

EMERSON RADIO CORP  
Form 10-Q  
August 14, 2013  
Table of Contents

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-07731

## EMERSON RADIO CORP.

(Exact name of registrant as specified in its charter)

Edgar Filing: EMERSON RADIO CORP - Form 10-Q

<b>DELAWARE</b> (State or other jurisdiction of incorporation or organization)	<b>22-3285224</b> (I.R.S. Employer Identification No.)
<b>3 University Plaza, suite 405, Hackensack, NJ</b> (Address of principal executive offices)	<b>07601</b> (Zip code)
<b>(973) 428-2000</b> (Registrant's telephone number, including area code)	
<b>(Former name, former address, and former fiscal year, if changed since last report)</b>	

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

Indicate the number of shares outstanding of common stock as of August 14, 2013: 27,129,832.

**Table of Contents**

**TABLE OF CONTENTS**

<u>PART I FINANCIAL INFORMATION</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition</u>	13
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	18
<u>Item 4. Controls and Procedures</u>	18
<u>PART II OTHER INFORMATION</u>	20
<u>Item 1. Legal Proceedings</u>	20
<u>Item 1A. Risk Factors</u>	20
<u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	20
<u>ITEM 3. Defaults Upon Senior Securities</u>	20
<u>ITEM 4. Mine Safety Disclosure</u>	20
<u>ITEM 5. Other Information</u>	20
<u>ITEM 6. Exhibits</u>	21
<u>SIGNATURES</u>	22

**Table of Contents**

## PART I FINANCIAL INFORMATION

**Item 1. Financial Statements.**

**EMERSON RADIO CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(In thousands, except earnings per share data)

	Three Months Ended June 30	
	2013	2012
<b>Net Revenues:</b>		
Net product sales	\$ 23,481	\$ 44,876
Licensing revenue	1,171	1,135
<b>Net revenues</b>	<b>24,652</b>	<b>46,011</b>
<b>Costs and expenses:</b>		
Cost of sales	20,984	39,173
Other operating costs and expenses	151	408
Selling, general and administrative expenses	2,188	2,008
	<b>23,323</b>	<b>41,589</b>
<b>Operating income</b>	<b>1,329</b>	<b>4,422</b>
<b>Other income:</b>		
Interest income, net	222	31
<b>Income before income taxes</b>	<b>1,551</b>	<b>4,453</b>
Provision for income taxes	182	613
<b>Net income</b>	<b>\$ 1,369</b>	<b>\$ 3,840</b>
<b>Net income per share:</b>		
Basic	\$ .05	\$ .14
Diluted	\$ .05	\$ .14
<b>Weighted average shares outstanding:</b>		
Basic	27,130	27,130
Diluted	27,130	27,130

The accompanying notes are an integral part of the interim consolidated financial statements.

**Table of Contents**

**EMERSON RADIO CORP. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**For The Periods Ended June 30, 2013 and 2012**

**(Unaudited)**

**(In thousands)**

	<b>June 30, 2013</b>	<b>June 30, 2012</b>
Net income	\$ 1,369	\$ 3,840
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment		427
Comprehensive income	\$ 1,369	\$ 4,267

**Table of Contents****EMERSON RADIO CORP. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands except share data)**

	June 30, 2013	March 31, 2013
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 15,983	\$ 21,412
Restricted cash		70
Short term investments	45,337	45,235
Accounts receivable, net	14,105	7,883
Other receivables	1,039	969
Due from affiliates		1
Inventory	6,064	3,454
Prepaid expenses and other current assets	5,286	1,873
Deferred tax assets	1,608	1,685
<b>Total Current Assets</b>	<b>89,422</b>	<b>82,582</b>
Property, plant and equipment, net	251	258
Trademarks, net	219	219
Deferred tax assets	1,078	1,121
Other assets	69	104
<b>Total Assets</b>	<b>\$ 91,039</b>	<b>\$ 84,284</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current maturities of long-term borrowings	43	43
Accounts payable and other current liabilities	13,026	7,790
Accrued sales returns	1,065	965
Income taxes payable	1,338	1,281
<b>Total Current Liabilities</b>	<b>15,472</b>	<b>10,079</b>
Long-term borrowings	19	30
Deferred tax liabilities	198	194
<b>Total Liabilities</b>	<b>15,689</b>	<b>10,303</b>
Shareholders' equity:		
Preferred shares -\$.01 par value, 10,000,000 shares authorized at June 30, 2013 and March 31, 2013, respectively; 3,677 shares issued and outstanding at June 30, 2013 and March 31, 2013, respectively; liquidation preference of \$3,677,000 at June 30, 2013 and March 31, 2013, respectively	3,310	3,310
Common shares \$.01 par value, 75,000,000 shares authorized, 52,965,797 shares issued at June 30, 2013 and March 31, 2013, respectively; 27,129,832 shares outstanding at June 30, 2013 and March 31, 2013, respectively	529	529
Additional paid-in capital	98,785	98,785
Accumulated deficit	(3,050)	(4,419)
Treasury stock, at cost, 25,835,965 shares	(24,224)	(24,224)
<b>Total Shareholders' Equity</b>	<b>75,350</b>	<b>73,981</b>

<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 91,039</b>	<b>\$ 84,284</b>
--	------------------	------------------

The accompanying notes are an integral part of the interim consolidated financial statements.

**Table of Contents**

**EMERSON RADIO CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(In thousands)

	<b>Three Months Ended June 30</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,369	\$ 3,840
<b>Adjustments to reconcile net income to net cash (used) by operating activities:</b>		
Depreciation and amortization	28	26
Deferred tax expense	124	122
Asset allowances, reserves and other	11	88
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(6,133)	(13,428)
Other receivables	(70)	203
Due from affiliates	1	
Inventories	(2,610)	1,401
Prepaid expenses and other current assets	(3,413)	(7,464)
Other assets	35	(12)
Accounts payable and other current liabilities	5,236	9,547
Due to affiliates		(11)
Interest and income taxes payable	57	274
<b>Net cash (used) by operating activities</b>	<b>(5,365)</b>	<b>(5,414)</b>
<b>Cash flows from investing activities:</b>		
Short term investment	(102)	
Decrease in restricted cash	70	145
Additions to property and equipment	(21)	(1)
Disposals of property and equipment		7
<b>Net cash (used) provided by investing activities</b>	<b>(53)</b>	<b>151</b>
<b>Cash flows from financing activities:</b>		
Repayments of short-term borrowings		1
Net (decrease) in capital lease and other rental obligations	(11)	(10)
<b>Net cash (used) by financing activities</b>	<b>(11)</b>	<b>(9)</b>
<b>Net (decrease) in cash and cash equivalents</b>	<b>(5,429)</b>	<b>(5,272)</b>
Cash and cash equivalents at beginning of period	21,412	44,960
<b>Cash and cash equivalents at end of period</b>	<b>\$ 15,983</b>	<b>\$ 39,688</b>
<b>Cash paid during the period for:</b>		
Interest	\$ 3	\$ 3
Income taxes	\$	\$ 2

The accompanying notes are an integral part of the interim consolidated financial statements.





