actively pursuing the strategic acquisition of synergistic integrators and specialty products and service companies to further fuel steady growth. Consistent with our expansion strategy, we acquired seven companies since August of 2002.

To finance our acquisitions, we have used a combination of internally generated cash, company common stock and bank debt. We currently have a \$5 million credit facility with TD Banknorth, which includes a \$1 million term loan of which \$429,447 and 377,795 was outstanding at June 30, 2007 and September 30, 2007, respectively. As part of our credit facility, we also have a \$4 million revolving credit facility. Borrowings under the revolving credit facility were \$3,635,897 at June 30 and September 30, 2007. 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, or the sale of equity securities, or the sale of existing Company assets.

### TRENDS

We anticipate our overall average operating margins for our business to be slightly negative for 2007, as compared to operating margins of (6.1)% and 5.0% for years 2006 and 2005, respectively.

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.

During the fourth quarter 2006, the Company began incurring costs related to the implementation of Sarbanes Oxley. While not significant in 2006, the spending will be significant in 2007 and 2008.

Our operations are divided into two business segments - Security System Integration ("Integration") and Specialty Products and Services ("Specialty"). The Integration segment provides "cradle to grave" services for a wide variety of security, communications and control systems. The Company specializes in turn-key systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. Through the Specialty segment we provide emergency preparedness programs, and specialized radio frequency communication equipment and integration. Each of the Company's segments markets nationwide with an emphasis in the Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia. Customers are primarily medium and large businesses and governmental agencies. The Company derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

### **Three Months Ended June 30, 2007 compared to June 30, 2006**

**Revenue** - Revenue for the three months ended June 30, 2007 was \$13,521,198, representing an increase of \$3,381,229 or 33.3% as compared to \$10,139,969 for the three months ended June 30, 2006. New Jersey, Arizona, Texas and Airorlite each experienced significant increases in revenues over the same period in the prior year. New Jersey's increase was mainly the result of larger jobs booked at the end of 2006 and early in 2007. The improvement in Texas was driven largely from the organizational changes made at the end of 2006. These changes have allowed us to more effectively take advantage of the opportunities that exist in this market. The Airorlite business improved over the prior year due to two projects that were underway during the quarter ended June 30, 2007. As previously disclosed, the Company made an investment in 2006 to provide a solution to the marketplace for Time Delay Interference ("TDI") in "In-Building" wireless systems. This solution for TDI was expected to have wider commercial application potential at the time the investment was made and, in fact, the Company believes this solution played a key role in being awarded the new projects in 2007. CIS Security Systems Corp. ("CIS") (Virginia and Maryland operations), acquired in October 2006, accounted for \$981,110 of the increase in revenues. In addition, the Arizona Division continues to steadily grow their operations.

Booked orders increased 186% to \$22,300,000 in the second quarter of 2007 as compared to \$7,800,000 in the second quarter of 2006. The Company's backlog as of June 30, 2007 was approximately \$32,300,000

**Cost of Revenue** - Cost of revenue for the three months ended June 30, 2007 was \$10,240,919 as compared to \$7,927,175 for the three months ended June 30, 2006. The gross profit margin for the three months ended June 30, 2007 was 24.3% as compared to 21.8% for the three months ended June 30, 2006. The primary reasons for the improvement in gross profit margin related to the Airorlite and Texas Divisions for the reasons noted above. In addition, the Arizona Division continues to perform well, with its margins improving over the same period in the prior year.

**Selling, General and Administrative Expenses** - Selling, general and administrative expense was \$2,981,986 for the three months ended June 30, 2007 as compared to \$2,577,086 for the three

months ended June 30, 2006. This increase of 15.7% or \$404,900 was attributable to increased costs associated with the CIS acquisition in our 2006 fourth quarter, lower labor utilization, as well as higher corporate costs, due mainly to organizational changes, and costs incurred in preparation for Sarbanes Oxley implementation.

**Interest Income** Interest income for the three months ended June 30, 2007 was \$14,332 as compared to \$6,234 for the three months ended June 30, 2006.

**Interest Expense** - Interest expense for the three months ended June 30, 2007 was \$96,732 as compared to \$8,890 for the three months ended June 30, 2006. The average outstanding debt balance was significantly higher in the three month period ended June 30, 2007 versus the three months ended June 30, 2006. In addition, the prime rate of interest was higher in the 2006 period than that of the same period in the previous year.

**Tax Expense** - Due to the loss before tax for the three months ended June 30, 2007, the Company received a net tax benefit for that period. The tax benefit, however, was somewhat offset by state income taxes incurred by subsidiaries in those jurisdictions that were profitable during the period.

