

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

- ☒ Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934 [Fee Required]
For the fiscal year ended June 30, 1997
or
☐ Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934 [No Fee Required]
For the Transition period from _____ to _____

COMMISSION FILE NUMBER: 0-10004

NAPCO SECURITY SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

Delaware 11-2277818
(State or other jurisdiction of (I.R.S. Employer I.D. Number)
incorporation or organization)

333 Bayview Avenue, Amityville, New York 11701
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:
(516) 842-9400

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value \$.01 per share
(Title of Class)

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 ☐
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As of September 18, 1997, 4,369,727 shares of Common Stock were
outstanding, and the aggregate market value of the stock (based upon the last
sale price of the stock on such date) held by non-affiliates was approximately
\$14,048,831.

Documents Incorporated by Reference: Portions of the Registrant's
Proxy Statement in connection with its 1997 Annual Meeting of Stockholders are
incorporated by reference in Part III.

Indicate by check mark if disclosure of delinquent filers pursuant to
Item 405 of Regulation S-K is not contained herein, and will not be contained,
to the best of Registrant's knowledge, in definitive proxy or information
statements incorporated by reference in Part III of this Form 10-K or any
amendment to this Form 10-K. ☐

ITEM 1. BUSINESS.

NAPCO Security Systems, Inc. ("NAPCO") was incorporated in December 1971 in the State of Delaware for the purpose of acquiring National Alarm Products Co., Inc., a New Jersey corporation founded in 1969 ("National"). In December 1971, NAPCO issued an aggregate of 300,000 shares of its common stock, par value \$.01 per share ("Common Stock"), to the stockholders of National in exchange for all of the issued and outstanding capital stock of National, after which National was merged into NAPCO.

NAPCO and its subsidiaries (collectively, the "Company") are engaged in the development, manufacture, distribution and sale of security alarm products and door security devices (the "Products") for commercial and residential installations.

Products

Alarm Systems. Alarm systems usually consist of various detectors, a control panel, a digital keypad and signaling equipment. When a break-in occurs, an intrusion detector senses the intrusion and activates a control panel via hard-wired or wireless transmission that sets off the signaling equipment and, in most cases, causes a bell or siren to sound. Communication equipment such as a digital communicator may be used to transmit the alarm signal to a central station or another person selected by a customer.

The Company manufactures and markets the following products for alarm systems:

Automatic Communicators. When a control panel is activated by a signal from an intrusion detector, it activates a communicator that can automatically dial one or more predesignated telephone numbers. If programmed to do so, a digital communicator dials the telephone number of a central monitoring station and communicates in computer language to a digital communicator receiver, which prints out an alarm message.

Control Panels. A control panel is the "brain" of an alarm system. When activated by any one of the various types of intrusion detectors, it can activate an audible alarm and/or various types of communication devices. For marketing purposes, the Company refers to its control panels by the trade name, generally "Magnum AlertTM" followed by a numerical designation.

Combination Control Panels/Digital Communicators and Digitkey Systems. A combination control panel, digital communicator and a digital keypad (a plate with push button numbers as on a telephone, which eliminates the need for

mechanical keys) has continued to grow rapidly in terms of dealer and consumer preference. Benefits of the combination format include the cost efficiency resulting from a single micro-computer function, as well as the reliability and ease of installation gained from the simplicity and sophistication of microcomputer technology.

Door Security Devices. The Company manufactures a variety of exit alarm locks ranging from simple dead bolt locks to door alarms.

Fire Alarm Control Panel. Multi-zone fire alarm control panels which accommodate an optional digital communicator for reporting to a central station are also manufactured by the Company.

Area Detectors. The Company's area detectors are both passive infra-red heat detectors and combination microwave/ passive infra-red detectors that are linked to alarm control panels. Passive infra-red heat detectors respond to the change in heat patterns caused by an intruder moving within a protected area. Combination units respond to both changes in heat patterns and changes in microwave patterns occurring at the same time.

Peripheral Equipment

The Company also markets peripheral and related equipment manufactured by other companies. Revenues from peripheral equipment have not been significant.

Research and Development

The Company's business involves a high technology element. A substantial amount of the Company's efforts are expended to develop and improve the Products. During the fiscal years ended June 30, 1997, 1996, and 1995, the Company expended approximately \$3,340,000, \$3,296,000 and \$3,252,000, respectively, on Company-sponsored research and development activities conducted by its engineering department and outside consultants. Substantially all of the Company's research and development activities during fiscal 1997, 1996 and 1995 were conducted by its engineering department. The Company intends to continue to conduct a significant portion of its future research and development activities internally.

Employees

As of June 30, 1997, the Company had approximately 1,000 full-time employees.

Marketing and Major Customers

The Company's staff of approximately 32 sales and marketing support employees located at the Company's headquarters sells and

markets the Products directly to independent distributors and wholesalers of security alarm and security hardware equipment. Management estimates that these channels of distribution represented approximately 80% of the Company's total sales for the fiscal year ended June 30, 1997. The Company's sales representatives periodically contact existing and potential customers to introduce new products and create demand for those as well as other Company products. These sales representatives, together with the Company's technical personnel, provide training and other services to wholesalers and distributors so that they can better service the needs of their customers. In addition to direct sales efforts, the Company advertises in technical trade publications and participates in trade shows in major United States cities. Some of the Company's products are marketed under the "private label" of certain customers.

Sales to A.D.I., A.D.T., and KingAlarm, each unaffiliated with the Company, together accounted for approximately 38% and 42% of the Company's total sales for the fiscal years ended June 30, 1997 and 1996 (see Note 9 to Consolidated Financial Statements as to percentage breakdown). The loss of any of these customers could have a material adverse effect on the Company's business. With respect to a customer that accounted for approximately 9% of the Company's sales in fiscal year 1997, the Company anticipates that there will be a significant reduction in the sales to such customer. However, the Company does not believe that such reduction will have a material adverse effect on the results of operations or financial condition of the Company.

Competition

The security alarm products industry is highly competitive. The Company's primary competitors are comprised of approximately 30 other companies that manufacture and market security equipment to distributors, dealers, central stations and original equipment manufacturers. The Company believes that no one of these competitors is dominant in the industry. Certain of these companies may have substantially greater financial and other resources than the Company.

The Company competes primarily on the basis of the features, quality, reliability and price of, and the incorporation of the latest innovative and technological advances into, its Products. The Company also competes by offering technical support services to its customers. In addition, the Company competes on the basis of its expertise, its proven products, reputation and its ability to provide Products to customers without delay. The inability of the Company to compete with respect to any one or more of the aforementioned factors could have an adverse impact on the Company's business. Relatively low-priced "do-it-yourself" alarm system products have become available in recent years and are available to the public at retail stores. The Company believes that these products compete with the Company only to a limited

extent because they appeal primarily to the "do-it-yourself" segment of the market. Purchasers of such systems do not receive professional consultation, installation, service or the sophistication that the Company's Products provide.

Raw Materials and Backlog

The Company prepares specifications for component parts used in the Products and purchases the components from outside sources or fabricates the components itself. These components, if standard, are generally readily available; if specially designed for the Company, there is usually more than one alternative source of supply available to the Company on a competitive basis. The Company generally maintains inventories of all critical components. The Company for the most part is not dependent on any one source for its raw materials.

In general, orders for the Products are processed by the Company from inventory. A backlog of approximately \$3,467,000 existed as of June 30, 1997. This compared to a backlog of approximately \$5,300,000 a year ago, which included several large orders received during the fourth quarter a year ago.

Government Regulation

The Company's telephone dialers, microwave transmitting devices utilized in its motion detectors and any new communication equipment that may be introduced from time to time by the Company must comply with standards promulgated by the Federal Communications Commission ("FCC") in the United States and similar agencies in other countries where the Company offers such products, specifying permitted frequency bands of operation, permitted power output and periods of operation, as well as compatibility with telephone lines. Each new Product of the Company that is subject to such regulation must be tested for compliance with FCC standards or the standards of such similar governmental agencies. Test reports are submitted to the FCC or such similar agencies for approval.

Patents

The Company has been granted several patents and trademarks relating to the Products. While the Company obtains patents and trademarks as it deems appropriate, the Company does not believe that its current or future success is dependent on its patents.

Foreign Sales

The revenues and identifiable assets attributable to the foreign and domestic operations of the Company for its last three fiscal years, and the amount of export sales in the aggregate, are summarized in the following tabulation.

Financial Information Relating to Foreign
and Domestic Operations and Export Sales(1)

	1997 ----	1996 ---- (in thousands)	1995 ----
Sales to unaffiliated customers:			
United States	\$53,302	\$49,088	\$48,078
Foreign	0	0	0
Identifiable assets:			
United States	\$41,242	\$33,084	\$36,031
Foreign	16,002	\$24,235	\$19,708
Export sales:			
United States(2)	\$10,355	\$ 7,994	\$ 7,646

ITEM 2. PROPERTIES.

The Company has executive offices and production and warehousing facilities at 333 Bayview Avenue, Amityville, New York. This facility consists of a fully-utilized 90,000 square foot building on a six acre plot. This six acre plot provides the Company with space for expansion of office, manufacturing and storage capacities. The Company constructed this facility with the proceeds from an industrial revenue bond financing in 1985.

The Company's foreign subsidiary, Napco/Alarm Lock Grupo Internacional, S.A. (formerly known as NSS Caribe, S.A.), is located in the Dominican Republic where it owns a building of approximately 167,000 square feet of production and warehousing space. That subsidiary also leases the land associated with this

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(1) Certain prior year amounts have been reclassified to conform to current year presentation.

(2) Export sales from the United States in fiscal year 1997 included sales of approximately \$6,046,000, \$1,608,000, and \$1,127,000 to Europe, North America, and South America respectively. Export sales from the United States in fiscal year 1996 included sales of approximately \$4,744,000, \$1,083,000, and \$451,000 to Europe, North America, and South America respectively.

building under a 99 year lease expiring in the year 2092. As of June 30, 1997, most of the Company's sales related to labor on assemblies, goods and subassemblies at these sites, utilizing U.S. quality control standards.

Management believes that these facilities are more than adequate to meet the needs of the Company in the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS.

There are no pending or threatened material legal proceedings to which NAPCO or its subsidiaries or any of their property is subject, other than as follows:

In May, 1995, the Company was advised of an unexpected Chapter 7 bankruptcy filing of one of its customers. As a result of anticipated cash recoveries, management believes that the Company's allowance for doubtful accounts at June 30, 1997 is sufficient and that this bankruptcy filing will not have a material adverse effect on the Company's financial position or results of operations.

In August 1995, the Internal Revenue Service ("IRS") informed the Company that it is proposing adjustments of the Company's Federal tax returns for fiscal years 1987 through 1992. The IRS has issued a report to the Company proposing adjustments that would result in taxes due of approximately \$4.3 million, excluding interest charges. The primary adjustments presented by the IRS relate to intercompany pricing and royalty charges, DISC earnings and charitable contributions. The Company disagrees with the IRS and intends to vigorously appeal this assessment using all remedies and procedural actions available under the law. In October 1996, the Company gave the IRS additional information supporting its position. As a result, the Appeals Division of the IRS advised the Company that the case had been returned to the Audit Division for further consideration. Subsequently, the case has again been returned to the Appeals Division of the IRS, with a meeting with such division scheduled for early November, 1997. The Company believes that it has provided adequate reserves at June 30, 1997 to address the ultimate resolution of this matter, so that it will not have a material impact on the Company's consolidated financial statements. (See Note 4 to Consolidated Financial Statements.)

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK
AND RELATED SECURITY HOLDER MATTERS.

Principal Market

NAPCO's Common Stock became publicly traded in the over-the-counter ("OTC") market in 1972. In December 1981, the Common Stock was approved for reporting by the National Association of Securities Dealers Automated Quotation System ("NASDAQ") under the symbol "NSSC", and in November 1984 the Common Stock was designated by NASDAQ as a National Market System Security, which has facilitated the development of an established public trading market for the Common Stock. The tables set forth below reflect the range of high and low sales of the Common Stock in each quarter of the past two fiscal years as reported by the NASDAQ National Market System.

	Quarter Ended			
	Fiscal 1997			
	Sept. 30	Dec. 31	March 31	June 30
Common Stock				
High	\$4.38	\$4.25	\$5.63	\$5.63
Low	\$3.50	\$3.38	\$3.75	\$4.75

	Quarter Ended			
	Fiscal 1996			
	Sept. 30	Dec. 31	March 31	June 30
Common Stock				
High	\$3.13	\$4.00	\$4.13	\$4.50
Low	\$2.00	\$2.25	\$3.00	\$3.38

Approximate Number of Security Holders

The number of holders of record of NAPCO's Common Stock as of September 18, 1997 was 239 (such number does not include beneficial owners of stock held in nominee name).

Dividend Information

NAPCO has declared no cash dividends during the past three years with respect to its Common Stock, and the Company does not anticipate paying any cash dividends in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

	Years Ended June 30,				
	1997	1996	1995	1994	1993
	----	----	----	----	----
	(in thousands, except for per share data)				
Operations					
- - - - -					
Net Sales	\$53,302	\$49,088	\$48,078	\$46,873	\$46,560
Gross Profit	12,778	11,302	11,325	11,068	11,925
Provision for (recovery of)					
Income Taxes	605	515	532	37	(32)
Net Income	1,639	1,014	512	1,254	2,317
Earnings per Share	.37	.23	.12	.29	.53
Cash Dividends per Share(1)	0	0	0	0	0

	As of June 30,				
	1997	1996	1995	1994	1993
	----	----	----	----	----
	(in thousands, except for per share data)				
Financial Condition					
- - - - -					
Total Assets	\$57,244	\$57,319	\$55,739	\$53,810	\$51,233
Long-term Debt	13,313	14,150	15,275	13,690	6,567
Working Capital	30,136	28,676	28,660	28,033	19,936
Stockholders' Equity	31,218	29,574	28,560	28,048	26,793
Stockholders' Equity per Outstanding Share	7.14	6.77	6.54	6.42	6.14

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS.

Liquidity and Capital Resources

The Company's cash on hand combined with proceeds from operating activities during fiscal 1997 were adequate to meet the Company's capital expenditure needs and short and long-term debt obligations. The primary source of financing related to borrowings under a \$16,000,000 secured revolving credit facility. The Company expects that cash generated from operations and cash available under the Company's bank line of credit will be adequate to meet its short-term liquidity requirements. The Company's primary internal source of liquidity is the cash flow generated from operations. As of June 30, 1997, the Company's

(1) The Company has never declared or paid a cash dividend on its common stock. It is the policy of the Board of Directors to retain earnings for use in the Company's business.

unused sources of funds consisted principally of \$1,006,000 in cash and approximately \$4,037,000 which represents the unused portion of its secured revolving credit facility.

In fiscal 1988, the Company completed construction of a new manufacturing and administrative facility in Amityville, N.Y. financed by a \$3.9 million industrial revenue bond issue bearing interest at a variable rate determined weekly by the underwriting bank based upon market conditions. During fiscal 1997, the average interest rate was approximately 3.28% per annum. The bonds had a maturity date of April 1, 2000, subject to quarterly sinking fund payments. Such bonds were retired in May 1997 as part of the Company's debt refinancing with its new primary bank as discussed below.

On April 26, 1993, the Company's foreign subsidiary entered into a 99-year lease of approximately 4 acres of land near its former facility in the Dominican Republic, at an annual cost of approximately \$272,000.

On July 27, 1994, the Company entered into an \$11,000,000 secured revolving credit and term loan facility with two banks, with the Company's primary bank acting as agent. The revolving credit loan, which provided for interest based upon a number of options available to the Company and did not require principal payments until conversion, converted to a term loan on June 30, 1997 payable in sixteen (16) equal quarterly installments beginning on September 30, 1997.

On May 13, 1997, the Company refinanced the majority of its bank debt with a new primary bank and entered into a \$16,000,000 secured revolving credit agreement, a \$3,000,000 line of credit to be used in connection with commercial and standby letters of credit, and replaced the \$2,500,000 standby letter of credit securing an earlier loan from another bank in connection with the Company's international operations. These agreements replaced the \$11,000,000 credit agreement described above. The Company restructured its debt to allow for future growth and expansion as well as to obtain terms more favorable to the Company. As part of the debt restructuring, the Company retired the outstanding industrial revenue bonds relating to the financing of the construction of the Company's Amityville, N.Y. facility. The revolving credit agreement will expire in May, 2000 and any outstanding borrowings are to be repaid on or before that time.