---

**Table of Contents**

**EMERSON RADIO CORP. AND SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 BACKGROUND AND BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Emerson Radio Corp. ( Emerson , consolidated the Company ), and its subsidiaries. The Company designs, sources, imports and markets a variety of houseware and consumer electronic products, and licenses the Company s trademarks for a variety of products domestically and internationally.

The unaudited interim consolidated financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary to present a fair statement of the Company s consolidated financial position as of June 30, 2013 and the results of operations for the three month periods ended June 30, 2013 and June 30, 2012. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary in order to make the financial statements not misleading have been included. All significant intercompany accounts and transactions have been eliminated in consolidation. The preparation of the unaudited interim consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes; actual results could materially differ from those estimates. The unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and accordingly do not include all of the disclosures normally made in the Company s annual consolidated financial statements. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended March 31, 2013 ( fiscal 2013 ), included in the Company s annual report on Form 10-K, as amended, for fiscal 2013.

The results of operations for the three month period ended June 30, 2013 are not necessarily indicative of the results of operations that may be expected for any other interim periods or for the full year ended March 31, 2014 ( fiscal 2014 ).

Certain reclassifications were made to conform the prior year s financial statements to the current presentation.

Unless otherwise disclosed in the notes to these financial statements, the estimated fair value of the financial assets and liabilities approximates the carrying value.

Subsequent events have been evaluated through August 14, 2013.

**Stock- Based Compensation**

The Company measures compensation cost for stock-based compensation arrangements based on grant date fair value. The computed fair value is expensed ratably over the requisite vesting period as required by ASC Topic 718 Compensation Stock Compensation . All outstanding stock based compensation arrangements issued by the Company were fully vested as of November 30, 2009. Consequently, the Company recorded no compensation costs during either of the three month periods ended June 30, 2013 and June 30, 2012.

**Sales Allowance and Marketing Support Expenses**

Sales allowances, marketing support programs, promotions and other volume-based incentives which are provided to retailers and distributors are accounted for on an accrual basis as a reduction to net revenues in the period in which the related sales are recognized in accordance with ASC topic 605, Revenue Recognition , subtopic 50 Customer Payments and Incentives and Securities and Exchange Commission Staff Accounting Bulletins 101 Revenue Recognition in Financial Statements, and 104 Revenue Recognition, corrected copy ( SAB s 101 and 104 ).

At the time of sale, the Company reduces recognized gross revenue by allowances to cover, in addition to estimated sales returns as required by ASC topic 605, Revenue Recognition , subtopic 15 Products , (i) sales incentives offered to customers that meet the criteria for accrual under ASC topic 605, subtopic 50 and (ii) under SAB s 101 and 104, an estimated amount to recognize additional non-offered deductions it anticipates and can reasonably estimate will be taken by customers which it does not expect to recover. Accruals for the estimated amount of future non-offered deductions are required to be made as contra-revenue items because that percentage of shipped revenue fails to meet the collectability criteria within SAB 104 s and 101 s four revenue recognition criteria, all of which are required to be met in order to recognize revenue.

## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

If additional marketing support programs, promotions and other volume-based incentives are required to promote the Company's products subsequent to the initial sale, then additional reserves may be required and are accrued for when such support is offered.

**Table of Contents****NOTE 2 NET EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended June 30	
	2013	2012
<b>Numerator:</b>		
Net income	\$ 1,369	\$ 3,840
<b>Denominator:</b>		
Denominator for basic earnings per share weighted average shares	27,130	27,130
Effect of dilutive securities on denominator:		
Options (computed using the treasury stock method)		
Denominator for diluted earnings per share weighted average shares and assumed conversions	27,130	27,130
Basic and diluted earnings per share	\$ .05	\$ .14

**NOTE 3 SHAREHOLDERS EQUITY**

Outstanding capital stock at June 30, 2013 consisted of common stock and Series A convertible preferred stock. The Series A convertible preferred stock is non-voting, has no dividend preferences and has not been convertible since March 31, 2002; however, it retains a liquidation preference.

At June 30, 2013, the Company had approximately 50,000 options outstanding with exercise prices ranging from \$3.07 to \$3.19.

**NOTE 4 INVENTORY**

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. As of June 30, 2013 and March 31, 2013, inventories consisted of the following (in thousands):

	June 30, 2013 (Unaudited)	March 31, 2013
Finished goods	\$ 6,064	\$ 3,454

**NOTE 5 INCOME TAXES****Income Tax Issues Concerning Overseas Income**

On April 15, 2013 and June 5, 2013, Emerson received correspondence from the IRS including a (i) Form 5701 and Form 886-A regarding Adjusted Sales Income (collectively referred to as NOPA 1 ) and (ii) Form 5701 and Form 886-A regarding Adjusted Subpart F-Foreign Base Company Sales Income (collectively referred to as NOPA 2 ).

With respect to NOPA 1, the IRS is (i) challenging the position of the Company with respect to the way the Company's controlled foreign corporation in Macao (the Macao CFC ) recorded its product sales during Fiscal 2010 and Fiscal 2011 and (ii) asserting that an upward adjustment to the Company's Fiscal 2010 and Fiscal 2011 taxable income of \$4,981,520 and \$5,680,182, respectively, is required.

## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

With respect to NOPA 2, the IRS is challenging the position of the Company with respect to the fact that the Company considered the service fee paid by the Company to the Macao CFC to be non-taxable in the U.S. The IRS has taken the position that the service fee paid to the Macao CFC by the Company constitutes foreign base company sales income ( FBCSI ). The IRS asserts that the service fee earned by the Macao CFC in connection with its sales of products to the Company should be taxable to the Company as FBCSI. As a result, the IRS determined that an upward adjustment to the Company's Fiscal 2010 and Fiscal 2011 taxable income of \$1,553,984 and \$1,143,162, respectively, is required.

The Company has evaluated the determinations made by the IRS as set forth in each of NOPA 1 and NOPA 2 in order to decide (a) how it will proceed and (b) the potential impact on the Company's financial condition and operations. Furthermore, although NOPA 1 and NOPA 2 represent potential adjustments to Fiscal 2010 and Fiscal 2011 only, the Company believes it is likely that the IRS will take the position that the same type of adjustments should be made for each of the Company's subsequent fiscal years. The assessment and payment of such additional taxes, penalties and interest would have a material adverse effect on the Company's financial condition and results of operations.