**Net Income** - As a result of the above noted factors our net income was \$150,044 for the three months ended June 30, 2007 compared to a net loss of \$393,999 for the three months ended June 30, 2006. This resulted in diluted income per share of \$0.03 on weighted average diluted common shares outstanding of 5,749,694 for the three months ended June 30, 2007, as compared to diluted loss per share of \$0.07 on weighted average diluted common shares outstanding of 5,905,556 for the three month period ended June 30, 2006.

#### **Six Months Ended June 30, 2007 compared to June 30, 2006**

**Revenue** - Revenue for the six months ended June 30, 2007 were \$24,392,499 representing an increase of \$5,107,702 or 26.5 % as compared to \$19,284,797 for the six months ended June 30, 2006. CIS Security Systems Corp. (CIS) (Virginia and Maryland operations) acquired in October 2006 accounted for the increase in revenues. Revenues from CIS were \$2,913,659 for the six months ended March 31, 2007. Increased revenues from our Arizona, Texas and California Divisions were somewhat offset by decline in our New Jersey and Colorado Divisions.

Booked orders increased 89% to \$28,900,000 in the six months ended June 30, 2007 as compared to \$15,300,000 in the corresponding period of 2006.

**Cost of Revenue** - Cost of revenue for the six months ended June 30, 2007 was \$18,956,044 as compared to \$14,133,828 for the six months ended June 30, 2006. The gross profit margin for the six months ended June 30, 2007 was 22.3% as compared to 26.7% for the six months ended June 30, 2006. The decline in the gross profit margin was driven principally from the New Jersey and California operations, principally in the quarter ended March 31, 2007. The decline in New Jersey was the result of cost overruns on a number of installations. In addition, several of the larger jobs booked at the end of 2006 or early in 2007 were underway in the quarter ended March 31, 2007, and these larger jobs have gross profit margins that are below the Company's historical average. California's decline was the result of cost overruns on a number of projects. In response to the decline in margins in our California Division there have been changes in management to more

effectively manage the operations. Margins for the California Division were significantly improved in the three months ended June 30, 2007 versus the three months ended March 31, 2007, however, gross margins in both quarters of 2007 were lower than the same previous periods in 2006.

**Selling, General and Administrative Expenses** - Selling, general and administrative expense was \$6,246,153 for the six months ended June 30, 2007 as compared to \$5,205,840 for the six months ended June 30, 2006. This increase of 20.0% or \$1,040,313 was attributable to increased costs associated with the CIS acquisition in our 2006 fourth quarter, lower labor utilization, as well as higher corporate costs, due mainly to organizational changes, and costs incurred in preparation for Sarbanes Oxley implementation.

**Interest Income** □ Interest income for the six months ended June 30, 2007 was \$21,273 as compared to \$6,414 for the six months ended June 30, 2006.

**Interest Expense** - Interest expense for the six months ended June 30, 2007 was \$167,189 as compared to \$35,618 for the six months ended June 30, 2006. The increase is for the same reasons noted above.

**Net Income** - As a result of the above noted factors our net loss was \$670,371 for the six months ended June 30, 2007 and our net loss was \$292,312 for the six months ended June 30, 2006. This resulted in diluted loss per share of \$0.12 on weighted average common shares outstanding of 5,749,964 for the six months ended June 30, 2007, as compared to diluted loss per share of \$0.05 on weighted average common shares outstanding of 5,905,784 for the six month period ended June 30, 2006.

**Liquidity and Capital Resources** - As of June 30, 2007, we had cash and cash equivalents of \$1,258,373. Our net working capital was \$6,606,298 at June 30, 2007 versus \$10,001,109 at December 31, 2006. Total debt at June 30, 2007 was \$4,586,398 compared to the December 31, 2006 balance of \$3,968,264.

Cash provided from operating activities was \$556,227 during the six months ended June 30, 2007. The most significant source of cash resulted from a net decline in accounts receivable of \$1,565,448 and an increase in accounts payable of \$993,841. This was partially offset by a decrease in accrued expenses of \$1,709,621.

Cash used from investing activities was \$74,367 and was for the purchase of property and equipment.

Cash from financing activities provided \$576,659, of which \$788,000 represents borrowings against the revolving credit facility. The offset was repayments of bank loans and other debt.