In addition, a subsidiary of the Company maintains a \$4,500,000 line of credit with another bank. The balance outstanding under the line as of December 31, 1994 automatically converted to a term loan payable in 20 equal quarterly installments commencing on that date. \$2,250,000 was outstanding as of June 30, 1997 (see Note 5 to Consolidated Financial Statements).

The Company takes into consideration a number of factors in measuring its liquidity, including the ratios set forth below:

	1997 ----	1996 ----	1995 ----
Current Ratio	3.5 to 1	3.2 to 1	3.5 to 1
Net Sales to Receivables	3.8 to 1	3.6 to 1	3.5 to 1
Total Debt to Equity	.8 to 1	.9 to 1	1.0 to 1

As of June 30, 1997, the Company had no material commitments for purchases or capital expenditures.

Working Capital. Working capital increased by \$1,460,000 to \$30,136,000 at June 30, 1997 from \$28,676,000 at June 30, 1996. This was primarily due to the Company's restructuring of its debt as previously discussed and improved cash flows as discussed below.

Accounts Receivable. Accounts receivable increased by \$178,000 to \$13,937,000 at June 30, 1997 from \$13,759,000 at June 30, 1996. This increase resulted primarily from an increase in sales in the second half of the fourth quarter as compared to sales in the same period a year ago.

Inventory. Inventory decreased by \$242,000 to \$25,702,000 at June 30, 1997 as compared to \$25,944,000 at June 30, 1996. This decrease is due primarily to improvements in the Company's MRP (Material Requirements Planning) system, the goal of which is to have shipments of raw materials as close as possible to "just in time". This improvement, which resulted in a reduction in inventory was partially offset by higher inventory levels necessary to support the increased sales volume.

Accounts Payable and Accrued Expenses. Accounts payable and accrued expenses decreased by \$987,000 to \$6,713,000 at June 30, 1997 from \$7,700,000 at June 30, 1996. This decrease is primarily the result of improved inventory management and stronger cash flows.

Results of Operations

Fiscal 1997 Compared to Fiscal 1996

Net Sales. Net Sales in fiscal 1997 increased approximately \$4,214,000 or 8.6% to \$53,302,000 from \$49,088,000 in fiscal 1996. This increase was primarily the result of increased export sales as well as the market's favorable reception to the Company's new hybrid hard-wired/wireless products and new digital locks that more than offset the decrease in sales of hard-wired only products, decreased sales to one major customer, and continued price pressure in the industry.

Gross Profit. The Company's gross profit increased \$1,476,000 to \$12,778,000 or 24.0% of net sales in fiscal 1997 as compared to \$11,302,000 or 23% of net sales in fiscal 1996. The increase in gross profit as a percentage of net sales was primarily due to improvements in the Company's manufacturing efficiency as well as efficiencies of scale resulting from the higher sales volume mentioned above.

Expenses. Selling, general and administrative expenses in fiscal 1997 increased 9% or \$759,000 to \$9,133,000 or 17.1% of net sales from \$8,374,000 or 17.1% of net sales in fiscal 1996. This increase is primarily due to the Company's additional marketing efforts relating to several new products introduced during the year.

Other Expenses. Other Expenses in fiscal 1997 remained relatively constant at \$1,401,000 as compared to \$1,399,000 in fiscal 1996.

Income Taxes. Provision for income taxes increased \$90,000 to \$605,000 or approximately 27% of income before provision for income taxes during fiscal 1997. This compared to a provision of \$515,000 or approximately 34% of income before provision for income taxes during fiscal 1996. The decrease in the provision as a percentage of income before provision for income taxes is primarily attributable to lower reserve requirements.

Fiscal 1996 Compared to Fiscal 1995

Net Sales. Net Sales in fiscal 1996 increased approximately \$1,010,000 or 2.1% to \$49,088,000 from \$48,078,000 in fiscal 1995. This increase was achieved despite a continued general price erosion in the marketplace.

Gross Profit. The Company's gross profit remained relatively flat at \$11,302,000 or 23% of net sales in fiscal 1996 as compared to \$11,325,000 or 23.6% of net sales in fiscal 1995. The decrease in gross profit as a percentage of net sales was primarily due to the aforementioned general price erosion in the marketplace, as partially offset by improvements in the Company's manufacturing efficiency.

Expenses. Selling, general and administrative expenses in fiscal 1996 decreased 6.9% or \$620,000 to \$8,374,000 or 17.1% of net sales from \$8,994,000 or 18.7% of net sales in fiscal 1995. This decrease is primarily the result of reduction in professional fees and bad debt expenses from those incurred in fiscal 1995. In addition, further decreases in expenses were achieved as a result of the continuation of general cost control procedures established by management.

Other Expenses. Other Expenses in fiscal 1996 increased 8.7% or \$112,000 to \$1,399,000 from \$1,287,000 in fiscal 1995. This increase is primarily the result of an unfavorable shift in

the UK Pounds Sterling exchange rates.

Income Taxes. Provision for income taxes decreased \$17,000 to \$515,000 or approximately 34% of income before provision for income taxes during fiscal 1996. This compared to a provision of \$532,000 or approximately 51% of income before provision for income taxes during fiscal 1995. The higher effective income tax rate in 1995 was primarily due to the recording of additional income taxes related to DISC earnings that no longer qualify for tax deferral.

Effects of Inflation

During the three-year period ended June 30, 1997, inflation and changing prices did not have a significant impact on the Company's operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

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AS OF JUNE 30, 1997 AND 1996

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Napco Security Systems, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of Napco Security Systems, Inc. (a Delaware corporation) and subsidiaries as of June 30, 1997 and 1996, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended June 30, 1997. These consolidated financial statements and the schedules referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedules based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Napco Security Systems, Inc. and subsidiaries as of June 30, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1997 in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The schedules listed in the index to consolidated financial statements are presented for purposes of complying with the Securities and Exchange Commission's rules and are not part of the basic consolidated financial statements. These schedules have been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, fairly state in all material respects, the financial data required to be set forth therein in relation to the basic consolidated financial statements taken as a whole.

/s/ Arthur Andersen LLP

Melville, New York
September 25, 1997

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF JUNE 30, 1997 AND 1996

	ASSETS -----	1997 ----- (in thousands, except share data)	1996 ----- (in thousands, except share data)
CURRENT ASSETS:			
Cash		\$ 1,006	\$ 426
Accounts receivable, less reserve for doubtful accounts of \$805 and \$864, respectively		13,937	13,759
Inventories, net		25,702	25,944
Prepaid expenses and other current assets		390	489
Deferred income taxes		986	911
		-----	-----
Total current assets		42,021	41,529
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation and amortization of approximately \$10,344 and \$9,137, respectively		12,088	12,549
GOODWILL, net of accumulated amortization of approximately \$1,042 and \$935, respectively		2,699	2,806
OTHER ASSETS		436	435
		-----	-----
		\$ 57,244	\$ 57,319
		=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY -----			
CURRENT LIABILITIES:			
Accounts payable		\$ 5,500	\$ 5,986
Accrued expenses		1,213	1,714
Accrued salaries and wages		595	502
Current portion of long-term debt		900	1,500
Accrued income taxes		3,677	3,151
		-----	-----
Total current liabilities		11,885	12,853
LONG-TERM DEBT		13,313	14,150
DEFERRED INCOME TAXES		828	742
		-----	-----
Total liabilities		26,026	27,745
		-----	-----
COMMITMENTS AND CONTINGENCIES (Note 10)			
STOCKHOLDERS' EQUITY:			
Common stock, par value \$.01 per share; 21,000,000 shares authorized; 5,898,602 and 5,896,602 shares issued, respectively; 4,369,727 and 4,367,727 shares outstanding, respectively		59	59
Additional paid-in capital		724	719
Retained earnings		30,436	28,797
Less: Treasury stock, at cost (1,528,875 shares)		(1)	(1)
		-----	-----
Total stockholders' equity		31,218	29,574
		-----	-----
		\$ 57,244	\$ 57,319
		=====	=====

The accompanying notes are an integral part of these consolidated balance sheets.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED JUNE 30, 1997, 1996 AND 1995

	1997 ----	1996 ----	1995 ----
	(in thousands, except share and per share data)		
NET SALES	\$ 53,302	\$ 49,088	\$ 48,078
COST OF SALES	40,524 -----	37,786 -----	36,753 -----
Gross profit	12,778	11,302	11,325
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	9,133 -----	8,374 -----	8,994 -----
Operating income	3,645 -----	2,928 -----	2,331 -----
OTHER INCOME (EXPENSE):			
Interest expense, net	(1,081)	(1,278)	(1,398)
Other, net	(320) -----	(121) -----	111 -----
	(1,401) -----	(1,399) -----	(1,287) -----
Income before provision for income taxes	2,244	1,529	1,044
PROVISION FOR INCOME TAXES	605 -----	515 -----	532 -----
Net income	\$ 1,639 =====	\$ 1,014 =====	\$ 512 =====
EARNINGS PER SHARE	\$.37 =====	\$.23 =====	\$.12 =====
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,383,000 =====	4,373,000 =====	4,390,000 =====

The accompanying notes are an integral part of these consolidated statements.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED JUNE 30, 1997, 1996 AND 1995
(in thousands except share data)

	Common Stock					
	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total
BALANCE AT JUNE 30, 1994	5,896,602	\$ 59	\$ 719	\$ 27,271	\$ (1)	\$ 28,048
Net income	-	-	-	512	-	512
BALANCE AT JUNE 30, 1995	5,896,602	59	719	27,783	(1)	28,560
Net income	-	-	-	1,014	-	1,014
BALANCE AT JUNE 30, 1996	5,896,602	59	719	28,797	(1)	29,574
Net income	-	-	-	1,639	-	1,639
Exercise of employee stock options	2,000	-	5	-	-	5
BALANCE AT JUNE 30, 1997	5,898,602	\$ 59	\$ 724	\$ 30,436	\$ (1)	\$ 31,218

The accompanying notes are an integral part of these consolidated statements.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1997, 1996 AND 1995

	1997 ----	1996 ---- (in thousands)	1995 ----
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 1,639	\$ 1,014	\$ 512
Adjustments to reconcile net income to net cash provided by operating activities-			
Depreciation and amortization	1,440	1,425	1,357
Provision for doubtful accounts	55	202	212
Deferred income taxes	(11)	351	(320)
Changes in operating assets and liabilities resulting from increases and decreases in:			
Accounts receivable	(233)	(314)	828
Inventories	242	(1,766)	(565)
Prepaid expenses and other current assets	99	(44)	25
Other assets	(105)	(112)	(97)
Accounts payable, accrued expenses, accrued salaries and wages and accrued income taxes	(368)	2,779	(1,259)
Net cash provided by operating activities	----- 2,758	----- 3,535	----- 693
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net purchases of property, plant and equipment	(746)	(1,170)	(3,332)
Net cash used in investing activities	----- (746)	----- (1,170)	----- (3,332)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from notes payable to bank	-	-	500
Principal payments on notes payable to bank	-	(500)	(8,100)
Principal payments on capital lease obligation	-	(7)	(21)
Principal payments on long-term debt	(13,400)	(1,800)	(1,925)
Proceeds from long-term debt	11,963	-	11,218
Proceeds from exercise of employee stock options	5	-	-
Net cash (used in) provided by financing activities	----- (1,432)	----- (2,307)	----- 1,672
NET INCREASE (DECREASE) IN CASH	580	58	(967)
CASH, beginning of year	426	368	1,335
CASH, end of year	\$ 1,006 =====	\$ 426 =====	\$ 368 =====
SUPPLEMENTAL CASH FLOW INFORMATION:			
Interest paid	\$ 1,076 =====	\$ 1,155 =====	\$ 1,388 =====
Income taxes paid	\$ 35 =====	\$ 144 =====	\$ 61 =====

The accompanying notes are an integral part of these consolidated statements.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1997, 1996 AND 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Napco Security Systems, Inc. and subsidiaries (the "Company") is engaged principally in the development, manufacture and distribution of security alarm products and door security devices for commercial and residential use.

Principles of Consolidation

The consolidated financial statements include the accounts of Napco Security Systems, Inc. and all of its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Accounting Estimates

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

Inventories

Inventories are valued at the lower of cost (using the first-in, first-out method) or market.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost. Depreciation is recorded over the estimated service lives of the related assets using primarily the straight-line method. Amortization of leasehold improvements is calculated by using the straight-line method over the estimated useful life of the asset or lease term, whichever is shorter.

Goodwill

Goodwill is being amortized on a straight-line basis over 35 years. Subsequent to its acquisition, the Company continually evaluates whether later events and circumstances have occurred that indicate the remaining estimated useful life of the goodwill may warrant revision or that the remaining balance may not be recoverable. When factors indicate that goodwill should be evaluated for possible impairment, the Company uses an estimate of the undiscounted cash flows over the remaining life of the goodwill in measuring whether it is recoverable. In the years ended June 30, 1997 and 1996, there were no adjustments to the carrying value of goodwill.

Revenue

Revenue is recognized upon shipment of the Company's products to its customers.

Income Taxes

Deferred income taxes are recognized for the expected future tax consequences of temporary differences between the amounts reflected for financial reporting and tax purposes. The provision for income taxes represents U.S. Federal and state taxes on income generated from U.S. operations. Income generated by the Company's foreign subsidiary is non-taxable. The Company accounts for the research and development credit as a reduction of income tax expense in the year in which such credits are allowable for tax purposes.

In prior years, the Company did not provide for income taxes on the undistributed earnings of its Domestic International Sales Corporation ("DISC") subsidiary because it was the Company's intent to continue the subsidiary's qualification for tax deferral. Due to the shifting of manufacturing outside the U.S., management determined in fiscal 1995 that the DISC no longer qualified for continued tax deferral. As a result, previously deferred earnings of the DISC totalling \$2,031,000 must now be reported as taxable income over a ten-year period in the Company's future tax returns. The respective tax liability was recorded in fiscal 1995.

The Company does not provide for income taxes on the undistributed earnings of its foreign subsidiary because such earnings are reinvested abroad and it is the intention of management that such earnings will continue to be reinvested abroad. As of June 30, 1997 and 1996, approximately \$18,328,000 and \$17,206,000 in cumulative earnings of the foreign subsidiary are included in consolidated retained earnings.

Earnings Per Share

Earnings per share is computed based upon the weighted average number of common shares and common stock equivalents (options) outstanding. Fully diluted earnings per share does not materially differ from the earnings per share presented in the consolidated statements of income.

Stock-Based Compensation

During October 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation". This statement establishes financial accounting and reporting standards for stock-based employee compensation plans. SFAS No. 123 encourages entities to adopt a fair value based method of accounting for stock compensation costs under pre-existing accounting pronouncements. If the fair value based method of accounting is not adopted, SFAS No. 123 requires pro forma disclosures of net income and earnings per share in the notes to the consolidated financial statements. The accounting requirements of SFAS No. 123 are effective for transactions entered into in fiscal years that begin after December 15, 1995, though they may be adopted on issuance. The disclosure requirements of SFAS No. 123 are effective for financial statements for fiscal years beginning after December 15, 1995, or for an earlier fiscal year for which SFAS No. 123 is initially adopted for recognizing compensation cost. The Company has adopted this standard in fiscal 1997, and has elected to continue the accounting set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and to provide the necessary pro-forma disclosures (Note 6).

Reclassifications

Certain prior year balances have been reclassified to conform with the current year presentation.

New Accounting Pronouncements

In March, 1997, the FASB issued SFAS No. 128, "Earnings Per Share". This statement establishes standards for computing and presenting earnings per share ("EPS"), replacing the presentation of currently required primary EPS with a presentation of Basic EPS. For entities with complex capital structures, the statement requires the dual presentation of both Basic EPS and Diluted EPS on the face of the statement of income. Under this new standard, Basic EPS is computed based on weighted average shares outstanding and excludes any potential dilution; Diluted EPS reflects potential dilution from the exercise or conversion of securities into common stock or from other contracts to issue common stock and is similar to the currently-required fully diluted EPS. SFAS No. 128 is effective for financial statements issued for periods ending after December 15, 1997, including interim periods, and earlier application is not permitted. When adopted, the Company will be required to restate its EPS data for all prior periods presented. The Company does not expect the impact of the adoption of this statement to be material to previously reported EPS amounts.