**Table of Contents**

With respect to NOPA 1, the Company is appealing the proposed adjustment with the IRS. In the event that the Company is not successful in its appeal, the Company estimates that it could be liable for a maximum in taxes, penalties and interest of approximately \$13.3 million pertaining to NOPA 1, in the aggregate, for its Fiscal 2010, Fiscal 2011, Fiscal 2012 and Fiscal 2013 periods. However, because the Company's current assessment is that its appeal of NOPA 1 is more likely than not to be successful, the Company has not recorded any liability to its March 31, 2013 balance sheet related to NOPA 1.

With respect to NOPA 2, the Company agrees in principle with the IRS' position that the service fee paid to the Macao CFC by the Company would be treated as FBCSI and taxable to the Company but the Company does not agree with the adjustment to the Company's taxable income as calculated by the IRS. However, the Company has estimated as approximately \$1.1 million the amount of taxes, penalties and interest for which it would be liable for its Fiscal 2010, Fiscal 2011, Fiscal 2012 and Fiscal 2013 periods using the adjustments to taxable income as proposed by the IRS, and recorded such amount as a liability to its March 31, 2013 balance sheet.

The Company has no U.S. federal net operating loss carry forwards and some U.S. state net operating loss carry forwards included in net deferred tax assets that are available to offset future taxable income and can be carried forward for 20 years. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax assets will be realized through tax planning strategies available in future periods and through future profitable operating results. The amount of the deferred tax asset considered realizable could be reduced or eliminated if certain tax planning strategies are not successfully executed or estimates of future taxable income during the carry forward period are reduced. If management determines that the Company would not be able to realize all or part of the net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

The Company's effective tax rate differs from the federal statutory rate primarily due to expenses that are not deductible for federal income tax purposes, income and losses incurred in foreign jurisdictions and taxed at locally applicable tax rates, and state income taxes.

The Company is subject to examination and assessment by tax authorities in numerous jurisdictions. A summary of the Company's open tax years is as follows as of June 30, 2013:

<b>Jurisdiction</b>	<b>Open tax years</b>
U.S. federal	2008-2012
States	2008-2012

Based on the outcome of tax examinations or due to the expiration of statutes of limitations, it is reasonably possible that the unrecognized tax benefits related to uncertain tax positions taken in previously filed returns may be different from the liabilities that have been recorded for these unrecognized tax benefits. As a result, the Company may be subject to additional tax expense.

**NOTE 6 RELATED PARTY TRANSACTIONS**

From time to time, Emerson engages in business transactions with its controlling shareholder, The Grande Holdings Limited (Provisional Liquidators Appointed) (Grande), a Bermuda Corporation, and one or more of Grande's direct and indirect subsidiaries. Set forth below is a summary of such transactions.

***Controlling Shareholder***

Grande has, together with S&T International Distribution Limited (S&T), a subsidiary of Grande, and Grande N.A.K.S. Ltd., a subsidiary of Grande (together with Grande, the Reporting Persons), filed, on April 29, 2013, a Schedule 13D/A with the Securities and Exchange Commission (SEC) stating that, as of the filing date, the Reporting Persons had the shared power to vote and direct the disposition of 15,243,283 shares, or approximately 56.2%, of the outstanding common stock of Emerson which, pursuant to an agreement between S&T and Deutsche Bank AG (Deutsche Bank) on March 26, 2013, are no longer subject to the rights granted to Deutsche Bank pursuant to a security agreement entered into between S&T and Deutsche Bank on January 20, 2010.

On April 10, 2013, Deutsche Bank filed a Form 4 with the SEC disclosing the redemption and release, as of April 2, 2013, of 3,380,079 shares of common stock (the Remaining Pledged Shares) of Emerson to S&T, Emerson's largest shareholder. On May 9, 2013, a Schedule 13G was filed with the SEC by Deutsche Bank AG stating that it had no voting or dispositive power over any of the outstanding common stock of Emerson. As a result, Deutsche Bank no longer claims beneficial ownership of any of the Remaining Pledged Shares. Furthermore, because S&T has regained control of a majority of the outstanding shares of common stock of Emerson, Emerson is once again a Controlled company, as defined in Section 801(a) of the NYSE MKT Rules.



**Table of Contents**

On May 31, 2011, upon application of a major creditor, the High Court of Hong Kong appointed Fok Hei Yu (who is also known by the anglicized name Vincent Fok), a current director of the Company, and Roderick John Sutton, both of FTI Consulting (Hong Kong) Limited ( FTI ), as Joint and Several Provisional Liquidators over Grande. Accordingly, as of May 31, 2011, the directors of Grande no longer have the ability to exercise control over Grande or the power to direct the voting and disposition of the 15,243,283 shares beneficially owned by Grande. Instead, Mr. Fok, as a Provisional Liquidator over Grande, has such power. In addition, on March 20, 2013, the Provisional Liquidators informed Emerson that they are obligated to liquidate the 15,243,283 shares beneficially owned by Grande. The Company can make no assurances regarding whether or to what extent such shares will be liquidated or retained by Grande, the timing, prices or amounts of any sales of shares or the impact, if any, on the Company, its other shareholders or the trading price of its common stock of any actual or anticipated dispositions of shares by the Provisional Liquidators.

***Related Party Transactions*****Rented Office Space in Hong Kong**

The Company is billed for service charges from Brighton Marketing Limited, a subsidiary of Grande, in connection with the Company's rented office space in Hong Kong. These charges totaled approximately \$1,000 for the three month period ended June 30, 2013 and approximately \$1,000 for the three month period ended June 30, 2012. Emerson owed Brighton Marketing Limited nil at both June 30, 2013 and June 30, 2012 pertaining to these charges.

During the three months ended June 30, 2013 and the three months ended June 30, 2012, the Company was also billed for service charges from The Grande Properties Management Limited, a related party to Christopher Ho, the Chairman of the Board of Directors of the Company, in connection with the Company's rented office space in Hong Kong, in the amount of approximately \$4,000 and approximately \$11,000, respectively. The Company owed nil to The Grande Properties Management Limited related to these charges at both June 30, 2013 and June 30, 2012.

Beginning July 3, 2012, the Company entered into a rental agreement with Lafe Strategic Services Limited ( Lafe ), which is a related party to Christopher Ho, whereby the Company was leasing out excess space within its rented office space in Hong Kong to Lafe. The rental agreement was on a month-by-month basis, cancellable by either the Company or Lafe on one month's written notice. The agreement was cancelled by Lafe effective April 1, 2013. At June 30, 2013, Lafe owed Emerson nil in rental payable from this arrangement, and Emerson owed Lafe an amount of approximately \$6,000 for a security deposit paid to the Company by Lafe at the inception of the agreement which was returned to Lafe in July 2013 in accordance with the terms of the agreement.