Borrowings under the revolving credit facility at September 30, 2007 were \$3,635,897. The Company is required to maintain certain financial and reporting covenants and restrictions on dividend payments under the terms of the Loan Agreement with TD Banknorth, N.A. The Company was not in compliance with certain of these bank covenants at June 30, 2007, March 31, 2007 and December 31,

2006. TD Banknorth, N.A. provided the Company with a waiver associated with the bank covenants in default in October 2007. As a condition of the waiver, the Company agreed to grant TD Banknorth a first security interest on its accounts receivable.

### **Critical Accounting Policies**

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, 2006. 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. At December 31, 2006, there was \$2,847,897 outstanding under this revolving credit facility and at June 30, 2007 and September 30, 2007, there was \$3,635,897 outstanding under this credit facility.

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

#### **(a) Evaluation of Disclosure Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer, Chief Operating Officer and Chief Financial Officer, of the design and operation of the Company's disclosure controls and procedures, as defined under Rule 13a-15(e) of the Securities and Exchange Act of 1934, as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer concluded that, as of June 30, 2007, the design and operation of the Company's disclosure controls and procedures were not effective.

We learned that the Company did not maintain adequate policies and reconciliation procedures over the accounting for intercompany clearing and cash accounts and income taxes. As a result of these weaknesses, we performed extensive detail testing and reconciliation of past transactions in order to

be able to determine the proper presentation of our financial information for past and current periods. This report contains restated financial results for the three and six months ended June 30, 2006. These weaknesses in our internal disclosure controls and procedures were the cause of the delay in the filing of our 2006 Annual Report on Form 10-K, our Quarterly Report on Form 10-Q for the period ended March 31, 2007 and this Quarterly Report on Form 10-Q.

While we are in the process of implementing a more efficient and reliable system of disclosure controls and procedures, we have, on an immediate basis, instituted interim compensating controls and procedures to ensure that information required to be disclosed in this Quarterly Report on Form 10-Q has been recorded, processed, summarized and reported to our senior management. The steps that we have taken to ensure that all material information about our company is accurately disclosed in this report include:

- the appointment of a new Chief Financial Officer in August 2006;
  - the appointment of a new Chief Operating Officer ("COO") in August 2006. The COO then assumed the additional responsibilities of President in March 2007;
  - the appointment of a new Corporate Controller in April 2007;
  - the appointment of a new Controller for our California operations in April 2007;
  - the engagement of an outside public accounting firm to assist management in the preparation of our financial statement income tax provision in February 2007;
  - the engagement of temporary accounting personnel to assist in the closing and reconciliation processes;
  - the performance of an extensive review of our financial statements for the year ended December 31, 2006 and quarters ended June 30, 2007 and March 31, 2007.
  - implemented revised accounting procedures for recording and reconciling intercompany clearing and cash accounts and designed changes within the Company's financial reporting system to ensure all intercompany accounts eliminate in consolidation. These changes substantially do away with the use of spreadsheets as the tool to ensure that all intercompany accounts eliminate in consolidation, which are inherently more difficult to ensure compliance with the Company's internal control policies. Eliminating the use of spreadsheets also allows for fuller use of the Company's financial reporting system and the internal control safeguards built into the financial reporting software;
  - designed changes within the Company's financial reporting system to allow the financial reporting system to be the sole source of the consolidation of financial results of the Company. This change eliminated the use of spreadsheets, which was the method formerly used to consolidate the Company's financial results; and
  - implemented monthly financial and operational review procedures with each of our operating units.
- Nonetheless, a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues have been detected.



**(b) Change in Internal Controls over Financial Reporting**

As required by Rule 13a-15(d), the Company's executive management including the Chief Executive Officer, the Chief Operating Officer and the Chief Financial Officer, also conducted an evaluation of the company's internal controls over financial reporting to determine whether any change occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting. Based on that evaluation, in order to correct the weaknesses described above and to improve our internal disclosure and control procedures on a going forward basis, we have continued to carryout the changes described in Item 4(a) above, and in addition we have hired additional qualified accounting personnel.

We intend to continue to evaluate our internal disclosure controls and procedures and implement improvements as required.

**Part II - Other Information**

**Item 1. Legal Proceedings**

Not applicable

**Item 1A. Risk Factors**

As of the quarter ended June 30, 2007 there were no material changes to the risk factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

**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: October 18, 2007

By: /s/ JAMES E. HENRY  
James E. Henry  
Chairman, Chief Executive Officer,  
Treasurer and Director

Date: October 18, 2007

By: /s/ BRIAN REACH  
Brian Reach  
President, Secretary, Chief Operating  
Officer and Director

Date: October 18, 2007

By: /s/ JOHN P. HOPKINS  
John P. Hopkins  
Chief Financial Officer