2. INVENTORIES:

Inventories, net, consist of the following:

	June 30,	
	1997	1996
	(in thousands)	
Component parts	\$12,197	\$17,908
Work-in-process	3,374	4,449
Finished products	10,131	3,587
	\$25,702	\$25,944
	=====	=====

3. PROPERTY, PLANT AND EQUIPMENT:

Property, plant and equipment consists of the following:

	June 30,		Depreciation/ amortization- annual rates
	1997	1996	
	(in thousands)		
Land	\$ 904	\$ 904	-
Building	8,911	8,807	3%
Molds and dies	2,554	2,339	20%
Furniture and fixtures	977	942	10% to 20%
Machinery and equipment	8,660	8,268	10% to 33%
Leasehold improvements	426	426	Shorter of the lease term or life of asset
	22,432	21,686	
Less: Accumulated depreciation and amortization	10,344	9,137	
	\$12,088	\$12,549	
	-----	-----	

Depreciation and amortization expense on property, plant and equipment was approximately \$1,332,000, \$1,222,000 and \$1,189,000 for the years ended June 30, 1997, 1996 and 1995, respectively.

4. INCOME TAXES:

In August 1995, the Internal Revenue Service (the "IRS") informed the Company that it had completed the audit of the Company's Federal tax returns for fiscal years 1987 through 1992. The IRS has issued a report to the Company proposing adjustments that would result in taxes due of approximately \$4.3 million, excluding interest charges. The primary adjustments presented by the IRS relate to intercompany pricing and royalty charges, DISC earnings and charitable contributions. The Company disagrees with the IRS and intends to vigorously appeal this assessment using all remedies and procedural actions available under the law. The Company believes that it has provided an adequate reserve to address the ultimate resolution of this matter, so that the resolution of this matter will not have a material adverse effect on the Company's consolidated financial statements.

The deferred tax assets and deferred tax liabilities at June 30, 1997 and 1996 are as follows (in thousands):

	Deferred Tax Assets		Deferred Tax Liabilities		Net Deferred Tax Assets (Liabilities)	
	1997	1996	1997	1996	1997	1996
Current:						
Accounts receivable	\$ 322	\$ 346	\$ -	\$ -	\$ 322	\$ 346
Inventories	548	495	-	-	548	495
Accrued liabilities	180	97	-	-	180	97
Other	29	54	93	81	(64)	(27)
	1,079	992	93	81	986	911
Noncurrent:						
Fixed assets	-	-	828	742	(828)	(742)
Total deferred taxes	\$ 1,079	\$ 992	\$ 921	\$ 823	\$ 158	\$ 169

As a result of the U.S. operations generating income in each of the three years in the period ended June 30, 1997, management believes it is more likely than not that the Company will realize the benefit of the net deferred tax assets existing at June 30, 1997 and 1996. Accordingly, the Company has not reflected any valuation allowance against the deferred tax assets at June 30, 1997 and 1996. Furthermore, management believes that the existing net deductible temporary differences will reverse during periods in which the Company generates net taxable income. There can be no assurance, however, that the Company will generate taxable earnings or any specific level of continuing earnings in the future.

Provision for income taxes consists of the following:

	For the Years Ended June 30,		
	1997	1996	1995
	(in thousands)		
Taxes currently payable:			
Federal	\$340	\$104	\$ 35
State	120	19	48
	460	123	83
Taxes on DISC earnings and other	156	41	769
Deferred income tax (benefit) provision	(11)	351	(320)
Provision for income taxes	\$605	\$515	\$ 532

The difference between the statutory U.S. Federal income tax rate and the Company's effective tax rate as reflected in the consolidated statements of income is as follows:

	1997		1996		1995	
	Amount	% of pre-tax Income	Amount	% of pre-tax Income	Amount	% of pre-tax Income
	(in thousands, except percentages)					
Tax at Federal statutory rate	\$763	34.0%	\$520	34.0%	\$355	34.0%
Increases (decreases) in taxes resulting from:						
State income taxes, net of Federal income tax benefit	96	4.3	44	2.9	32	3.1
Amortization of non-deductible goodwill	36	1.6	36	2.4	36	3.6
Non-taxable foreign source income	(382)	(17.0)	(260)	(17.0)	(177)	(17.0)
Taxes on previously deferred DISC earnings, net	-	-	-	-	563	53.9
Utilization of net operating loss carryforward	-	-	-	-	(348)	(33.3)
Other, net	92	4.1	175	11.4	71	6.7
Provision for income taxes	\$605	27.0%	\$515	33.7%	\$532	51.0%
	====	====	====	====	====	====

Foreign income taxes are not provided on income generated by the Company's subsidiary in the Dominican Republic, as such income is presently exempt from domestic income tax.

5. LONG-TERM DEBT:

Long-term debt consists of the following:

	June 30,	
	1997	1996
	(in thousands)	
Revolving credit and term loan facility (a) (b)	\$11,963	\$11,000
Notes payable to banks (c)	2,250	3,375
Industrial Revenue Bonds (d)	-	1,275
	14,213	15,650
Less: Current portion	900	1,500
	\$13,313	\$14,150
	=====	=====

- (a) On May 13, 1997, the Company refinanced the majority of its bank debt with a new primary bank and entered into a \$16,000,000 secured revolving credit agreement, a \$3,000,000 line of credit to be used in connection with commercial and standby letters of credit, and replaced the \$2,500,000 standby letter of credit securing an earlier loan from another bank in connection with the Company's international operations. The revolving credit agreement and the letters of credit are secured by all the accounts receivable, inventory and certain other assets of Napco Security Systems, Inc., a first and second mortgage on the Company's headquarters in Amityville, New York as well as common stock of two of the Company's subsidiaries. The revolving credit agreement bears interest at either the bank's prime rate (8.5% at June 30, 1997) or an alternate rate based on LIBOR as described in the agreement. These agreements replaced the \$11,000,000 credit agreement described below. The Company restructured its debt to allow for future growth and expansion as well as to obtain terms more favorable to the Company. As part of the debt restructuring, the Company retired the outstanding Industrial Revenue Bonds relating to the financing of the

construction of the Company's Amityville, New York facility described below. The revolving credit agreement will expire in May, 2000 and any outstanding borrowings are to be repaid on or before that time. The agreement contains various restrictions and covenants including, among others, restrictions on payment of dividends, restrictions on borrowings, restrictions on capital expenditures, the maintenance of minimum amounts of tangible net worth, and compliance with other certain financial ratios, as defined in the agreement. As of June 30, 1997, the Company was in compliance with all of these financial covenants.

- (b) On July 27, 1994, the Company entered into an \$11,000,000 secured revolving credit and term loan facility with two banks, with the Company's primary bank acting as an agent. In conjunction with this agreement, the banks received as collateral all accounts receivable and inventory located in the United States. These facilities were paid in full by the Company in fiscal 1997, in conjunction with the refinancing described above.
- (c) In November 1991, a subsidiary of the Company entered into a \$4,500,000 line of credit agreement with a bank in connection with the Company's international operations. The line is secured by a letter of credit from the Company's primary bank. Interest on amounts outstanding under this line is payable quarterly at a rate determined periodically based on a number of options available to the Company. The balance outstanding under the line as of December 31, 1994 automatically converted to a term loan payable in 20 equal quarterly installments commencing on that date. At June 30, 1997 and 1996, the amounts outstanding bore interest at rates of 5.94% and 5.73%, respectively.

Under the terms of the agreement, all advances under the line must be used to pay for certain specified costs incurred by this subsidiary. In addition, the terms of the agreement limit, among other things, the amount of additional debt or liens that may be incurred and prohibit the payment of dividends by this subsidiary.

In May 1997, the Company entered into an agreement with its primary bank to replace a previous \$2,500,000 standby letter of credit agreement which expired in February 1997 with a new \$2,500,000 standby letter of credit, as described above, for the purpose of providing additional collateral for the line of credit agreement.

- (d) In connection with the Company's refinancing of its bank debt in May 1997, the Company repaid the remaining portion of the \$3,900,000 of Industrial Revenue Bonds issued by the Town of Babylon (the "Town"), which were used for the purchase of land and the construction of a new office and manufacturing facility in Amityville, New York. Based on the terms of the bond agreement, the Company purchased the facilities for \$1 at the date of the repayment of the bonds as title to the land and building was held by the Town as security for the bonds.

Maturities of long-term debt are as follows (in thousands):

Year ending June 30,

1998	\$ 900
1999	900
2000	12,413

	\$14,213
	=====

6. STOCK OPTIONS:

In November 1992, the stockholders approved a 10-year extension of the already existing 1982 Incentive Stock Option Plan (the "1992 Plan"). The 1992 Plan authorizes the granting of awards, the exercise of which would allow up to an aggregate of approximately 815,000 shares of the Company's common stock to be acquired by the holders of such awards. Under the 1992 Plan, the Company may grant stock options, which are intended to qualify as incentive stock options ("ISOs"), to key employees, officers, and employee directors. Any plan participant who is granted ISOs and possesses more than 10% of the voting rights of the Company's outstanding common stock must be granted an option with a price at least 110% of the fair market value on the date of grant and the option must be exercised within five years from the date of grant. Under the 1992 Plan, stock options have been granted to employees and directors for terms of up to 5 years at an exercise price equal to the fair market on the date of grant and are exercisable in whole or in part at 20% per year from the date of grant. At June 30, 1997, 46,750 stock options granted to employees and directors were exercisable. The Company accounts for awards granted to employees, directors and key employees under APB Opinion No. 25, under which compensation cost is recognized for stock options granted at an exercise price less than the market value of the options on the grant date. Had compensation cost for all stock option grants in fiscal years 1997 and 1996 been determined consistent with SFAS No. 123, the Company's net income and earnings per share would have been:

		1997	1996
		----	----
Net income:	As Reported	\$1,639	\$1,014
	Pro Forma	1,629	1,005
Earnings per Share:	As Reported	.37	.23
	Pro Forma	.37	.23

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 does not apply to option awards granted prior to fiscal year 1996, and additional awards in future years are anticipated.

The following table reflects activity under the plan year ended:

	June 30, 1997		June 30, 1996	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
	-----	-----	-----	-----
Outstanding at beginning of year	76,000	\$3.02	81,000	\$3.07
Granted	3,250	3.59	35,000	2.52
Exercised	(2,000)	2.25	-	-
Forfeited	-	-	(2,400)	3.25
Canceled/Lapsed	(1,500)	2.25	(37,600)	2.63
	-----	-----	-----	-----
Outstanding at end of year	75,750	3.083	76,000	3.02
	=====		=====	
Exercisable at end of year	46,750	3.208	35,100	3.17
	=====		=====	
Weighted average fair value of options granted	\$1.76		\$1.24	

The fair value of each stock option grant is estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	1997 ----	1996 ----
Risk-Free Interest Rates	5.99%	6.05%
Expected Lives	5 years	5 years
Expected Volatility	47%	47%
Expected Dividend Yields	0%	0%

The following table summarizes information about stock options outstanding at June 30, 1997:

Range of Exercise Prices -----	Options Outstanding -----			Options Exercisable -----	
	Number Outstanding at 6/30/97 -----	Weighted Average Remaining Contractual Life -----	Weighted Average Exercise Price -----	Number Exercisable at 6/30/97 -----	Weighted Average Exercise Price -----
\$2.50 - \$3.75	54,750	2.60	\$2.59	29,950	\$2.55
3.76 - 5.64	21,000	1.57	4.38	16,800	4.38
	-----			-----	
2.50 - 5.64	75,750	2.31	3.08	46,750	3.21
	=====			=====	

Effective October 1990, the Company established a non-employee stock option plan (the "1990 Plan") to encourage non-employee directors and consultants of the Company to invest in the Company's stock. The 1990 Plan provides for the granting of non-qualified stock options, the exercise of which would allow up to an aggregate of 50,000 shares of the Company's common stock to be acquired by the holders of the stock options. The 1990 Plan provides that the option price shall not be less than 100% of the fair market value of the stock at the date of grant. Options are exercisable at 20% per year and expire five years after the date of grant. The Company has adopted SFAS No. 123 to account for stock-based compensation awards granted to non-employee directors and consultants, under which a compensation cost is recognized for the fair value of the options granted as of the date of grant. As of June 30, 1997, no shares have been granted under this plan.

7. RESEARCH AND DEVELOPMENT COSTS:

Research and development costs charged to cost of sales were approximately \$3,340,000, \$3,296,000, \$3,252,000 for the years ended June 30, 1997, 1996 and 1995, respectively.

8. 401(k) PLAN:

The Company maintains a 401(k) plan covering all employees with one or more years of service. The plan is qualified under Sections 401(a) and 401(k) of the Internal Revenue Code. The Company provides for matching contributions of 50% of the first 2% of employee contributions. Company contributions to the plan totaled approximately \$47,000, \$48,000 and \$56,000 for the years ended June 30, 1997, 1996 and 1995, respectively.

9. BUSINESS AND CREDIT CONCENTRATIONS:

The Company is engaged in one major line of business - the development, manufacture and distribution of security alarm products and door security devices for commercial and residential use. Sales to unaffiliated customers are primarily shipped from the United States. The Company's customers are primarily located throughout the United States and Europe. Identifiable assets (net of intercompany receivables and payables) relating to the Company's foreign operations were approximately \$16,002,000 and \$24,235,000 at June 30, 1997 and 1996, respectively.

Export sales amounted to \$10,355,000, \$7,994,000 and \$7,646,000 for the years ended June 30, 1997, 1996 and 1995, respectively. At June 30, 1997 and 1996, the Company had three customers with accounts receivable balances that aggregated 40% and 58% of the Company's accounts receivable, respectively. Revenues from the three largest customers are summarized as follows:

	Percentage of Net Sales		

	For the Years Ended June 30,		
	1997	1996	1995
	----	----	----
Customer 1	21%	21%	22%
Customer 2	8%	9%	6%
Customer 3	9%	12%	11%

The Company anticipates a significant decrease in sales to Customer 3 during fiscal 1998. However, the Company does not believe that such decrease will have a material adverse effect on the results of operations or financial condition.

10. COMMITMENTS AND CONTINGENCIES:

Leases

The Company is committed under various operating leases which do not extend beyond fiscal 2001. Minimum lease payments through the expiration dates of these leases, with the exception of the land lease referred to below, are as follows (in thousands):

Year ending June 30,	

1998	\$423
1999	338
2000	63
2001	28

	\$852
	=====

Rent expense totaled approximately \$736,000, \$389,000 and \$369,000 for the years ended June 30, 1997, 1996 and 1995, respectively.

Land Lease

On April 26, 1993, the Company's foreign subsidiary entered into a 99 year lease for approximately four acres of land in the Dominican Republic, at an annual cost of approximately \$272,000, on which the Company's main production facility is located.

Letters of Credit

At June 30, 1997, the Company was committed for approximately \$2,961,000 under open commercial letters of credit and steamship guarantees.