**Consulting Services Provided to Emerson by one of its Directors**

During the three months ended June 30, 2013 and June 30, 2012, Emerson paid consulting fees of approximately \$29,000 and \$29,000, respectively, to Mr. Eduard Will, a director of Emerson, for work performed by Mr. Will related to strategy for the Kayne Litigation as more fully described in Note 9 Legal Proceedings Kayne Litigation and merger and acquisition research. In addition, during the three months ended June 30, 2013 and June 30, 2012, Emerson paid expense reimbursements and advances, in the aggregate, of nil and approximately \$2,000, respectively, to Mr. Will, related to this consulting work and his service as a director of Emerson.

At both June 30, 2013 and June 30, 2012, the Company owed Mr. Will nil related to these activities.

**Dividend-Related Issues with S&T**

On March 2, 2010, the Board declared an extraordinary dividend of \$1.10 per common share, which was paid on March 24, 2010. In connection with the Company's determination as to the taxability of the dividend, the Board relied upon information and research provided to it by the Company's tax advisors and, in reliance on the stock-for-debt exception in the Internal Revenue Code Sections 108(e)(8) and (e)(10), concluded that 4.9% of such dividend paid was taxable to the recipients.

In August 2012, the Company received a Form 886-A from the IRS which challenges the Company's conclusions and determines that the Company does not qualify for the above-referenced exception. Accordingly, the IRS has concluded that 100% of the dividend paid was taxable to the recipients. The Company is defending its position and calculations and is contesting the position asserted by the IRS. The Company prepared and, on October 25, 2012, delivered its rebuttal to the IRS contesting the IRS determination. There can be no assurance that the Company will be successful in defending its position.



## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

In the event that the Company is not successful in establishing with the IRS that the Company calculations were correct, then the shareholders who received the dividend likely will be subject to and liable for an assessment of additional taxes due. Moreover, the Company may be contingently liable for taxes due by certain of its shareholders resulting from the dividend paid by the Company.

**Table of Contents**

Initially, the Company withheld from the dividend paid to foreign shareholders an amount equal to the tax liability associated with such dividend. On April 7, 2010, upon a request made to the Company by its foreign controlling shareholder, S&T, the Company entered into an agreement with S&T (the Agreement), whereby the Company returned to S&T on April 7, 2010 that portion of the funds withheld for taxes from the dividend paid on March 24, 2010 to S&T, which the Company believes is not subject to U.S. tax based on the Company's good-faith estimate of its accumulated earnings and profits. The Agreement includes provisions pursuant to which S&T agreed to indemnify the Company for any liability imposed on it as a result of the Company's agreement not to withhold such funds for S&T's possible tax liability and a pledge of stock as collateral. The Company continues to assert that such dividend is largely not subject to U.S. tax based on the Company's good-faith estimate of its accumulated earnings and profits. In addition, the Company also continues to assert that this transaction results in an off-balance sheet arrangement and a possible contingent tax liability of the Company, which, if recognized, would be offset in part by the calling by the Company on S&T of the indemnification provisions of the Agreement.

Per the terms of the Agreement, Emerson invoiced S&T in June 2010 approximately \$42,000 for reimbursement of legal fees incurred by Emerson with regard to the Agreement and approximately \$33,000 as a transaction fee for having entered into the Agreement. In January 2011, Emerson agreed, upon the request of S&T, to waive approximately \$5,000 of the legal charges that had been invoiced to S&T in June 2010. S&T paid the full amount owed to Emerson of approximately \$70,000 in February 2011.

In February 2011, upon the request of S&T to the Company, the Company and S&T agreed that the collateral pledged as a part of the Agreement would no longer be required and such collateral was returned by the Company to S&T in March 2011 and the Agreement was amended and restated to remove the collateral requirement but retain the indemnification provisions. The Agreement, as amended (the Amended Agreement), remains in effect as of today. In the event that (i) the Company is not successful in establishing with the IRS that the Company's calculations were correct and (ii) S&T is unable or unwilling to pay the additional taxes due or indemnify the Company under the terms of the Amended Agreement, the Company may be liable to pay such additional taxes which would have a material adverse effect on the Company's financial condition and results of operations.

**Other**

During each of the three months ended June 30, 2013 and June 30, 2012, Emerson invoiced Vigers Appraisal & Consulting Ltd. (Vigers), a related party of Christopher Ho, approximately \$1,000 for usage of telephone and data lines maintained by Emerson. Vigers owed Emerson nil at June 30, 2013 and approximately \$1,000 at June 30, 2012 related to this activity.

**NOTE 7 BORROWINGS****Short-term Borrowings**

*Letters of Credit* The Company uses Hang Seng Bank to issue letters of credit on behalf of the Company, as needed, on a 100% cash collateralized basis. At June 30, 2013, the Company had no outstanding letters of credit.

**Long-term Borrowings**

At June 30, 2013 and March 31, 2013, borrowings under long-term facilities consisted of the following (in thousands):

	June 30, 2013 (Unaudited)	March 31, 2013
Capitalized lease obligations	62	73
Less current maturities	(43)	(43)
<b>Long term debt and notes payable</b>	<b>\$ 19</b>	<b>\$ 30</b>

---

**Table of Contents**

**NOTE 8 LEGAL PROCEEDINGS**

***Kayne Litigation.*** On July 7, 2011, the Company was served with an amended complaint (the Complaint) filed in the United States District Court for the Central District of California alleging, among other things, that the Company, certain of its present and former directors and other entities or individuals now or previously associated with Grande, intentionally interfered with the ability of the plaintiffs to collect on a judgment (now approximately \$47 million) they had against Grande by engaging in transactions (such as the dividend paid to all shareholders in March 2010) which transferred assets out of the United States. The Complaint also asserts claims under the civil RICO statute and for alter ego liability. In the Company's opinion, the claims appear to be devoid of merit. Accordingly, on September 27, 2011, Emerson moved to dismiss the action for failure to state a claim. On or about February 27, 2012, the Court dismissed the intentional interference claim and portions of the Civil RICO claim with leave to re-plead, but denied the motion to dismiss the alter ego claim. On March 19, 2012, the plaintiffs filed a Second Amended Complaint setting forth the same claims as the Complaint. On April 20, 2012, the Company moved to dismiss the re-pleaded intentional interference and RICO claims, and oral arguments on this motion were held on June 18, 2012. On September 6, 2012, the Court dismissed the RICO claim, but granted the plaintiffs leave to re-plead. On September 17, 2012, the plaintiffs filed a Third Amended Complaint setting forth the same claims as the Complaint. The Company's response to the Third Amended Complaint was due and filed on October 4, 2012, which joined in a co-defendants' motion to dismiss the alter ego claim and the RICO claim. The Court heard oral argument on December 17, 2012. On May 9, 2013, the Court granted, in part, the motion to dismiss and dismissed the RICO claim with prejudice. On May 23, 2013, Emerson filed an Answer in which it denied the allegations of the Third Amended Complaint. Discovery, which included the exchange of thousands of documents and numerous depositions of fact and expert witnesses, is now complete. On June 24, 2013, Emerson, and the other parties moved for summary judgment seeking dismissal of the remaining two claims. The court held oral argument on that motion on July 29, 2013 and reserved decision. In the event the motion for summary judgment is denied, Emerson will continue to defend the action vigorously. This matter is scheduled for trial on October 29, 2013.