Litigation

In the normal course of business, the Company is a party to claims and/or litigation. Management believes that the settlement of such claims and/or litigation, considered in the aggregate, will not have a material adverse effect on the Company's financial position and results of operations.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES
SCHEDULE I - CONDENSED FINANCIAL INFORMATION ON PARENT COMPANY
CONDENSED BALANCE SHEETS

	As of June 30	
	1997	1996
	(in thousands)	
ASSETS		
CASH	\$ 872	\$ 427
ACCOUNTS RECEIVABLE, net	11,735	12,053
INVENTORIES, net	16,890	8,755
PREPAID EXPENSES AND OTHER CURRENT ASSETS	279	324
DUE FROM SUBSIDIARIES	-	1,551
DEFERRED INCOME TAXES	986	911
Total current assets	30,762	24,021
INVESTMENT IN SUBSIDIARIES, on equity basis	24,345	23,223
PROPERTY, PLANT AND EQUIPMENT, net	5,808	5,956
OTHER ASSETS	240	317
	\$ 61,155	\$ 53,517
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES	\$ 10,516	\$ 11,301
DUE TO SUBSIDIARIES	6,630	-
LONG-TERM DEBT	11,963	11,900
DEFERRED INCOME TAXES	828	742
Total liabilities	29,937	23,943
STOCKHOLDERS' EQUITY	31,218	29,574
	\$ 61,155	\$ 53,517
	=====	=====

This schedule should be read in conjunction with the accompanying consolidated financial statements and notes thereto.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

SCHEDULE I - CONDENSED FINANCIAL INFORMATION ON PARENT COMPANY

CONDENSED STATEMENTS OF INCOME

	For the Years Ended June 30,		
	1997	1996	1995
	----	----	----
	(in thousands)		
NET SALES	\$ 43,921	\$ 40,482	\$ 38,547
COST OF SALES	33,733	30,319	27,938
	-----	-----	-----
Gross profit	10,188	10,163	10,609
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	7,826	7,277	7,808
	-----	-----	-----
Operating income	2,362	2,886	2,801
EQUITY IN EARNINGS (LOSS) OF SUBSIDIARIES	1,122	(184)	(561)
OTHER EXPENSE, net	(1,240)	(1,173)	(1,196)
	-----	-----	-----
Income before provision for income taxes	2,244	1,529	1,044
PROVISION FOR INCOME TAXES	605	515	532
	-----	-----	-----
Net income	\$ 1,639	\$ 1,014	\$ 512
	=====	=====	=====

This schedule should be read in conjunction with the accompanying consolidated financial statements and notes thereto.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES
 SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS
 (in thousands)

Column A	Column B	Column C	Column D	Column E
Description -----	Balance at Beginning of Period -----	Charged to Costs and Expenses -----	Deductions Describe (1) -----	Balance at End of Period -----
For the year ended June 30, 1995:				
Allowance for doubtful accounts (deducted from accounts receivable)	\$454 =====	\$212 =====	\$ 4 =====	\$662 =====
For the year ended June 30, 1996:				
Allowance for doubtful accounts (deducted from accounts receivable)	\$662 =====	\$202 =====	\$ - =====	\$864 =====
For the year ended June 30, 1997:				
Allowance for doubtful accounts (deducted from accounts receivable)	\$864 =====	\$ 55 =====	\$114 =====	\$805 =====

(1) Deductions relate to uncollectible accounts charged off to valuation accounts, net of recoveries.

This schedule should be read in conjunction with the accompanying consolidated financial statements and notes thereto.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON
ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS.

ITEM 11. EXECUTIVE COMPENSATION.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND
MANAGEMENT.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required by Part III (Items 10, 11, 12 and 13) is incorporated herein by reference from the Company's definitive proxy statement for the 1997 annual meeting of stockholders which the Company intends to file with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the Company's 1997 fiscal year, and, accordingly, items 10, 11, 12 and 13 are omitted pursuant to General Instruction G(3).

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a)1. Financial Statements

The following consolidated financial statements of Napco Security Systems, Inc. and its subsidiaries are included in Part II, Item 8:

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Report of Independent Public Accountants as of June 30, 1997 and 1996 and for the three years in the Period Ended June 30, 1997	15
Consolidated Balance Sheets as of June 30, 1997 and 1996	16
Consolidated Statements of Income for the Years Ended June 30, 1997, 1996 and 1995	17
Consolidated Statements of Stockholders' Equity for the Years Ended June 30, 1997, 1996 and 1995	18
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(a)2. Financial Statement Schedules

The following consolidated financial statement schedules of Napco Security Systems, Inc. and its subsidiaries are included in Part II, Item 8:

I: Condensed Financial Information on Parent Company	30
II: Valuation and Qualifying Accounts	32

Schedules other than those listed above are omitted because of the absence of the conditions under which they are required or because the required information is shown in the consolidated financial statements and/or notes thereto.

Exhibit No. - - - - -	Title -----	
Ex-3.(i)	Articles of Incorporation, as amended. .	Exhibit 3a to Report on Form 10-K for fiscal year ended June 30, 1988
Ex-3.(ii)	By-Laws	Exhibit 3b to Report on Form 10-K for fiscal year ended June 30, 1988
Ex-10.A	1992 Amended and Restated Incentive Stock Option Plan (extending 1982 Plan).	Exhibit 4(a) of Form S-8 of the Registrant filed October 24, 1996
Ex-10.B	1990 Non-Employee Stock Option Plan. . .	Exhibit 10c to Report on Form 10-K for fiscal year ended June 30, 1991
Ex-10.C	Defined Contribution Pension Plan Basic Plan Document.	Exhibit 10d to Report on Form 10-K for fiscal year ended June 30, 1989
Ex-10.D	Defined Contribution Pension Plan 401(k) Profit Sharing Plan Adoption Agreement	Exhibit 10e to Report on Form 10-K for fiscal year ended June 30, 1989

Ex-10.E	Promissory Note dated as of November 8, 1991 between Citibank, N.A. and the Company	Exhibit 10-i to Report on Form 10-K for fiscal year ended June 30, 1992
Ex-10.F	Credit Agreement dated November 8, 1991 between N.S.S. Caribe S.A. and Citibank, N.A.	Exhibit 10-j to Report on Form 10-K for fiscal year ended June 30, 1992
Ex-10.G	Construction Contract dated June 5, 1993	Exhibit 10-l to Report on Form 10-K for fiscal year ended June 30, 1993
Ex-10.H	First Amendment dated as of November 5, 1993 to Credit Agreement dated as of November 8, 1991 with Citibank, N.A.	Exhibit 10-o to Report on Form 10-K for fiscal year ended June 30, 1993
Ex-10.I	Loan and Security Agreement with Marine Midland Bank dated as of May 12, 1997	E-1
Ex-10.J	Revolving Credit Note #1 to Marine Midland Bank dated as of May 12, 1997. .	E-49
Ex-10.K	Revolving Credit Note #2 to Marine Midland Bank dated as of May 12, 1997. .	E-56
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Ex-12	Computation of ratios	E-68
Ex-21	Subsidiaries of the Registrant	E-69
Ex-23	Consent of Independent Public Accountants	E-70
Ex-27	Financial Data Schedule	E-71

Exhibits have been included in copies of this Report filed with the Securities and Exchange Commission. Stockholders of the registrant will be provided with copies of these exhibits upon written request to the Company.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the three months ended June 30, 1997.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 10, 1997

NAPCO SECURITY SYSTEMS, INC.
(Registrant)

By: /s/ RICHARD SOLOWAY

Richard Soloway
Chairman of the Board of
Directors and Secretary
(Co-Principal Executive Officer)

By: /s/ KENNETH ROSENBERG

Kenneth Rosenberg
President and Treasurer
(Co-Principal Executive
Officer)

By: /s/ KEVIN S. BUCHEL

Kevin S. Buchel
Senior Vice President of
Operations and Finance
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and the dates indicated.

Signature -----	Title -----	Date ----
/s/RICHARD SOLOWAY ----- Richard Soloway	Chairman of the Board of Directors	October 10, 1997
/s/KENNETH ROSENBERG ----- Kenneth Rosenberg	Director	October 10, 1997
/s/RANDY B. BLAUSTEIN ----- Randy B. Blaustein	Director	October 10, 1997
/s/ANDREW J. WILDER ----- Andrew J. Wilder	Director	October 10, 1997

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LOAN AND SECURITY AGREEMENT

between

NAPCO SECURITY SYSTEMS, INC.
("Debtor")

With a place of business at:

333 Bayview Avenue
Amityville, NY 11701
(Suffolk County)

and

MARINE MIDLAND BANK
("Secured Party")

With a place of business at:

534 Broad Hollow Road
New York, NY 11747

Dated as of May 12, 1997

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DEBTOR AND SECURED PARTY AGREE AS FOLLOWS:

1. DEFINITIONS:

1.1. CERTAIN SPECIFIC TERMS. For purposes of this Agreement, the following terms shall have the following meanings:

(a) ACCOUNT DEBTOR means the person, firm, or entity obligated to pay a Receivable.

(b) ADJUSTED LIBOR RATE means a rate per annum (rounded upwards, if necessary, to the next 1/16 of 1%) equal to the product arrived at by multiplying the Base Libor Rate (as hereinafter defined) with respect to the applicable Interest Period (as hereinafter defined) by a fraction (expressed as a decimal); the numerator of which shall be the number one and the denominator of which shall be the number one minus the aggregate reserve percentages (expressed as a decimal) from time to time established by the Board of Governors of the Federal Reserve System of the United States and other banking authority to which the Secured Party is now or hereafter subject, including, but not limited to, any Reserve Eurocurrency Liabilities as defined in Regulation D of the Board of Governors of the Federal Reserve System of the United States at the ratios provided in such Regulation, from time to time, it being agreed that any portion of the Indebtedness (as hereinafter defined) bearing interest at a Libor Rate shall be deemed to constitute Eurocurrency Liabilities, as defined by such Regulation, and it being further agreed that such Eurocurrency Liabilities shall be deemed to be subject to such reserve requirements without benefit of or credit for prorations, exceptions or offsets that may be available to the Secured Party from time to time under such Regulation and irrespective of whether the Secured Party actually maintains all or any portion of such reserve.

(c) ADVANCE means a loan made to Debtor by Secured Party, pursuant to this Agreement.

(d) AGREEMENT or LOAN AGREEMENT means this Loan and Security Agreement including all exhibits hereto, as the same may be amended or otherwise modified from time to time; the terms "herein", "hereunder" and like terms shall be taken as referring to this Agreement in its entirety and shall not be limited to any particular section or provision thereof.

(e) BASE LIBOR RATE applicable to a particular Interest Period means a rate per annum (rounded upwards, if necessary, to the next 1/16th of 1%) equal to the rate at which dollars approximately equal in principal amount to the applicable portion of the Indebtedness and for a maturity equal to the applicable

Interest Period are offered in immediately available funds to the Secured Party by leading banks in the London Interbank Market for Eurodollars at approximately 11:00 a.m., London time, two (2) Business Days prior to the commencement of such Interest Period.

(f) BORROWING means the incurrence of an Advance on a given date.

(g) BORROWING CAPACITY means, at the time of computation, \$16,000,000.

(h) BUSINESS DAY means a day other than a Saturday, Sunday, or other day on which banks are authorized or required to close under the laws of New York or the State.

(i) COLLATERAL means collectively all of the property of Debtor subject to the Security Interest and described in Sections 3.1 and 3.2.

(j) COMMITMENT or COMMITMENTS means Secured Party's obligations, pursuant to the terms of this Agreement, to make Advances under the Revolving Credit Facility.

(k) CONSOLIDATED SUBSIDIARY means Alarm Lock Systems, Inc. ("Alarm"), NAPCO Security Systems International, Inc. ("NAPCO International"), UMI Manufacturing Corp. ("UMI"), E.E. Electronic Components Inc. ("E.E."), Derringer Security Systems, Inc. ("Derringer"), Raltech Logic, Inc. ("Raltech") and any other corporation of which at least 50% of the voting stock is owned by Debtor directly, or indirectly, through one or more Consolidated Subsidiaries.

(l) CURRENT ASSETS shall be determined in accordance with GAAP.

(m) CURRENT LIABILITIES shall be determined in accordance with GAAP.

(n) DEBTOR means the person or entity defined on the cover page to this Agreement.

(o) DEBT SERVICE COVERAGE RATIO means net income plus non cash expense plus interest expense divided by interest expense plus current portion of long term debt.

(p) DISPOSAL means the intentional or unintentional abandonment, discharge, deposit, injection, dumping, spilling, leaking, burning, thermal destruction, or placing of any Hazardous Substance so that it or any of its constituents may enter the environment.

(q) ENVIRONMENT means any water including, but not limited to, surface water and ground water or water vapor; any land including land surface or subsurface; stream sediments; air, fish, wildlife, plants; and all other natural resources or environmental media.

(r) ENVIRONMENTAL LAWS means all federal, state, and local environmental, land use, zoning, health, chemical use, safety and sanitation laws, statutes, ordinances, regulations, codes, and rules relating to the protection of the Environment and/or governing the use, storage, treatment, generation, transportation, processing, handling, production, or disposal of Hazardous Substances and the policies, guidelines, procedures, interpretations, decisions, orders, and directives of federal, state, and local governmental agencies and authorities with respect thereto.

(s) ENVIRONMENTAL PERMITS means all licenses, permits, approvals, authorizations, consents or registrations required by any applicable Environmental Laws and all applicable judicial and administrative orders in connection with ownership, lease, purchase, transfer, closure, use, and/or operation of any property owned, leased or operated by Debtor or any Consolidated Subsidiary and/or as may be required for the storage, treatment, generation, transportation, processing, handling, production, or disposal of Hazardous Substances.

(t) ENVIRONMENTAL QUESTIONNAIRE means a questionnaire and all attachments thereto concerning (i) activities and conditions affecting the Environment at any property of Debtor or any Consolidated Subsidiary or (ii) the enforcement or possible enforcement of any Environmental Law against Debtor or any Consolidated Subsidiary.

(u) ENVIRONMENTAL REPORT means a written report prepared for Secured Party by an environmental consulting or environmental engineering firm.

(v) ERISA means the Employee Retirement Income Security Act of 1974, as amended from time to time.

(w) EVENT OF DEFAULT or EVENTS OF DEFAULT means an Event of Default or Events of Default as defined in Section 11.1.

(x) FEDERAL BANKRUPTCY CODE means Title 11 of the United States Code, entitled "Bankruptcy," as amended, or any successor federal bankruptcy law.

(y) GAAP means Generally Accepted Accounting Principles set forth in the opinions and pronouncements of the Accounting Principles Board and the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or such other statements by such other entity as may be approved by a significant segment of the accounting profession, which are applicable in the circumstances as of the date in question, consistently applied within a period and from period to period, provided, however, that if employment of more than one principle shall be permissible at such time in respect to a particular accounting matter, "GAAP" shall refer to the principle which is then employed by Debtor with the concurrence of the independent certified public accountants of Debtor.

(z) HAZARDOUS SUBSTANCES means, without limitation, any explosives, radon, radioactive materials, asbestos, urea formaldehyde foam insulation, polychlorinated biphenyls, petroleum and petroleum products, methane, hazardous materials, hazardous wastes, hazardous or toxic substances, and any other material defined as a hazardous substance in Section 101(14) of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. Section 9601(14).

(aa) INDEBTEDNESS means the indebtedness secured by the Security Interest and described in Section 3.3.

(bb) INTANGIBLE ASSETS means (1) all loans or advances to, and other receivable owing from, any officers, employees, subsidiaries and other affiliates, (2) all investments in a subsidiary, (3) goodwill, (4) any other assets deemed intangible under GAAP.

(cc) INTEREST PERIOD means the period of time during which a particular Libor Rate Option (as hereinafter defined) will be applicable to a portion of the Indebtedness, it being agreed that (i) each Interest Period shall be of a duration of, at the option of the Borrower, one month, two months, three months, four months, six months, nine months or twelve months (ii) no Interest Period shall extend beyond the Term, (iii) the principal balance with respect to which a particular Interest Period is applicable will bear interest at the Libor Rate Option pertaining to such Interest Period from and including the first day of such Interest Period to, but not including, the last day of such Interest Period.

(dd) INTERNAL REVENUE CODE means the Internal Revenue Code of 1986, as amended from time to time.

(ee) INVENTORY means inventory, as defined in the Uniform Commercial Code as in effect in the State as of the date of this Agreement, and in any event shall include returned or repossessed

(ff) LIBOR RATE OPTION means a rate per annum equal to one and one half of one (1.50%) percent per annum plus the Adjusted Libor Rate with respect to the applicable Interest Period.

(gg) PENSION EVENT means, with respect to any Pension Plan, the occurrence of (i) any prohibited transaction described in Section 406 of ERISA or in Section 4975 of the Internal Revenue Code; (ii) any Reportable Event; (iii) any complete or partial withdrawal, or proposed complete or partial withdrawal, of Debtor or any Consolidated Subsidiary from such Pension Plan; (iv) any complete or partial termination, or proposed complete or partial termination, of such Pension Plan; or (v) any accumulated funding deficiency (whether or not waived), as defined in Section 302 of ERISA or in Section 412 of the Internal Revenue Code.