***Other.*** Except for the litigation matter described above, the Company is not currently a party to any legal proceedings other than litigation matters, in most cases involving ordinary and routine claims incidental to our business. Management cannot estimate with certainty the Company's ultimate legal and financial liability with respect to such pending litigation matters. However, management believes, based on our examination of such matters, that the Company's ultimate liability will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

**NOTE 9 SHORT TERM INVESTMENTS**

At June 30, 2013 and March 31, 2013, the Company held short-term investments totaling \$45.3 million and \$45.2 million, respectively. At June 30, 2013, these investments were comprised of bank certificates of deposit with maturities in August, September and December 2013.

## **Table of Contents**

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

The following discussion of the Company's operations and financial condition should be read in conjunction with the Financial Statements and notes thereto included elsewhere in this Quarterly Report.

In the following discussions, most percentages and dollar amounts have been rounded to aid presentation. Accordingly, all amounts are approximations.

#### **Forward-Looking Information**

This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

Forward-looking statements include statements with respect to the Company's beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions, and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond the Company's control, and which may cause the Company's actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. The reader can identify these forward-looking statements through the Company's use of words such as may, will, can, anticipate, assume, should, indicate, would, contemplate, expect, seek, estimate, continue, plan, project, predict, could, intend, target, potential, and other similar words in the future. These forward-looking statements may not be realized due to a variety of factors, including, without limitation:

the impact, if any, on the Company's business, financial condition and results of operation arising from the appointment of the Provisional Liquidators over Grande;

the decline in, and any further deterioration of, consumer spending for retail products, such as the Company's products;

the Company's inability to resist price increases from its suppliers or pass through such increases to its customers;

the loss of any of the Company's key customers or reduction in the purchase of the Company's products by any such customers;

conflicts of interest that exist based on the Company's relationship with Grande;

the Company's inability to improve and maintain effective internal controls or the failure by its personnel to comply with such internal controls;

the Company's inability to maintain its relationships with its licensees and distributors, renew existing licenses, or the failure to obtain new licensees or distribution relationships on favorable terms;

cash generated by operating activities represents the Company's principal source of funding and therefore the Company depends on its ability to successfully manage its operating cash flows to fund its operations;

the Company's inability to anticipate market trends, enhance existing products or achieve market acceptance of new products;

## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

the Company's dependence on a limited number of suppliers for its components and raw materials;

the Company's dependence on third party manufacturers to manufacture and deliver its products;

changes in consumer spending and economic conditions;

the failure of third party sales representatives to adequately promote, market and sell the Company's products;

the Company's inability to protect its intellectual property;

the effects of competition;

changes in foreign laws and regulations and changes in the political and economic conditions in the foreign countries in which the Company operates;

changes in accounting policies, rules and practices;

limited access to financing or increased cost of financing;

the effects of the continuing appreciation of the renminbi and increases in costs of production in China and;

the other factors listed under "Risk Factors" in the Company's Form 10-K, as amended, for the fiscal year ended March 31, 2013 and other filings with the Securities and Exchange Commission (the "SEC").

**Table of Contents**

All forward-looking statements are expressly qualified in their entirety by this cautionary notice. The reader is cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date of this report or the date of the document incorporated by reference into this report. The Company has no obligation, and expressly disclaims any obligation, to update, revise or correct any of the forward-looking statements, whether as a result of new information, future events or otherwise. Management has expressed its expectations, beliefs and projections in good faith and it believes it has a reasonable basis for them. However, management cannot assure the reader that its expectations, beliefs or projections will be achieved or accomplished.

**Results of Operations**

The following table summarizes certain financial information for the three month periods ended June 30, 2013 (first quarter of fiscal 2014) and June 30, 2012 (first quarter of fiscal 2013) (in thousands):

	<b>Three months ended</b>	
	<b>June 30</b>	
	<b>2013</b>	<b>2012</b>
Net product sales	\$ 23,481	\$ 44,876
Licensing revenue	1,171	1,135
<b>Net revenues</b>	<b>24,652</b>	<b>46,011</b>
Cost of sales	20,984	39,173
Other operating costs and expenses	151	408
Selling, general and administrative expenses	2,188	2,008
<b>Operating income</b>	<b>1,329</b>	<b>4,422</b>
Interest income, net	222	31
<b>Income before income taxes</b>	<b>1,551</b>	<b>4,453</b>
Provision for income taxes	182	613
<b>Net income</b>	<b>\$ 1,369</b>	<b>\$ 3,840</b>

Net product sales Net product sales for the first quarter of fiscal 2014 were \$23.5 million as compared to \$44.9 million for fiscal 2013, a decrease of \$21.4 million, or 47.7%. The Company's sales during the first quarters of fiscal 2014 and 2013 were highly concentrated among the Company's two largest customers, where gross product sales comprised approximately 88.4% and 94.7%, respectively, of the Company's total gross product sales. Net product sales may be periodically impacted by adjustments made to the Company's sales allowance and marketing support accrual to record unanticipated customer deductions from accounts receivable or to reduce the accrual by any amounts which were accrued in the past but not taken by customers through deductions from accounts receivable within a certain time period. In the aggregate, these adjustments had the effect of increasing net product sales and operating income by \$0.1 million and \$0.3 million for the first quarters of fiscal 2014 and fiscal 2013, respectively. The Company confronts increasing pricing pressure which is a trend that management expects to continue.

Net product sales are comprised primarily of the sales of houseware and audio products which bear the Emerson® brand name. The major elements which contributed to the overall decrease in net product sales were as follows:

i) Houseware product net sales decreased \$21.5 million, or 49.1%, to \$22.3 million in the first quarter of fiscal 2014 as compared to \$43.8 million in the first quarter of fiscal 2013, on decreased net sales of microwave ovens, compact refrigerators and wine coolers.

As reported by the Company in a Form 8-K filed with the SEC on October 19, 2012, the Company was informed by its customer Wal-Mart, that, commencing with the Spring of 2013, Wal-Mart would discontinue purchasing from Emerson two microwave oven products that had been currently sold by the Company to Wal-Mart. Emerson continued shipping these two products throughout the remainder of Fiscal 2013 (the year ending March 31, 2013), with sales of such products declining through the fourth quarter of Fiscal 2013. During Fiscal 2013, these two microwave oven products comprised, in the aggregate, approximately \$36.1 million, or 29.7%, of the Company's net product sales. Emerson anticipates that the full impact of Wal-Mart's decision will be realized by the Company in Fiscal 2014, which began on April 1, 2013. As previously disclosed by the Company, the complete loss of, or significant reduction in, business with either of the Company's key customers will have a material adverse effect on the Company's business and results of operations. Accordingly, Wal-Mart's decision will have a material

## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

adverse effect on the Company's business and results of operations. There can be no assurance that the Company will be able to increase sales of such products at levels sufficient to offset the adverse impact of Wal-Mart's decision, if at all.

As a result of the above, during the first quarter of fiscal 2014, sales of these two products by the Company were nil as compared to approximately \$12.1 million during the first quarter of fiscal 2013.

---

## **Table of Contents**

ii) Audio product net sales were \$1.2 million in the first quarter of fiscal 2014 as compared to \$1.1 million in the first quarter of fiscal 2013, an increase of \$0.1 million, or 8.2%, resulting from increased net sales of the Company's clock radio and portable audio product offerings.

**Licensing revenue** Licensing revenue in the first quarter of fiscal 2014 was \$1.2 million as compared to \$1.1 million in the first quarter of fiscal 2013, an increase of \$0.1 million, or 9.1%, due to higher year-over-year sales by the Company's licensees of branded products under license from the Company during the first quarter of fiscal 2014 as compared to the first quarter of fiscal 2013.

The Company's largest license agreement is with Funai Corporation, Inc. (Funai), which accounted for approximately 80% of the Company's total licensing revenue for the first quarter of fiscal 2014 and which was amended in December 2012 to extend the term of the agreement until March 31, 2015. The agreement provides that Funai will manufacture, market, sell and distribute specified products bearing the Emerson® trademark to customers in the U.S. and Canadian markets. Under the terms of the agreement, the Company receives non-refundable minimum annual royalty payments of \$3.75 million each calendar year and a license fee on sales of product subject to the agreement in excess of the minimum annual royalties. During the first quarter of fiscal 2014 and 2013, revenues of \$0.9 million and \$0.9 million, respectively, were earned under this agreement.

**Net revenues** As a result of the foregoing factors, the Company's net revenues were \$24.7 million in the first quarter of fiscal 2014 as compared to \$46.0 million in the first quarter of fiscal 2013, a decrease of \$21.3 million, or 46.4%.

**Cost of sales** In absolute terms, cost of sales decreased \$18.2 million, or 46.4%, to \$21.0 million in the first quarter of fiscal 2014 as compared to \$39.2 million in the first quarter of fiscal 2013. Cost of sales, as a percentage of net revenues was 85.1% in the first quarter of each of fiscal 2014 and fiscal 2013. Cost of sales, as a percentage of net product sales was 89.4% in the first quarter of fiscal 2014 as compared to 87.3% in the first quarter of fiscal 2013. The decrease in absolute terms for the first quarter of fiscal 2014 as compared to the first quarter of fiscal 2013 was primarily related to the reduced net product sales, partially offset by a smaller increase to the sales return reserve compared to the prior year.

The Company purchases the products it sells from a limited number of factory suppliers. For the first quarter of fiscal 2014 and fiscal 2013, 75% and 72%, respectively, of such purchases were from the Company's largest two suppliers.

**Other operating costs and expenses** Other operating costs and expenses as a percentage of net revenues were 0.6% in the first quarter of fiscal 2014 and 0.9% in the first quarter of fiscal 2013. In absolute terms, other operating costs and expenses decreased \$257,000, or 63.0%, to \$151,000 in the first quarter of fiscal 2014 as compared to \$408,000 in the first quarter of fiscal 2013 resulting from lower warranty and returns processing costs.

**Selling, general and administrative expenses (S,G&A)** S,G&A, as a percentage of net revenues, was 8.9% in the first quarter of fiscal 2014 as compared to 4.4% in the first quarter of fiscal 2013. S,G&A, in absolute terms, increased \$0.2 million, or 9.0%, to \$2.2 million in the first quarter of fiscal 2014 as compared to \$2.0 million in the first quarter of fiscal 2013. The increase in S,G&A in absolute terms between the first quarter of fiscal 2014 and the first quarter of fiscal 2013 was primarily due to an increase in legal fees of \$0.2 million, an increase in tax consulting fees of \$0.1 million and a reduced benefit in bad debt recoveries of \$0.1 million, partially offset by a decrease in compensation costs of \$0.2 million.

**Interest income, net** Interest income, net, was \$222,000 in the first quarter of fiscal 2014 as compared to \$31,000 in the first quarter of fiscal 2013 resulting from the interest earned during the first quarter of fiscal 2014 on investments in Certificates of Deposit which were made subsequent to the first quarter of fiscal 2013.

**Provision for income taxes** In the first quarter of fiscal 2014 and the first quarter of fiscal 2013, the Company recorded income tax expense of \$0.2 million and \$0.6 million, respectively. In the first quarter of fiscal 2014, the amount of income tax expense recorded by the Company was lower than in the first quarter of fiscal 2013 because the Company recorded a larger percentage of its taxable earnings in the first quarter of fiscal 2014 in tax jurisdictions with lower comparative tax rates than in the first quarter of fiscal 2013.

**Net income** As a result of the foregoing factors, the Company's net income was \$1.4 million in the first quarter of fiscal 2014 as compared to net income of \$3.8 million in the first quarter of fiscal 2013.