(hh) PENSION PLAN means any pension plan, as defined in Section 3(2) or ERISA, which is a multiemployer plan or a single employer plan, as defined in Section 4001 of ERISA, and subject to Title IV of ERISA and which is (i) a plan maintained by Debtor or any Consolidated Subsidiary for employees or former employees of Debtor or of any Consolidated Subsidiary; (ii) a plan to which Debtor or any Consolidated Subsidiary contributes or is required to contribute; (iii) a plan to which Debtor or any Consolidated Subsidiary was required to make contributions at any time during the five (5) calendar years preceding the date of this Agreement; or (iv) any other plan with respect to which Debtor or any Consolidated Subsidiary has incurred or may incur liability, including, without limitation, contingent liability, under Title IV of ERISA either to such plan or to the Pension Benefit Guaranty Corporation. For purposes of this definition, and for purposes of Sections 1.1(cc), 4.12, and 11.1(i), Debtor shall include any trade or business (whether or not incorporated) which, together with Debtor or any Consolidated Subsidiary, is deemed to be a "single employer" within the meaning of Section 4001(b)(1) of ERISA.

(ii) PRIME RATE means the rate of interest publicly announced by Marine Midland Bank from time to time as its prime rate and is a base rate for calculating interest on certain loans. The rate announced by Marine Midland Bank as its prime rate may or may not be the most favorable rate charged by Marine Midland Bank to its customers.

(jj) RECEIVABLE means the right to payment for Goods sold or leased or services rendered by Debtor, whether or not earned by performance, and may, without limitation, in whole or in part be in the form of an Account, Chattel Paper, Document, or Instrument.

(kk) RELEASE means "release", as defined in Section

101(22) of the Comprehensive, Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. Section 9601(22), and the regulations promulgated thereunder.

(ll) REPORTABLE EVENT means any event described in Section 4043(b) of ERISA or in regulations issued thereunder with regard to a Pension Plan.

(mm) REVOLVING CREDIT FACILITY means the Advances made or to be made available to Debtor by Secured Party pursuant to the terms of this Agreement, and as evidenced by the Revolving Credit Note.

(nn) REVOLVING CREDIT NOTE or NOTE means, individually, jointly, severally, and collectively, the revolving credit note #1 in the aggregate sum not to exceed \$1,000,000., as the same may be amended and/or extended from time to time ("Note #1") and the revolving credit note # 2 in the aggregate sum not to exceed \$15,000,000. ("Note #2"), as the same may be amended and/or extended from time to time ("Note #2"),.

(oo) RESPONSIBLE PARTY means an Account Debtor, a general partner of an Account Debtor, or any party otherwise in any way directly or indirectly liable for the payment of a Receivable.

(pp) SECURED PARTY means the person or entity defined on the cover page of this Agreement and any successors or assigns of Secured Party.

(qq) SECURITY INTEREST means the security interest granted to Secured Party by Debtor as described in Section 3.1.

(rr) STATE means New York State.

(ss) TANGIBLE NET WORTH means total stockholders' equity minus Intangible Assets, all to be determined in accordance with GAAP.

(tt) TERM or LOAN PERIOD means the period from the date hereof until the Termination Date.

(uu) TERMINATION DATE means the earlier to occur of (a) May __, 2000 or if such day shall not be a Business Day, the next succeeding Business Day, or (b) upon the occurrence of an Event of Default.

(vv) THIRD PARTY means any person or entity who has executed and delivered, or who in the future may execute and deliver, to Secured Party any agreement, instrument, or document, pursuant to which such person or entity has guarantied to Secured

Party the payment of the Indebtedness or has granted Secured Party a security interest in or lien on some or all of such person's or entity's real or personal property to secure the payment of the Indebtedness.

(ww) TOTAL LIABILITIES shall be determined in accordance with GAAP, but, in any event, shall exclude the principal balance of any debt that is subordinated to Secured Party in a manner satisfactory to Secured Party.

(xx) TRANSACTION DOCUMENTS means this Agreement and all documents, including, without limitation, collateral documents, letter of credit agreements, notes, acceptance credit agreements, security agreements, pledges, guaranties, mortgages, title insurance, assignments, and subordination agreements required to be executed by Debtor, any Third Party, or any Responsible Party pursuant hereto or in connection herewith, in connection with the issuance of a certain standby letter of credit in the amount not to exceed \$2,500,000. by Secured Party in favor of Citibank, N.A., at the request of and for the benefit of Debtor, the reimbursement obligations being evidenced by a promissory note in the principal sum not to exceed \$2,500,000., and a letter of credit application and reimbursement agreement, each dated of even date hereof, and a certain uncommitted trade line established by Marine in favor of Debtor to provide for commercial and standby letters of credit, evidenced by, among other documents, a continuing letter of credit agreement, and a continuing indemnity agreement, each dated of even date hereof.

(yy) VARIABLE RATE OPTION means a fluctuating annual rate equal to the Prime Rate.

1.2. SINGULARS AND PLURALS. Unless the context otherwise requires, words in the singular number include the plural, and in the plural include the singular.

1.3. U.C.C. DEFINITIONS. Unless otherwise defined in Section 1.1 or elsewhere in this Agreement, capitalized words shall have the meanings set forth in the Uniform Commercial Code as in effect in the State as of the date of this Agreement.

1.4. ACCOUNTING TERMS. All other accounting terms used herein or in the other Transaction Documents not specifically defined shall have the meanings defined under GAAP.

2. ADVANCES.

2.1. REQUESTS FOR AN ADVANCE. From time to time, Debtor may make a written or oral request for an Advance, so long as the sum

of the aggregate principal balance of outstanding advances and the requested Advance does not exceed the Borrowing Capacity as then computed; and Secured Party shall make such requested Advance, provided that (i) the Borrowing Capacity would not be so exceeded; (ii) there has not occurred an Event of Default for which a waiver signed by a duly authorized Officer of Secured Party was not obtained, or an event which, with notice or lapse of time or both, would constitute an Event of Default; and (iii) all representations and warranties contained in this Agreement and in the other Transaction Documents are true and correct on the date such requested Advance is made as though made on and as of such date. Each oral request for an Advance shall be conclusively presumed to be made by a person authorized by Debtor to do so, and the making of the Advance to Debtor as hereinafter provided shall conclusively establish Debtor's obligation to repay the Advance.

2.2. PROCEEDS OF AN ADVANCE. Proceeds of Advances shall be paid in the manner agreed by Debtor and Secured Party in writing or, absent any such agreement, as determined by Secured Party.

2.3. Intentionally Deleted.

2.4. LETTERS OF CREDIT. At the request of Debtor, and upon execution of Letter of Credit documentation satisfactory to Secured Party, Secured Party, within the limits of the Borrowing Capacity as then computed, may issue Letters of Credit from time to time for the account of Debtor in an amount not exceeding in the aggregate at any one time outstanding \$2,500,000.00. The Letters of Credit shall be on terms mutually acceptable to Secured Party and Debtor and no Letter of Credit shall have an expiration date later than the termination date of this Agreement. An Advance in an amount equal to any amount paid by Secured Party on any draft drawn under any Letter of Credit shall be deemed made to Debtor, without request therefor, immediately upon any payment by Secured Party on such draft. In connection with the issuance of Letters of Credit, Debtor shall pay to Secured Party fees as mutually agreed upon.

3. COLLATERAL AND INDEBTEDNESS SECURED.

3.1. SECURITY INTEREST. Debtor hereby grants to Secured Party a security interest in, and a lien on, the following property of Debtor wherever located and whether now owned or hereafter acquired:

(a) All Accounts, Inventory, General Intangibles, Chattel Paper, Documents, and Instruments, whether or not specifically assigned to Secured Party, including, without limitation, all Receivables.

(b) All guaranties, collateral, liens on, or security

interests in, real or personal property, leases, letters of credit and other rights, agreements, and property securing or relating to payment of Receivables.

(c) All books, records, ledger cards, data processing records, computer software, and other property at any time evidencing or relating to Collateral.

(d) All monies, securities, and other property now or hereafter held, or received by, or in transit to, Secured Party from or for Debtor, and all of Debtor's deposit accounts, credits, and balances with Secured Party existing at any time.

(e) All parts, accessories, attachments, special tools, additions, replacements, substitutions and accessions to or for all of the foregoing.

(f) All Proceeds and products of all of the foregoing in any form, including, without limitation, amounts payable under any policies of insurance insuring the foregoing against loss or damage, and all increases and profits received from all of the foregoing.

3.2. OTHER COLLATERAL. Nothing contained in this Agreement shall limit the rights of Secured Party in and to any other collateral securing the Indebtedness which may have been, or may hereafter be, granted to Secured Party by Debtor or any Third Party, pursuant to any other agreement.

3.3. INDEBTEDNESS SECURED. The Security Interest secures payment of any and all indebtedness, and performance of all obligations and agreements, of Debtor to Secured Party, whether now existing or hereafter incurred or arising, of every kind and character, primary or secondary, direct or indirect, absolute or contingent, sole, joint or several, and whether such indebtedness is from time to time reduced and thereafter increased, or entirely extinguished and thereafter reincurred, including, without limitation: (a) all Advances; (b) all interest which accrues on any such indebtedness, until payment of such indebtedness in full, including, without limitation, all interest provided for under this Agreement; (c) all other monies payable by Debtor, and all obligations and agreements of Debtor to Secured Party, pursuant to the Transaction Documents; (d) all debts owed, or to be owed, by Debtor to others which Secured Party has obtained, or may obtain, by assignment or otherwise; (e) all monies payable by any Third Party, and all obligations and agreements of any Third Party to Secured Party, pursuant to any of the Transaction Documents; and (f) all monies due, and to become due, pursuant to Section 7.3.

4. REPRESENTATIONS AND WARRANTIES. To induce Secured Party to enter into this Agreement, and make Advances to Debtor from time to time as herein provided, Debtor represents and warrants, to the best of its knowledge, and, so long as any Indebtedness remains unpaid or this Agreement remains in effect, shall be deemed continuously to represent and warrant as follows:

4.1. CORPORATE EXISTENCE. Debtor and Alarm each is duly organized and existing and in good standing under the laws of the state of Delaware and is duly licensed or qualified to do business and in good standing in every state in which the nature of its business or ownership of its property requires such licensing or qualification. Other than Alarm (Alarm being a corporation organized under the laws of the state of Delaware) and other than Raltech (Raltech having been dissolved by proclamation, with Raltech not having any present intention of being reinstated), each domestic Consolidated Subsidiary is duly organized and existing and in good standing under the laws of the State and is duly licensed or qualified to do business and in good standing in every state in which the nature of its business or ownership of its property requires such licensing or qualification.

4.2 CORPORATE CAPACITY. The execution, delivery and performance of the Transaction Documents are within Debtor's corporate powers, have been duly authorized by all necessary and appropriate corporate and shareholder action, and are not in contravention of any law or the terms of Debtor's articles or certificate of incorporation or by-laws or any amendment thereto, or of any indenture, agreement, undertaking, or other document to which Debtor is a party or by which Debtor or any of Debtor's property is bound or affected.

4.3. VALIDITY OF RECEIVABLES. (a) each copy of each invoice is a true and genuine copy of the original invoice sent to the account debtor named therein and accurately evidences the transaction from which the underlying Receivable arose, and the date payment is due as stated on each Invoice or computed based on the information set forth on each such Invoice is correct; (b) all Chattel Paper, and all promissory notes, drafts, trade acceptances, and other instruments for the payment of money relating to or evidencing each Receivable, and each endorsement thereon, are true and genuine and in all respects what they purport to be, and are the valid and binding obligation of all parties thereto, and the date or dates stated on all such items as the date on which payment in whole or in part is due is correct; (c) all Inventory described in each Invoice has been delivered to the Account Debtor named in such Invoice or placed for such delivery in the possession of a carrier not owned or controlled directly or indirectly by Debtor; (d) all evidence of the delivery or shipment of Inventory is true and genuine; (e) all services to be performed by Debtor in

connection with each Receivable have been performed by Debtor; and (f) all evidence of the performance of such services by Debtor is true and genuine.

4.4. INVENTORY. (a) All representations made by Debtor to Secured Party, and all documents and schedules given by Debtor to Secured Party, relating to the description, quantity, quality, condition, and valuation of the Inventory are true and correct; (b) Inventory is located only at the address or addresses of Debtor set forth at the beginning of this Agreement, or such other place or places as approved by Secured Party in writing; (however Debtor has signed a lease for a location at 9/21 Prestwood, Risley, Warrington, England, where it will house Inventory (c) all Inventory is insured as required by Section 9.11, pursuant to policies in full compliance with the requirements of such Section; and (d) all domesticly manufactured or produced Inventory has been

produced by Debtor in accordance with the Federal Fair Labor Standards Act of 1938, as amended, and all rules, regulations and orders promulgated thereunder.

4.5. TITLE TO COLLATERAL. (a) Debtor is the owner of the Collateral free of all security interests, liens, and other encumbrances, except the Security Interest; (b) Debtor has the unconditional authority to grant the Security Interest to Secured Party; and (c) assuming that all necessary Uniform Commercial Code filings have been made and, if applicable, assuming compliance with the Federal Assignment of Claims Act of 1940, as amended, Secured Party has an enforceable first lien on all Collateral.

4.6. Intentionally Deleted Prior to Execution.

4.7. Intentionally Deleted Prior to Execution.

4.8. PLACE OF BUSINESS. (a) Debtor is engaged in business operations which are in whole, or in part, carried on at the address or addresses specified at the beginning of this Agreement and at no other address or addresses (except that Debtor has signed a lease for space at 9/21 Prestwood, Risley, Warrington, England); (b) if Debtor has more than one place of business, its chief executive office is at the address specified as such at the beginning of this Agreement; and (c) Debtor's records concerning the Collateral are kept at the address specified at the beginning of this Agreement.

4.9. FINANCIAL CONDITION. Debtor has furnished to Secured Party Debtor's most current financial statements, including, without limiting the foregoing, the most recent interim statements of Debtor, which statements represent correctly and fairly the

results of the operations and transactions of Debtor and the Consolidated Subsidiaries as of the dates, and for the period referred to, and have been prepared in accordance with GAAP applied during each interval involved and from interval to interval. Since the date of such financial statements, there have not been any materially adverse changes in the financial condition reflected in such financial statements, except as disclosed in writing by Debtor to Secured Party.

4.10. TAXES. Except as disclosed in writing by Debtor to Secured Party including Debtor's financial statements provided to Secured Party: (a) all federal and other tax returns required to be filed by Debtor and each Consolidated Subsidiary have been filed, and all taxes required by such returns have been paid; and (b) neither Debtor nor any Consolidated Subsidiary has received any notice from the Internal Revenue Service or any other taxing authority proposing additional taxes.

4.11. LITIGATION. Except as disclosed in writing by Debtor to Secured Party, there are no actions, suits, proceedings, or investigations pending or, to the knowledge of Debtor, threatened against Debtor or any Consolidated Subsidiary or any basis therefor which, if adversely determined, would, in any case or in the aggregate, materially adversely affect the property, assets, financial condition, or business of Debtor or any Consolidated Subsidiary or materially impair the right or ability of Debtor or any Consolidated Subsidiary to carry on its operations substantially as conducted on the date of this Agreement.

4.12. ERISA MATTERS. (a) No Pension Plan has been terminated, or partially terminated, or is insolvent, or in reorganization, nor have any proceedings been instituted to terminate or reorganize any Pension Plan; (b) neither Debtor nor any Consolidated Subsidiary has withdrawn from any Pension Plan in a complete or partial withdrawal, nor has a condition occurred which, if continued, would result in a complete or partial withdrawal; (c) neither Debtor nor any Consolidated Subsidiary has incurred any withdrawal liability, including, without limitation, contingent withdrawal liability, to any Pension Plan, pursuant to Title IV of ERISA; (d) neither Debtor nor any Consolidated Subsidiary has incurred any liability to the Pension Benefit Guaranty Corporation other than for required insurance premiums which have been paid when due; (e) no Reportable Event has occurred; (f) no Pension Plan or other "employee pension benefit plan" as defined in Section 3(2) of ERISA, to which Debtor or any Consolidated Subsidiary is a party has an "accumulated funding deficiency" (whether or not waived), as defined in Section 302 of ERISA or in Section 412 of the Internal Revenue Code; (g) the present value of all benefits vested under any Pension Plan

does not exceed the value of the assets of such Pension Plan allocable to such vested benefits; (h) each Pension Plan and each other "employee benefit plan", as defined in Section 3(3) of ERISA, to which Debtor or any Consolidated Subsidiary is a party is in substantial compliance with ERISA, and no such plan or any administrator, trustee, or fiduciary thereof has engaged in a prohibited transaction described in Section 406 of ERISA or in Section 4975 of the Internal Revenue Code; (i) each Pension Plan and each other "employee benefit plan" as defined in Section 3(2) of ERISA, to which Debtor or any Consolidated Subsidiary is a party has received a favorable determination by the Internal Revenue Service with respect to qualification under Section 401(a) of the Internal Revenue Code; and (j) neither Debtor nor any Consolidated Subsidiary has incurred any liability to a trustee or trust established pursuant to Section 4049 of ERISA or to a trustee appointed pursuant to Section 4042(b) or (c) of ERISA.