## **Liquidity and Capital Resources**

### **General**



## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

As of June 30, 2013, the Company had cash and cash equivalents of approximately \$16.0 million, as compared to approximately \$39.7 million of June 30, 2012. Working capital increased to \$74.0 million at June 30, 2013 as compared to \$68.5 million at June 30, 2012. The decrease in cash and cash equivalents of approximately \$23.7 million was primarily due to an increase in short term investments of \$45.3 million, partially offset by a decrease in accounts receivable of \$11.5 million, a decrease in prepaid expenses and other current assets of \$5.7 million, a reduction in accounts payable and other current liabilities of \$5.7 million, a decrease in inventory of \$3.8 million and the net income generated by the Company of \$3.5 million during the twelve months ended June 30, 2013,

## **Table of Contents**

Cash flow used by operating activities was \$5.4 million for the three months ended June 30, 2013, resulting primarily from increases in accounts receivable, prepaid expenses and other current assets and inventory, partially offset by increased accounts payable and other current liabilities and the net income generated during the period. The increase in accounts receivable at June 30, 2013 as compared to March 31, 2013 was due to increased sales in June 2013 as compared to March 2013. The increase in prepaid expenses and other current assets at June 30, 2013 as compared to March 31, 2013 was due to a higher level of prepaid factory purchases at June 30, 2013 as compared to March 31, 2013.

Net cash used by investing activities was \$0.1 million for the three months ended June 30, 2013, which was primarily due to an increase in short term investments.

Net cash used by financing activities was \$11,000 for the three months ended June 30, 2013, resulting from a decrease in the Company's long term borrowings.

## **Other Events and Circumstances Pertaining to Liquidity**

### **Potential Income Tax Issues Concerning the Extraordinary Dividend Paid by the Company in March 2010**

On March 2, 2010, the Board declared an extraordinary dividend of \$1.10 per common share which was paid on March 24, 2010. In connection with the Company's determination as to the taxability of the dividend, the Board relied upon information and research provided to it by the Company's tax advisors and, in reliance on the stock-for-debt exception in the Internal Revenue Code Sections 108(e)(8) and (e)(10), concluded that 4.9% of such dividend paid was taxable to the recipients.

In August 2012, the Company received a Form 886-A from the IRS which challenges the Company's conclusions and determines that the Company does not qualify for the above-referenced exception. Accordingly, the IRS has concluded that 100% of the dividend paid was taxable to the recipients. The Company is defending its position and calculations and is contesting the position asserted by the IRS. The Company prepared and, on October 25, 2012, delivered its rebuttal to the IRS contesting the IRS determination. There can be no assurance that the Company will be successful in defending its position.

In the event that the Company is not successful in establishing with the IRS that the Company calculations were correct, then the shareholders who received the dividend likely will be subject to and liable for an assessment of additional taxes due. Moreover, the Company may be contingently liable for taxes due by certain of its shareholders resulting from the dividend paid by the Company.

Initially, the Company withheld from the dividend paid to foreign shareholders an amount equal to the tax liability associated with such dividend. On April 7, 2010, upon a request made to the Company by its foreign controlling shareholder, S&T, the Company entered into an agreement with S&T (the Agreement), whereby the Company returned to S&T on April 7, 2010 that portion of the funds withheld for taxes from the dividend paid on March 24, 2010 to S&T, which the Company believes is not subject to U.S. tax based on the Company's good-faith estimate of its accumulated earnings and profits. The Agreement includes provisions pursuant to which S&T agreed to indemnify the Company for any liability imposed on it as a result of the Company's agreement not to withhold such funds for S&T's possible tax liability and a pledge of stock as collateral. The Company continues to assert that such dividend is largely not subject to U.S. tax based on the Company's good-faith estimate of its accumulated earnings and profits. In addition, the Company also continues to assert that this transaction results in an off-balance sheet arrangement and a possible contingent tax liability of the Company, which, if recognized, would be offset in part by the calling by the Company on S&T of the indemnification provisions of the Agreement.

---

## **Table of Contents**

In February 2011, upon the request of S&T to the Company, the Company and S&T agreed that the collateral pledged as a part of the Agreement would no longer be required and such collateral was returned by the Company to S&T in March 2011 and the Agreement was amended and restated to remove the collateral requirement but retain the indemnification provisions. The Agreement, as amended (the Amended Agreement), remains in effect as of today. In the event that (i) the Company is not successful in establishing with the IRS that the Company's calculations were correct and (ii) S&T is unable or unwilling to pay the additional taxes due or indemnify the Company under the terms of the Amended Agreement, the Company may be liable to pay such additional taxes which would have a material adverse effect on the Company's financial condition and results of operations.

### **Income Tax Issues Concerning Overseas Income**

On April 15, 2013 and June 5, 2013, Emerson received correspondence from the IRS including a (i) Form 5701 and Form 886-A regarding Adjusted Sales Income (collectively referred to as NOPA 1) and (ii) Form 5701 and Form 886-A regarding Adjusted Subpart F-Foreign Base Company Sales Income (collectively referred to as NOPA 2).

With respect to NOPA 1, the IRS is (i) challenging the position of the Company with respect to the way the Company's controlled foreign corporation in Macao (the Macao CFC) recorded its product sales during Fiscal 2010 and Fiscal 2011 and (ii) asserting that an upward adjustment to the Company's Fiscal 2010 and Fiscal 2011 taxable income of \$4,981,520 and \$5,680,182, respectively, is required.

With respect to NOPA 2, the IRS is challenging the position of the Company with respect to the fact that the Company considered the service fee paid by the Company to the Macao CFC to be non-taxable in the U.S. The IRS has taken the position that the service fee paid to the Macao CFC by the Company constitutes foreign base company sales income (FBCSI). The IRS asserts that the service fee earned by the Macao CFC in connection with its sales of products to the Company should be taxable to the Company as FBCSI. As a result, the IRS determined that an upward adjustment to the Company's Fiscal 2010 and Fiscal 2011 taxable income of \$1,553,984 and \$1,143,162, respectively, is required.

The Company has evaluated the determinations made by the IRS as set forth in each of NOPA 1 and NOPA 2 in order to decide (a) how it will proceed and (b) the potential impact on the Company's financial condition and operations. Furthermore, although NOPA 1 and NOPA 2 represent potential adjustments to Fiscal 2010 and Fiscal 2011 only, the Company believes it is likely that the IRS will take the position that the same type of adjustments should be made for each of the Company's subsequent fiscal years. The assessment and payment of such additional taxes, penalties and interest would have a material adverse effect on the Company's financial condition and results of operations.

With respect to NOPA 1, the Company is appealing the proposed adjustment with the IRS. In the event that the Company is not successful in its appeal, the Company estimates that it could be liable for a maximum in taxes, penalties and interest of approximately \$13.3 million pertaining to NOPA 1, in the aggregate, for its Fiscal 2010, Fiscal 2011, Fiscal 2012 and Fiscal 2013 periods. However, because the Company's current assessment is that its appeal of NOPA 1 is more likely than not to be successful, the Company has not recorded any liability to its March 31, 2013 balance sheet related to NOPA 1.