4.13. ENVIRONMENTAL MATTERS.

(a) Any Environmental Questionnaire previously provided to Secured Party was and is accurate and complete and does not omit any material fact the omission of which would make the information contained therein materially misleading.

(b) No above ground or underground storage tanks containing Hazardous Substances are, or have been located on, any property owned, leased, or operated by Debtor or any domestic Consolidated Subsidiary.

(c) No property owned, leased, or operated by Debtor or any domestic Consolidated Subsidiary is, or has been, used for the Disposal of any Hazardous Substance or for the treatment, storage, or Disposal of Hazardous Substances.

(d) No Release of a Hazardous Substance has occurred, or is threatened on, at, from, or near any property owned, leased, or operated by Debtor or any domestic Consolidated Subsidiary.

(e) Neither Debtor nor any domestic Consolidated Subsidiary is subject to any existing, pending, or threatened suit, claim, notice of violation, or request for information under any Environmental Law nor has Debtor or any domestic Consolidated Subsidiary provided any notice or information under any Environmental Law.

(f) Debtor and each domestic Consolidated Subsidiary are in compliance with, and have obtained all Environmental Permits required by, all Environmental Laws.

4.14. VALIDITY OF TRANSACTION DOCUMENTS. The Transaction Documents constitute the legal, valid, and binding obligations of Debtor and each Consolidated Subsidiary and any Third Parties thereto, enforceable in accordance with their respective terms, except as enforceability may be limited by applicable bankruptcy and insolvency laws and laws affecting creditors' rights generally.

4.15. NO CONSENT OR FILING. No consent, license, approval, or authorization of, or registration, declaration, or filing with, any court, governmental body or authority, or other person or entity is required in connection with the valid execution, delivery, or performance of the Transaction Documents or for the conduct of Debtor's business as now conducted, other than filings and recordings to perfect security interests in or liens on the Collateral in connection with the Transaction Documents.

4.16. NO VIOLATIONS. Neither Debtor nor any Consolidated Subsidiary is in violation of any term of its articles, or Certificate of Incorporation, or by-laws, or of any mortgage, borrowing agreement, or other instrument or agreement pertaining to indebtedness for borrowed money. Neither Debtor nor any Consolidated Subsidiary is in violation of any term of any other indenture, instrument, or agreement to which it is a party or by which it or its property may be bound, resulting, or which might reasonably be expected to result, in a material and adverse effect upon its business or assets. Neither Debtor nor any Consolidated Subsidiary is in violation of any order, writ, judgment, injunction, or decree of any court of competent jurisdiction or of any statute, rule or regulation of any governmental authority. The execution and delivery of the Transaction Documents and the performance of all of the same, is, and will be, in compliance with the foregoing and will not result in any violation thereof, or result in the creation of any mortgage, lien, security interest, charge, or encumbrance upon, any properties or assets except in favor of Secured Party. There exists no fact or circumstance (whether or not disclosed in the Transaction Documents) which materially adversely affects, or in the future (so far as Debtor can now foresee) may materially adversely affect, the condition, business, or operations of Debtor or any Consolidated Subsidiary.

4.17. TRADEMARKS AND PATENTS. Debtor and each Consolidated Subsidiary possesses all trademarks, trademark rights, patents, patent rights, tradenames, tradename rights and copyrights that are required to conduct its business as now conducted without conflict with the rights or claimed rights of others. A list of the foregoing as set forth in Exhibit A attached hereto.

4.18. CONTINGENT LIABILITIES. There are no suretyship agreements, guaranties, or other contingent liabilities of Debtor or any Consolidated Subsidiary which are not disclosed by the financial statements described in Section 4.9.

4.19. COMPLIANCE WITH LAWS. Debtor is in compliance with all applicable laws, rules, regulations, and other legal requirements with respect to its business and the use, maintenance and operations of the real and personal property owned or leased by it in the conduct of its business.

4.20. LICENSES, PERMITS, ETC. Each franchise, grant, approval, authorization, license, permit, easement, consent, certificate, and order of and registration, declaration, and filing with, any court, governmental body or authority, or other person or entity required for or in connection with the conduct of Debtor's and each Consolidated Subsidiary's business as now conducted is in full force and effect.

4.21. LABOR CONTRACTS. Neither Debtor nor any Consolidated Subsidiary is a party to any collective bargaining agreement or to any existing or threatened labor dispute or controversies.

4.22. CONSOLIDATED SUBSIDIARIES. Debtor has no Consolidated Subsidiaries other than those listed in Exhibit B attached hereto and the percentage ownership of Debtor in each such Consolidated Subsidiary is specified in such Exhibit B.

4.23. AUTHORIZED SHARES. Debtor's total authorized common shares, the par value of such shares, and the number of such shares issued and outstanding, are set forth in Exhibit C. All of such shares are of one class and have been validly issued in full compliance with all applicable federal and state laws, and are fully paid and non-assessable. No other shares of the Debtor of any class or type are authorized or outstanding.

4.24. LABOR MATTERS.

(a) Debtor is not engaged in any unfair labor practice. Debtor is in compliance in all material respects with all applicable federal, state and local laws, regulations, rules, orders or other requirements respecting terms and conditions of employment, employment practices, and wages and hours,

(b) No strike, walkout or similar business interruption resulting from any labor dispute has been suffered by Debtor during the last five years nor is any state of facts known to Debtor which would indicate that such event or circumstance is likely to occur

in the next twelve months.

(c) There is no pending, or to the knowledge of Debtor, threatened unfair labor practice complaint against Debtor, before the National Labor Relations Board.

(d) There is no strike, labor dispute, slowdown or stoppage actually pending or, to the knowledge of Debtor, threatened against them.

(e) No union representation question exists respecting the employees, or any group of employees, of Debtor.

(f) No grievance which might have a material adverse effect on Debtor or the conduct of their business nor any arbitration proceeding arising out of or under collective bargaining agreements is pending, and no claims therefor exist.

(g) No collective bargaining agreement which is binding on Debtor restricts Debtor from relocating or closing any office, warehouse or any other facility presently being used by Debtor.

(h) Debtor has not experienced any material work stoppage or other material labor difficulty at any office, warehouse or other facility.

(i) There are no claims, complaints or charges pending before any state or federal agency concerning employment penalties, including without limitation, employment discrimination, retaliatory discharge and wage and hour claims.

4.25 MATERIALITY. Notwithstanding anything to the contrary contained in Section 4 hereof, no representation or warranty contained in Section 4 shall be deemed false or cause an Event of Default to the extent that the falsity of such representation or warranty is not material, would not have a material adverse effect on Debtor and/or any domestic Consolidated Subsidiary, would not cause an untrue statement of material fact, and/or would not result in an omission to state a material fact in order to make the statements contained herein not misleading, and/or would not materially adversely affect the financial and/or business condition of Debtor and/or any domestic Consolidated Subsidiary.

5. Intentionally Deleted Prior to Execution.

6. REVOLVING CREDIT FACILITY.

6.1. COMMITMENT TO MAKE ADVANCES.

(a) Secured Party agrees, subject to the terms and conditions contained herein, to make Advances from the date hereof until but not including the Termination Date (the "Commitment Period"), provided that (i) each request for an Advance be in writing and specify the Interest Rate Option selected, as more specifically described in Section 7.2. herein and shall be accompanied by a Compliance Certificate, in the form attached hereto as Exhibit D; (ii) all representations and warranties contained in this Agreement are true and correct in all respects on the date of the Advance; (iii) all covenants and agreements contained in this Agreement and the other Loan Documents have been complied with; and (iv) no Event of Default has occurred and be continuing under the Transaction Documents.

6.2. ADVANCES. Debtor's obligation to pay the principal, and interest on, the Obligations under the Revolving Credit Loan Credit Facility shall be evidenced by the Revolving Credit Note. Availability under the Revolving Credit Loan Credit Facility is subject to the terms and conditions contained herein, including but not limited to, those set forth herein.

6.3. INTEREST RATE. For each Advance, the Interest Rate shall be as set forth in Section 7 herein and be evidenced by the Revolving Credit Note.

6.4. DEFAULT. The Note shall provide that upon the happening of any "Event of Default" hereunder and/or under the Transaction Documents, the principal sum hereof, together with accrued interest and all other expenses, including, but not limited to reasonable attorneys' fees for legal services incurred by the holder hereof in connection with the collection of the Note and/or the enforcement of payment hereof whether or not suit is brought, and if suit is brought, then through all appellate actions, shall immediately become due and payable at the option of the holder of the Note, notwithstanding the Termination Date set forth herein. In the Event of Default, whether the Bank exercises any of its rights and remedies contained herein, including the right to declare all Obligations hereunder to be immediately due and payable, the Borrower shall pay interest on the unpaid principal balance hereunder at a rate equal to the Default Rate. The unpaid principal balance under the Note shall bear the Default Rate of Interest until the first to occur of the following: (i) all Obligations under this Note are paid in full; (ii) Debtor has cured said Event of Default to the satisfaction of the Bank; or (iii) the Bank, in writing, has waived said Event of Default. Notwithstanding anything to the contrary contained in the Revolving Credit Note, the Revolving Credit Note is subject to the express condition that at no time shall Debtor be obligated to be required to pay interest on the principal balance of the Revolving Credit Note at a rate which could subject Secured Party either to civil or

criminal penalty as a result of being in excess of the maximum rate which Debtor is permitted by law to contract or agree to pay. If by the terms of the Revolving Credit Note, Debtor at any time are required or obligated to pay interest on the principal balance of such note at a rate in excess of such maximum rate then the rate of interest under such note shall be deemed to be immediately reduced to such maximum rate and interest payable hereunder shall be computed at such maximum rate and any prior interest payments made in excess of such maximum rate shall be applied and shall be deemed to have been payments made in reduction of the principal balance of such note.

6.5. METHOD AND PLACE OF PAYMENT. All payments under the Revolving Credit Note and this Agreement shall be made by debiting the checking account of Debtor required to be maintained with Secured Party pursuant to the terms hereof.

6.6. REVOLVING CREDIT NOTE. The amount of Indebtedness under the Revolving Credit Facility may increase and decrease from time to time as Secured Party advances, Debtor repays, and Secured Party readvances, sums on account of the Revolving Credit Facility. It is hereby agreed that all Advances, first, shall be deemed evidenced by Note #1 up to the principal amount of \$1,000,000., so that the first sums advanced by Secured Party shall be evidenced by Note #1. Note #1, and the Indebtedness evidenced by Note #1, shall be reduced only by the last and final sums that Debtor repays with respect to the Revolving Credit Facility and shall not be reduced by any intervening repayments of Advances by Secured Party until all Indebtedness under Note #2 has been repaid. All Advances

(including readvances) shall first be deemed borrowed under Note #1 (to the extent of \$1,000,000.) and all repayments of Advances shall first be applied to Note #2.

7. PAYMENT OF PRINCIPAL, INTEREST, FEES AND COSTS AND EXPENSES- Revolving Credit Facility.

7.1. PROMISE TO PAY PRINCIPAL. Debtor promises to pay to Secured Party the outstanding principal of Advances in full upon termination of the Revolving Credit Facility pursuant to Section 13.13, or acceleration of the time for payment of the Indebtedness, pursuant to Section 11.2. Whenever the outstanding principal balance of Advances exceeds the Borrowing Capacity, Debtor shall immediately pay to Secured Party the excess of the outstanding principal balance of Advances over the Borrowing Capacity.

7.2. PROMISE TO PAY INTEREST.

(a) Debtor promises to pay to Secured Party interest on the outstanding principal of Advances from time to time unpaid at either (a) the Variable Rate Option, or (b) the Libor Rate Option for the Interest Period selected by Debtor. The amount of principal based upon the Libor Rate Option shall be minimum amounts of \$50,000.00 for the Interest Period selected by Debtor. From the date of the occurrence of, and during the continuance of, an Event of Default, Debtor, as additional compensation to Secured Party for its increased credit risk promises to pay interest on (i) the principal of Advances, whether or not past due; and (ii) past due interest and any other amount past due under the Transaction Documents, at a per annum rate of the Prime Rate plus three percent per annum ("Default Rate").

(b) Interest shall be paid (i) on the first day of each month in arrears, (ii) on the Termination Date, (iii) on acceleration of the time for payment of the Indebtedness, pursuant to Section 11.2, and (iv) on the date the Indebtedness is paid in full.

(c) Any change in the interest rate resulting from a change in the Prime Rate shall take effect simultaneously with such change in the Prime Rate. Whether the Variable Rate Option or Libor Rate Option is in effect, interest shall be computed on the daily unpaid principal balance of Advances. Interest shall be calculated for each calendar day at 1/360th of the applicable per annum rate which will result in an effective per annum rate higher than the rate specified herein. In no event shall the rate of interest exceed the maximum rate permitted by applicable law. If Debtor pays to Secured Party interest in excess of the amount permitted by applicable law, such excess shall be applied in reduction of the principal of Advances under the Revolving Credit Facility made pursuant to this Agreement, and any remaining excess interest, after application thereof to the principal of Advances, shall be refunded to Debtor.

(d) At Debtor's option, Debtor may elect to pay interest on one or more Advances for one or more Interest Periods or for the term of this Note, or any period of time, so long as such period is made available by Secured Party and does not extend beyond the Term, subject to the provisions contained herein, by giving notice of such election to the Secured Party by 11:00 a.m. at least three (3) Business Days before the first day of such Advance. If the Debtor does not elect an Interest Rate Option for an Advance, or prior to the expiration of an Interest Period, the Variable Rate Option shall be deemed to have been chosen by Debtor.

(e) At the option of Debtor, Debtor may elect to pay interest on the Indebtedness herein or portion(s) thereof, in minimum amounts of \$50,000.00 at the Libor Rate Option for the

Interest Period selected by the Debtor by giving notice of such election by the Secured Party by 11:00 a.m. at least three (3) Business Days before the first day of such Interest Period.

(f) All written notices of Interest Rate Selection and/or Requests for Advances shall be substantially in the form annexed hereto as Exhibit E, attached hereto and incorporated herein by this reference.

(g) At any time while the LIBOR Rate Option is in effect, Debtor agrees to pay to Secured Party and hold Secured Party harmless from any loss or expense ("breakage fees" or "breakage costs") which Secured Party may sustain or incur as a consequence of such prepayment. Such breakage fees shall equal the amount of the Indebtedness being prepaid, multiplied by a per annum interest rate equal to the difference between the then applicable Base Libor Rate and the 360-day equivalent interest yield (hereinafter the "Bank Bid Rate") reasonably selected by the Secured Party in its sole and absolute discretion, for an aggregate amount comparable to the then remaining principal balance of the Indebtedness, and with maturities comparable to the Rollover Date (as hereinafter defined) applicable to the principal balance of the Indebtedness, calculated over a period of time from and including the date of prepayment to, but not including, the Rollover Date applicable to the then remaining principal balance of the Indebtedness being prepaid. If the Base Libor Rate applicable to the principal balance of the portion of the Indebtedness being prepaid is equal to or less than the Bank Bid Rate, no Libor Rate breakage fee shall be due. The term "Rollover Date" applicable to a particular Libor Interest Period shall mean the last day of Libor Interest Period. The Secured Party shall submit a certificate to the Debtor setting forth in reasonable detail the amount of the breakage costs, which certificate shall be conclusive in the absence of manifest error. The breakage costs shall also apply to prepayments due as a result of a default. There shall be no breakage costs for any portion of the indebtedness being prepaid bearing interest at the Variable Rate Option.

7.3. PROMISE TO PAY FEES. Debtor promises to pay to Secured Party monthly, on the first day of each calendar month, an unused fee equal to one quarter of one percent (.25%) of \$16,000,000. less the aggregate principal balance of all Advances outstanding during the calendar month just ended under the Revolving Credit Facility.

7.4. PROMISE TO PAY COSTS AND EXPENSES.

(a) Debtor agrees to pay to Secured Party, on demand, all costs and expenses as provided in this Agreement, and all costs and expenses incurred by Secured Party from time to time in connection with this Agreement, including, without limitation, those incurred

in: (i) preparing, negotiating, amending, waiving, or granting consent with respect to the terms of any or all of the Transaction Documents; (ii) enforcing the Transaction Documents; (iii) performing, pursuant to Section 13.2, Debtor's duties under the Transaction Documents upon Debtor's failure to perform them; (iv) filing financing statements, assignments, or other documents relating to the Collateral (e.g., filing fees, recording taxes, and documentary stamp taxes); (v) realizing upon or protecting any Collateral; (vi) enforcing or collecting any Indebtedness or guaranty thereof; and (vii) upon the occurrence of an Event of Default, employing collection agencies or other agents to collect any or all of the Receivable.

(b) Without limiting Section 7.4(a), Debtor also agrees to pay to Secured Party, on demand, the actual reasonable fees and disbursements incurred by Secured Party for attorneys retained by Secured Party for advice, suit, appeal, or insolvency or other proceedings under the Federal Bankruptcy Code or otherwise upon the occurrence of an Event of Default specified in Section 13.13.

7.5. METHOD OF PAYMENT OF PRINCIPAL, INTEREST, FEES AND COSTS AND EXPENSES.

7.7. ACCOUNT STATED. Debtor agrees that each monthly or other statement of account mailed or delivered by Secured Party to Debtor pertaining to the outstanding balance of Advances, the amount of interest due thereon, fees, and costs and expenses shall be final, conclusive, and binding on Debtor and shall constitute an "account stated" with respect to the matters contained therein unless, within thirty (30) calendar days from when such statement is mailed or, if not mailed, delivered to Debtor, Debtor shall deliver to Secured Party written notice of any objections which it may have as to such statement of account, and in such event, only the items to which objection is expressly made in such notice shall be considered to be disputed by Debtor.

8. Intentionally Deleted Prior to Execution.

9. AFFIRMATIVE COVENANTS. So long as any part of the Indebtedness remains unpaid, or this Agreement remains in effect, Debtor shall comply with the covenants contained elsewhere in this Agreement, and with the covenants listed below:

9.1. FINANCIAL STATEMENTS. Debtor shall furnish to Secured Party:

(a) Annual Audited Financial Statements of Debtor. Within one hundred twenty (120) days after the end of each fiscal year, audited consolidated financial statements of Debtor and each Consolidated Subsidiary as of the end of such year, fairly

presenting Debtor's and each Consolidated Subsidiary's financial position, which statements shall consist of a balance sheet and related statements of income, retained earnings, and cash flow covering the period of Debtor's immediately preceding fiscal year, and which shall be prepared by Debtor and audited by independent certified public accountants satisfactory to Secured Party in the form submitted to the Securities and Exchange Commission, and in accordance with GAAP. At the same time, Debtor shall deliver to Secured Party a copy of the Form 10-K filed with the Securities and Exchange Commission, and internally prepared consolidating financial statements of Debtor and each Consolidated Subsidiary. All such financial statements and other documents delivered to Secured Party are to be certified as accurate by the chief financial officer of Debtor.

(b) Quarterly 10-Q Reports. Within sixty (60) days of each first, second and third fiscal quarter of each fiscal year, consolidated 10-Q report filed with the Securities and Exchange Commission of Debtor and each Consolidated Subsidiary as of the end of such period, fairly presenting Debtor's and each Consolidated Subsidiary's financial position, and internally prepared consolidating financial statements of Debtor and each Consolidated Subsidiary. All such reports shall be in such detail as the Securities and Exchange Commission shall request and in accordance with GAAP and shall be signed and certified to be correct by the chief financial officer of Debtor or such other financial officer satisfactory to Secured Party.

(c) Management Letters. Within sixty (60) days of each fiscal quarter of each fiscal year end (but in connection with year end statements, 120 days after each fiscal year end) a management letter certifying that there are no defaults to the Transaction Documents and the accounts receivable aging reports and inventory designation reports required to be submitted to Secured Party executed by the chairman, president or chief financial officer of Debtor or other financial officer satisfactory to Secured Party, and otherwise in form and substance satisfactory to Secured Party in its reasonable discretion. Simultaneously with the delivery of such financial statements, Debtor shall deliver to Secured Party a compliance certificate executed by the president or chief financial officer of Debtor or other financial officer satisfactory to Secured Party in the form of Exhibit E attached hereto and made a part hereof. In addition, Debtor shall deliver to Secured Party, as soon as available, a true copy of any "Management Letter" or other communication to Debtor, from its certified public accountants regarding matters which arose or were ascertained during the course of their review and which such accountants determined ought to be brought to management's attention.

(d) Other Reporting. Within forty five days of each fiscal

quarter of each fiscal year concerning Debtor and all Consolidated Subsidiaries, all such reports to be in form and substance satisfactory to Secured Party in its reasonable discretion:

- (i) accounts receivable aging reports; and
- (ii) inventory designation reports.

(e) Other Information. Copies of any and all proxy statements, financial statements, and reports which Debtor sends to its shareholders, and copies of any and all periodic and special reports and registration statements which Debtor files with the Securities and Exchange Commission, and such additional information as Secured Party may from time to time reasonably request regarding the financial and business affairs of Debtor or any Consolidated Subsidiary.

9.2. GOVERNMENT AND OTHER SPECIAL RECEIVABLES. Debtor shall promptly notify Secured Party in writing of the existence of any Receivable as to which the perfection, enforceability, or validity of Secured Party's Security Interest in such Receivable, or Secured Party's right or ability to obtain direct payment to Secured Party of the Proceeds of such Receivable, is governed by any federal or state statutory requirements other than those of the Uniform Commercial Code, including, without limitation, any Receivable subject to the Federal Assignment of Claims Act of 1940, as amended.

9.3. Intentionally Deleted.

9.4. BOOKS AND RECORDS. Debtor shall maintain, at its own cost and expense, accurate and complete books and records with respect to the Collateral, in form satisfactory to Secured Party, and including, without limitation, records of all payments received and all Credits and Extensions granted with respect to the Receivables, of the return, rejection, repossession, stoppage in transit, loss, damage, or destruction of any Inventory, and of all other dealings affecting the Collateral. Debtor shall deliver such books and records to Secured Party or its representative upon reasonable request. At Secured Party's request, Debtor shall mark all or any records to indicate the Security Interest. Debtor shall further indicate the Security Interest on all financial statements issued by it or shall cause the Security Interest to be so indicated by its accountants.

9.5. INVENTORY IN POSSESSION OF THIRD PARTIES. If any Inventory remains in the hands or control of any of Debtor's agents, finishers, contractors, or processors, or any other third party, Debtor, if requested by Secured Party, shall notify such party of Secured Party's Security Interest in the Inventory and

shall instruct such party to hold such Inventory for the account of Secured Party and subject to the instructions of Secured Party.

9.6. EXAMINATIONS. Debtor shall at all reasonable times and from time to time permit Secured Party or its agents upon reasonable advance notice to Debtor to inspect the Collateral and to examine and make extracts from, or copies of, any of Debtor's books, ledgers, reports, correspondence, and other records.

9.7. VERIFICATION OF COLLATERAL. Secured Party shall have the right to verify all or any Collateral in any manner and through any medium Secured Party may consider appropriate and Debtor agrees to furnish all assistance and information and perform any acts which Secured Party may require in connection therewith.

9.8. RESPONSIBLE PARTIES. Debtor shall notify Secured Party of the occurrence of any event specified in Section 11.1(v)(iv) with respect to any Responsible Party promptly after receiving notice thereof.

9.9. TAXES. Debtor shall promptly pay and discharge all of its taxes, assessments, and other governmental charges prior to the date on which penalties are attached thereto, establish adequate reserves for the payment of such taxes, assessments, and other governmental charges, make all required withholding and other tax deposits, and, upon request, provide Secured Party with receipts or other proof that such taxes, assessments, and other governmental charges have been paid in a timely fashion; provided, however, that nothing contained herein shall require the payment of any tax, assessment, or other governmental charge so long as its validity is being contested in good faith, and by appropriate proceedings diligently conducted, and adequate reserves for the payment thereof have been established.

9.10. LITIGATION.

(a) Debtor shall promptly notify Secured Party in writing of any litigation, proceeding, or counterclaim against, or of any investigation of, Debtor or any Consolidated Subsidiary if: (i) the outcome of such litigation, proceeding, counterclaim, or investigation may materially and adversely affect the finances or operations of Debtor or any Consolidated Subsidiary or title to, or the value of, any Collateral; or (ii) such litigation, proceeding, counterclaim, or investigation questions the validity of any Transaction Document or any action taken, or to be taken, pursuant to any Transaction Document.

(b) Debtor shall furnish to Secured Party such information regarding any such litigation, proceeding, counterclaim, or investigation as Secured Party shall request.

9.11. INSURANCE.

(a) Debtor shall at all times carry and maintain in full force and effect such insurance as Secured Party may from time to time require, in coverage, form, and amount, and issued by insurers, satisfactory to Debtor and Secured Party, including, without limitation: workers' compensation or similar insurance; public liability insurance; business interruption insurance; and insurance against such other risks as are usually insured against by business entities of established reputation engaged in the same or similar businesses as Debtor and similarly situated.

(b) Debtor shall deliver to Secured Party the policies of insurance required by Secured Party, with appropriate endorsements designating Secured Party as an additional insured, mortgagee and loss payee as requested by Secured Party. Each policy of insurance shall provide that if such policy is cancelled for any reason whatsoever, if any substantial change is made in the coverage which affects Secured Party, or if such policy is allowed to lapse for nonpayment of premium, such cancellation, change, or lapse shall not be effective as to Secured Party until thirty (30) days after receipt by Secured Party of written notice thereof from the insurer issuing such policy.

9.12. GOOD STANDING; BUSINESS.

Debtor shall take all necessary steps to preserve its corporate existence and its right to conduct business in all states in which the nature of its business or ownership of its property requires such qualification.

9.13. PENSION REPORTS. Upon the occurrence of any Pension Event, Debtor shall furnish to Secured Party, as soon as possible and, in any event, within thirty (30) days after Debtor knows, or has reason to know, of such occurrence, the statement of the president or chief financial officer of Debtor setting forth the details of such Pension Event and the action which Debtor proposes to take with respect thereto.

9.14. NOTICE OF NON-COMPLIANCE. Debtor shall notify Secured Party in writing of any failure by Debtor or any Third Party to comply with any provision of any Transaction Document within ten (10) days of learning of such non-compliance, or if any representation or warranty contained in any Transaction Document is no longer true.

9.15. COMPLIANCE WITH ENVIRONMENTAL LAWS.

(a) Debtor shall comply with all Environmental Laws.

(b) Debtor shall not suffer, cause, or permit the Disposal of Hazardous Substances at any property owned, leased, or operated by it or any domestic Consolidated Subsidiary.

(c) Debtor shall promptly notify Secured Party in the event of the Disposal of any domestic Hazardous Substance at any property owned, leased, or operated by Debtor or any domestic Consolidated Subsidiary, or in the event of any Release, or threatened Release, of a Hazardous Substance, from any such property.

(d) Debtor shall, at Secured Party's request, provide, at Debtor's expense, updated Environmental Questionnaires concerning any property owned, leased, or operated by Debtor or any domestic Consolidated Subsidiary.

(e) Debtor shall deliver promptly to Secured Party (i) copies of any documents received from the United States Environmental Protection Agency or any state, county, or municipal environmental or health agency concerning Debtor's or any domestic Consolidated Subsidiary's operations and (ii) copies of any documents submitted by Debtor or any domestic Consolidated Subsidiary to the United States Environmental Protection Agency or any state, county, or municipal environmental or health agency concerning its operations.

9.16. DEFEND COLLATERAL. Debtor shall defend the Collateral against the claims and demands of all other parties (other than Secured Party), including, without limitation, defenses, setoffs, and counterclaims asserted by any Account Debtor against Debtor or Secured Party.

9.17. USE OF PROCEEDS. Debtor shall use the proceeds of Advances solely for Debtor's working capital and for such other legal and proper corporate purposes as are consistent with all applicable laws, Debtor's articles or certificate of incorporation and by-laws, resolutions of Debtor's Board of Directors, and the terms of this Agreement.

9.18. COMPLIANCE WITH LAWS. Debtor shall comply with all applicable laws, rules, regulations, and other legal requirements with respect to its business and the use, maintenance, and operations of the real and personal property owned or leased by it in the conduct of its business.

9.19. MAINTENANCE OF PROPERTY. Debtor shall maintain its property, including, without limitation, the Collateral, in good

condition and repair and shall prevent the Collateral, or any part thereof, from being or becoming an accession to other goods not constituting Collateral.

9.20 LICENSES, PERMITS, ETC. Debtor shall maintain all of its franchises, grants, authorizations, licenses, permits, easements, consents, certificates, and orders, if any, in full force and effect until their respective expiration dates.

9.21. TRADEMARKS AND PATENTS. Debtor shall maintain all of its trademarks, trademark rights, patents, patent rights, licenses, permits, tradenames, tradename rights, and approvals, if any, in full force and effect until their respective expiration dates.

9.22. ERISA. Debtor shall comply with the provisions of ERISA and the Internal Revenue Code with respect to each Pension Plan.

9.23. MAINTENANCE OF OWNERSHIP. Debtor shall at all times maintain ownership of the percentages of issued and outstanding capital stock of each Consolidated Subsidiary set forth in Exhibit B and notify Secured Party in writing prior to the incorporation of any new Consolidated Subsidiary.

9.24. ACTIVITIES OF CONSOLIDATED SUBSIDIARIES. Unless the provisions of this Section 9.24 are expressly waived by Secured Party in writing, Debtor shall cause each domestic Consolidated Subsidiary (except for Raltech Logic, Inc.) to comply with Sections 9.1(b) 9.9, 9.11(a), 9.12, 9.15, 9.26 and 9.18 through 9.22, inclusive, and any of the provisions contained in Schedule, and shall cause each domestic Consolidated Subsidiary to refrain from doing any of the acts proscribed by Sections 10.2, 10.3, and 10.5 through 10.14, inclusive.

9.25. LABOR DISPUTES. Debtor shall notify the Secured Party promptly upon Debtor's learning of any material labor dispute to which Debtor may become a party to, any strikes or walkouts relating to any of its plants or any of its facilities and/or the expiration of any labor contract to which Debtor is a party to or by which Debtor is bound.

9.26. FINANCIAL COVENANTS. The financial covenants to include the following:

(a) Debtor and its Consolidated Subsidiaries shall maintain, at all times, on a consolidated basis, a ratio of Total Liabilities to Tangible Net Worth of not greater than 1.00 to 1, to be tested each fiscal quarter end of each fiscal year, based upon the financial statements required to be presented to Secured Party pursuant to Section 9.1. hereinabove.

(b) Debtor and its Consolidated Subsidiaries shall maintain, at fiscal year end June 30, 1997, on a consolidated basis, a minimum Tangible Net Worth of not less than \$28,000,000., and at each fiscal year end thereafter, the required minimum Tangible Net Worth shall increase by \$1,000,000. per fiscal year; to be tested each fiscal quarter end of each fiscal year, based upon the financial statements required to be presented to Secured Party pursuant to Section 9.1. hereinabove.

(c) At all times, Debtor and its Consolidated Subsidiaries shall maintain, on a consolidated basis, a ratio of Current Assets to Current Liabilities (i) of not less than 2.75 to 1 from the date hereof through June 29, 1998, (ii) of not less than 3.00 to 1 from June 30, 1998 through June 29, 1999, (iii) of not less than 3.25 to 1 from June 30, 1999 through June 29, 2000 and beyond, to be tested each fiscal quarter end of each fiscal year, based upon the financial statements required to be presented to Secured Party pursuant to Section 9.1. hereinabove.