With respect to NOPA 2, the Company agrees in principle with the IRS position that the service fee paid to the Macao CFC by the Company would be treated as FBCSI and taxable to the Company but the Company does not agree with the adjustment to the Company's taxable income as calculated by the IRS. However, the Company has estimated as approximately \$1.1 million the amount of taxes, penalties and interest for which it would be liable for its Fiscal 2010, Fiscal 2011, Fiscal 2012 and Fiscal 2013 periods using the adjustments to taxable income as proposed by the IRS, and recorded such amount as a liability to its March 31, 2013 balance sheet.

### **Credit Arrangements**

*Letters of Credit* The Company uses Hang Seng Bank to issue letters of credit on behalf of the Company, as needed, on a 100% cash collateralized basis. At June 30, 2013, the Company had no outstanding letters of credit.

### **Short-term Liquidity**

In the first quarter of fiscal 2014, products representing approximately 71% of net sales were imported directly to the Company's customers. The direct importation of product by the Company to its customers significantly benefits the Company's liquidity because this inventory does not need to be financed by the Company.

The Company's principal existing sources of cash are generated from operations. The Company believes that its existing cash balance and sources of cash will be sufficient to support existing operations over the next 12 months.



---

## **Table of Contents**

### **Recently Issued Accounting Pronouncements**

The following Accounting Standards Updates ( ASUs ) were issued by the Financial Accounting Standards Board during the three months ended June 30, 2013 or during the interim period between June 30, 2013 and August 14, 2013 which relate to or could relate to the Company as concerns the Company's normal ongoing operations or the industry in which the Company operates:

#### **Accounting Standards Update 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (Issued July 2013)**

The amendments in this Update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013.

#### **Accounting Standards Update 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (Issued July 2013)**

An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. For example, an entity should not evaluate whether the deferred tax asset expires before the statute of limitations on the tax position or whether the deferred tax asset may be used prior to the unrecognized tax benefit being settled. The amendments in this Update do not require new recurring disclosures. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

### **Inflation, Foreign Currency, and Interest Rates**

The Company's exposure to currency fluctuations has been minimized by the use of U.S. dollar denominated purchase orders. The Company purchases virtually all of its products from manufacturers located in China.

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

Not applicable.

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

(a) *Disclosure controls and procedures.*

The Company maintains 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 )) that are designed to ensure that information required to be disclosed in its Exchange Act reports are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons; by collusion of two or more people, or by management override of the control. Our controls and procedures can only provide

## Edgar Filing: EMERSON RADIO CORP - Form 10-Q

reasonable, not absolute, assurance that the above objectives have been met.

The Company's management concluded that disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of June 30, 2013, are effective to reasonably ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

**Table of Contents**

*(b) Changes in Internal Controls Over Financial Reporting*

There have been no changes in the Company's internal control over financial reporting that occurred during the fiscal quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

---

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

**Kayne Litigation.** On July 7, 2011, the Company was served with an amended complaint (the Complaint) filed in the United States District Court for the Central District of California alleging, among other things, that the Company, certain of its present and former directors and other entities or individuals now or previously associated with Grande, intentionally interfered with the ability of the plaintiffs to collect on a judgment (now approximately \$47 million) they had against Grande by engaging in transactions (such as the dividend paid to all shareholders in March 2010) which transferred assets out of the United States. The Complaint also asserts claims under the civil RICO statute and for alter ego liability. In the Company's opinion, the claims appear to be devoid of merit. Accordingly, on September 27, 2011, Emerson moved to dismiss the action for failure to state a claim. On or about February 27, 2012, the Court dismissed the intentional interference claim and portions of the Civil RICO claim with leave to re-plead, but denied the motion to dismiss the alter ego claim. On March 19, 2012, the plaintiffs filed a Second Amended Complaint setting forth the same claims as the Complaint. On April 20, 2012, the Company moved to dismiss the re-pleaded intentional interference and RICO claims, and oral arguments on this motion were held on June 18, 2012. On September 6, 2012, the Court dismissed the RICO claim, but granted the plaintiffs leave to re-plead. On September 17, 2012, the plaintiffs filed a Third Amended Complaint setting forth the same claims as the Complaint. The Company's response to the Third Amended Complaint was due and filed on October 4, 2012, which joined in a co-defendants' motion to dismiss the alter ego claim and the RICO claim. The Court heard oral argument on December 17, 2012. On May 9, 2013, the Court granted, in part, the motion to dismiss and dismissed the RICO claim with prejudice. On May 23, 2013, Emerson filed an Answer in which it denied the allegations of the Third Amended Complaint. Discovery, which included the exchange of thousands of documents and numerous depositions of fact and expert witnesses, is now complete. On June 24, 2013, Emerson, and the other parties moved for summary judgment seeking dismissal of the remaining two claims. The court held oral argument on that motion on July 29, 2013 and reserved decision. In the event the motion for summary judgment is denied, Emerson will continue to defend the action vigorously. This matter is scheduled for trial on October 29, 2013.

**Other.** Except for the litigation matter described above, the Company is not currently a party to any legal proceedings other than litigation matters, in most cases involving ordinary and routine claims incidental to our business. Management cannot estimate with certainty the Company's ultimate legal and financial liability with respect to such pending litigation matters. However, management believes, based on our examination of such matters, that the Company's ultimate liability will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

There were no material changes in any risk factors previously disclosed in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on July 16, 2013.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None

**ITEM 3. Defaults Upon Senior Securities.**

(a) None

(b) None

**ITEM 4. Mine Safety Disclosure.  
Not applicable.**



**ITEM 5. Other Information.**

None

**Table of Contents**

**ITEM 6. Exhibits.**

- 31.1 Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 31.2 Certification of the Company's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 32 Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*\*
- 101.1+ XBRL Instance Document. \*\*\*
- 101.2+ XBRL Taxonomy Extension Schema Document. \*\*\*
- 101.3+ XBRL Taxonomy Extension Calculation Linkbase Document. \*\*\*
- 101.4+ XBRL Taxonomy Extension Definition Linkbase Document. \*\*\*
- 101.5+ XBRL Taxonomy Extension Label Linkbase Document. \*\*\*
- 101.6+ XBRL Taxonomy Extension Presentation Linkbase Document. \*\*\*

\* filed herewith

\*\* furnished herewith

\*\*\* The XBRL information is being furnished and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any registration statement under the Securities Act of 1933, as amended.

**Table of Contents**

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.

EMERSON RADIO CORP.  
(Registrant)

Date: August 14, 2013

/s/ Duncan Hon  
Duncan Hon  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 14, 2013

/s/ Andrew L. Davis  
Andrew L. Davis  
Chief Financial Officer  
(Principal Financial and Accounting Officer)