(d) Debtor and its Consolidated Subsidiaries shall maintain, on a consolidated basis, a minimum "Debt Service Coverage Ratio" of 1.25 to 1, to be tested at the end of each fiscal year, based upon the financial statements required to be presented to Secured Party pursuant to Section 9.1. hereinabove.

(e) At all times during the Loan Period, Debtor and its Consolidated Subsidiaries shall maintain, on a consolidated basis, a ratio of the aggregate of cash plus total Receivables to Current Liabilities (i) of not less than 1.00 to 1 from the date hereof through June 29, 1998, (ii) of not less than 1.25 to 1 from June 30, 1998 through June 29, 1999, (iii) of not less than 1.50 to 1 from June 30, 1999 through June 29, 2000 and beyond, to be tested each fiscal quarter of each fiscal year, based upon the financial statements required to be presented to Secured Party pursuant to Section 9.1. hereinabove.

The above ratios of this Section 9.26. are being calculated assuming that in the last year of the Loan Agreement, the Advances under the Revolving Credit Facility are viewed as long term debt, unless there is an event of default which is continuing under the Revolving Credit Facility.

10. NEGATIVE COVENANTS. So long as any part of the Indebtedness remains unpaid or this Agreement remains in effect, Debtor, without the written consent of Secured Party, shall not violate any covenant contained otherwise herein and shall not:

10.1. LOCATION OF INVENTORY, EQUIPMENT, AND BUSINESS RECORDS. Move the Inventory, Equipment or the records concerning the

Collateral from the location where they are kept as specified herein, except in the ordinary course of business.

10.2. BORROWED MONEY. Create, incur, assume, or suffer to exist any liability for borrowed money, except to Secured Party and except for permitted Capital Expenditures.

10.3. SECURITY INTEREST AND OTHER ENCUMBRANCES. Create, incur, assume, or suffer to exist any mortgage, security interest, lien, or other encumbrance upon any of its properties or assets, whether now owned or hereafter acquired, except mortgages, security interests, liens, and encumbrances (a) except in favor of Secured Party, (b) except all existing liens, mortgages, or encumbrances, and (c) except in connection with the grant of a security interest in Equipment in connection with financing the purchase of Equipment or in connection with the leasing of Equipment, so long as Debtor is in compliance with Sections 10.10 and 10.11. herein.

10.4. STORING AND USE OF COLLATERAL. Place the Collateral in any warehouse which may issue a negotiable Document with respect thereto or use the Collateral in violation of any provision of the Transaction Documents, of any applicable statute, regulation, or ordinance, or of any policy insuring the Collateral.

10.5. MERGERS, CONSOLIDATIONS, OR SALES.

(a) Merge or consolidate with or into any corporation; (b) enter into any joint venture or partnership with any person, firm, or corporation; (c) convey, lease, or sell all or any material portion of its property or assets or business to any other person, firm, or corporation except for the sale of Inventory in the ordinary course of its business and in accordance with the terms of this Agreement; or (d) convey, lease, or sell any of its assets to any person, firm or corporation for less than the fair market value thereof.

10.6. CAPITAL STOCK. Purchase or retire any of its capital stock or issue any capital stock, except (1) in connection with its employee stock option plan and its non-employee stock option plan and (2) pro rata to its present stockholders, or otherwise change the capital structure of Debtor or change the relative rights, preferences, or limitations relating to any of its capital stock.

10.7. DIVIDENDS OR DISTRIBUTIONS. Pay or declare any cash or other dividends or distributions on any of its corporate stock, or permit a Consolidated Subsidiary to pay or declare and cash or other dividends or distributions on any of the corporate stock of any Consolidated Subsidiary, or accept any such cash or other dividends or distributions from a Consolidated Subsidiary.

10.8. INVESTMENTS AND ADVANCES. Make any investment in, or advances to, any other person, firm, or corporation, except (a) advance payments or deposits against purchases made in the ordinary course of Debtor's regular business; (b) direct obligations of the United States of America, money-market funds or certificates of deposit; or (c) any existing investments in, or existing advances to, the Consolidated Subsidiaries.

10.9. GUARANTIES. Become a guarantor, a surety, or otherwise liable for the debts or other obligations of any other person, firm, or corporation, whether by guaranty or suretyship agreement, agreement to purchase indebtedness, agreement for furnishing funds through the purchase of goods, supplies, or services (or by way of stock purchase, capital contribution, advance, or loan) for the purpose of paying or discharging indebtedness, or otherwise, except as an endorser of instruments for the payment of money deposited to its bank account for collection in the ordinary course of business.

10.10. LEASES. Enter, as lessee, into any lease of real or personal property (whether such lease is classified on Debtor's financial statements as a capital lease or operating lease) in excess of \$500,000 per fiscal year.

10.11. CAPITAL EXPENDITURES. During any fiscal year during the Loan Period, cause the Capital Expenditures of Debtor and its Consolidated Subsidiaries to exceed, on a combined basis, \$1,500,000 per fiscal year.

10.12. Intentionally Deleted.

10.13. NAME CHANGE. Change its name without giving at least thirty (30) days prior written notice of its proposed new name to Secured Party, together with delivery to Secured Party of UCC-1 Financing Statements reflecting Debtor's new name, all in form and substance satisfactory to Secured Party.

10.14. DISPOSITION OF COLLATERAL. Sell, assign, or otherwise transfer, dispose of, or encumber the Collateral or any interest therein, or grant a security interest therein, or license thereof, except to Secured Party and except the sale or lease of Inventory in the ordinary course of business of Debtor and in accordance with the terms of this Agreement.

10.15. FINANCIAL COVENANTS. Fail to comply with the financial covenants set forth in Section 9.26. hereinabove.

10.16. NEGATIVE PLEDGE. Encumber or cause to encumber, or cause NAPCO/Alarm Lock Grupo Internacional, S.A. f/k/a NSS Caribe S.A. to encumber, the assets (personal property, fixtures or real property) of NAPCO/Alarm Lock Grupo Internacional, S.A. f/k/a NSS

11. EVENTS OF DEFAULT.

11.1. EVENTS OF DEFAULT. The occurrence of any one or more of the following events shall constitute an event of default (individually, an Event of Default and, collectively, Events of Default):

(a) Nonpayment. Nonpayment when due of any principal, interest, premium, fee, cost, or expense due under the Transaction Documents, and such nonpayment is not cured within ten (10) days after notice thereof by Secured Party to Debtor.

(b) Negative Covenants. Default in the observance of any covenant or agreement of Debtor contained in Article 10, and any such default is not cured by Debtor or waived by Secured Party within ten (10) days after notice thereof by Secured Party to Debtor.

(c) Article 6. Default in the observance of any covenant or agreement of Debtor contained in Article 6, and such default is not cured by Debtor or waived by Secured Party within ten (10) days after notice thereof by Secured Party to Debtor.

(d) Other Covenants. Default in the observance of any of the covenants or agreements of Debtor contained in the Transaction Documents, other than in Article 10, Article 6 or Sections 7.1, 7.2, 7.3, or 7.4, or in any other agreement with Secured Party which is not remedied within the earlier of thirty (30) days after (i) notice thereof by Secured Party to Debtor, or (ii) ten (10) days after date Debtor was required to give notice to Secured Party under Section 9.14.

(e) Cessation of Business or Voluntary Insolvency Proceedings. The (i) cessation of operations of Debtor's business as conducted on the date of this Agreement; (ii) filing by Debtor of a petition or request for liquidation, reorganization, arrangement, adjudication as a bankrupt, relief as a debtor, or other relief under the bankruptcy, insolvency, or similar laws of the United States of America or any state or territory thereof or any foreign jurisdiction now or hereafter in effect; (iii) making by Debtor of a general assignment for the benefit of creditors; (iv) consent by the Debtor to the appointment of a receiver or

trustee, including, without limitation, a "custodian," as defined in the Federal Bankruptcy Code, for Debtor or any of Debtor's assets; (v) making of any, or sending of any, notice of any intended bulk sale by Debtor; or (vi) execution by Debtor of a consent to any other type of insolvency proceeding (under the Federal Bankruptcy Code or otherwise) or any formal or informal proceeding for the dissolution or liquidation of, or settlement of, claims against or winding up of affairs of, Debtor.

(f) Involuntary Insolvency Proceedings. (i) The appointment of a receiver, trustee, custodian, or officer performing similar functions, including, without limitation, a "custodian," as defined in the Federal Bankruptcy Code, for Debtor or any of Debtors assets; or the filing against Debtor of a request or petition for liquidation, reorganization, arrangement, adjudication as a bankrupt, or other relief under the bankruptcy, insolvency, or similar laws of the United States of America, any state or territory thereof, or any foreign jurisdiction now or hereafter in effect; or of any other type of insolvency proceeding (under the Federal Bankruptcy Code or otherwise) or any formal or informal proceeding for the dissolution or liquidation of, settlement of claims against, or winding up of affairs of Debtor shall be instituted against Debtor; and (ii) such appointment shall not be vacated, or such petition or proceeding shall not be dismissed, within sixty (60) days after such appointment, filing, or institution.

(g) Other Indebtedness and Agreements. Failure by Debtor to pay, when due, (or, if permitted by the terms of any applicable documentation, within any applicable grace period) any indebtedness owing by Debtor to Secured Party or any other person or entity (other than the Indebtedness incurred, pursuant to this Agreement, and including, without limitation, indebtedness evidencing a deferred purchase price), whether such indebtedness shall become due by scheduled maturity, by required prepayment, by acceleration, by demand, or otherwise, or failure by the Debtor to perform any term, covenant, or agreement on its part to be performed under any agreement or instrument (other than a Transaction Document) evidencing or securing or relating to any indebtedness owing by Debtor when required to be performed if the effect of such failure is to permit the holder to accelerate the maturity of such indebtedness, and such failure is not cured within thirty (30) days after such failure to pay when due.

(h) Judgments. Any judgment or judgments against Debtor (other than any judgment for which Debtor is fully insured) shall remain unpaid, unstayed on appeal, undischarged, unbonded, or undismissed for a period of thirty (30) days.

(i) Pension Default. Any Reportable Event which Secured Party shall determine in good faith constitutes grounds for the termination of any Pension Plan by the Pension Benefit Guaranty Corporation, or for the appointment by an appropriate United States district court of a trustee to administer any Pension Plan, shall occur and shall continue thirty (30) days after written notice thereof to Debtor by Secured Party; or the Pension Benefit Guaranty Corporation shall institute proceedings to terminate any Pension Plan or to appoint a trustee to administer any Pension Plan; or a trustee shall be appointed by an appropriate United States district court to administer any Pension Plan; or any Pension Plan shall be terminated; or Debtor or any Consolidated Subsidiary shall withdraw from a Pension Plan in a complete withdrawal or a partial withdrawal; or there shall arise vested unfunded liabilities under any Pension Plan that, in the good faith opinion of Secured Party, have or will or might have a material adverse effect on the finances or operations of Debtor; or Debtor or any Consolidated Subsidiary shall fail to pay to any Pension Plan any contribution which it is obligated to pay under the terms of such plan or any agreement or which is required to meet statutory minimum funding standards, and such pension default is not remedied within thirty (30) days of default;

(j) Collateral; Impairment. There shall occur with respect to the Collateral any (i) misappropriation, conversion, diversion, or fraud; (ii) levy, seizure, or attachment; or (iii) material loss, theft, or damage, and such impairment is not cured to the reasonable satisfaction of Secured Party within ten (10) days of written notice by Secured Party to Debtor.

(k) Insecurity; Change. Secured Party shall believe in good faith that the prospect of payment of all, or any part, of the Indebtedness or performance of Debtor's obligations under the Transaction Documents or any other agreement between Secured Party and Debtor is impaired; or there shall occur any materially adverse change in the business or financial condition of Debtor.

(l) Third Party Default. There shall occur with respect to any Third Party or any Consolidated Subsidiary, including, without limitation, any guarantor or Consolidated Subsidiary (i) any event described in Section 11.1(e), 11.1(f), 11.1(g), or 11.1(h); (ii) any pension default event such as described in Section 11.1(i) with respect to any pension plan maintained by such Third Party or such Consolidated Subsidiary; or (iii) any failure by Third Party or such Consolidated Subsidiary to perform in accordance with the terms of any agreement between such Third Party and Secured Party, and such Third Party default remains unremedied within thirty (30) days of default.

(m) Representations. Any certificate, statement,

representation, warranty, or financial statement furnished by, or on behalf of, Debtor or any Third Party, pursuant to, or in connection with, this Agreement (including, without limitation, representations and warranties contained herein) or as an inducement to Secured Party to enter into this Agreement or any other lending agreement with Debtor shall prove to have been false in any material respect at the time as of which the facts therein set forth were certified or to have omitted any substantial contingent or unliquidated liability or claim against Debtor or any such Third Party, or if on the date of the execution of this Agreement there shall have been any materially adverse change in any of the facts disclosed by any such statement or certificate which shall not have been disclosed in writing to Secured Party at, or prior to, the time of such execution.

(n) Challenge to Validity. Debtor or any Third Party commences any action or proceeding to contest the validity or enforceability of any Transaction Document or any lien or security interest granted or obligations evidenced by any Transaction Document.

(o) Death or Incapacity; Termination. Any Third Party dies or becomes incapacitated, or terminates or attempts to terminate, in accordance with its terms or otherwise, any guaranty or other Transaction Document executed by such Third Party.

(p) Intentionally deleted prior to execution.

(q) Location of Collateral Within the United States. If, at any time during the Loan Period, Debtor and its Consolidated Subsidiaries shall fail to maintain, on a consolidated basis, not less than fifty (50%) of the value of all of their identifiable assets (as disclosed in the 10k statement) in the United States, to be tested annually, at each fiscal year end.

11.2. EFFECTS OF AN EVENT OF DEFAULT.

(a) Upon the happening of one or more Events of Default (except an Event of Default under either Section 11.1(e) or 11.1(f)), Secured Party may declare any obligations it may have hereunder to be cancelled, and the principal of the Indebtedness then outstanding to be immediately due and payable, together with all interest thereon and costs and expenses accruing under the Transaction Documents. Upon such declaration, any obligations Secured Party may have hereunder shall be immediately cancelled, and the Indebtedness then outstanding shall become immediately due and payable without presentation, demand, or further notice of any kind to Debtor.

(b) Upon the happening of one or more Events of Default

under Section 11.1(e) or 11.1(f), Secured Party's obligations hereunder shall be cancelled immediately, automatically, and without notice, and the Indebtedness then outstanding shall become immediately due and payable without presentation, demand, or notice of any kind to the Debtor.

12. SECURED PARTY'S RIGHTS AND REMEDIES.

12.1. GENERALLY. Secured Party's rights and remedies with respect to the Collateral, in addition to those rights granted herein and in any other agreement between Debtor and Secured Party now or hereafter in effect, shall be those of a secured party under the Uniform Commercial Code as in effect in the State and under any other applicable law.

12.2. INTENTIONALLY DELETED PRIOR TO EXECUTION.

12.3. POSSESSION OF COLLATERAL. Whenever Secured Party may take possession of the Collateral, pursuant to Section 12.1, Secured Party may take possession of the Collateral on Debtor's premises or may remove the Collateral, or any part thereof, to such other places as the Secured Party may, in its sole discretion, determine. If requested by Secured Party, Debtor shall assemble the Collateral and deliver it to Secured Party at such place as may be designated by Secured Party.

12.4. COLLECTION OF RECEIVABLES. Upon the occurrence of an Event of Default or an event which with notice or lapse of time, or both, would constitute an Event of Default, Secured Party may demand, collect, and sue for all monies and proceeds due, or to become due, on the Receivables (in either Debtor's or Secured Party's name at the latter's option) with the right to enforce, compromise, settle, or discharge any or all Receivables. If Secured Party takes any action contemplated by this Section with respect to any Receivable, Debtor shall not exercise any right that Debtor would otherwise have had to take such action with respect to such Receivable.

12.5. Intentionally Deleted Prior to Execution

12.6. LICENSE TO USE PATENTS, TRADEMARKS AND TRADENAMES. Debtor grants to Secured Party a royalty-free license to use any and all patents, trademarks, and tradenames now or hereafter owned by, or licensed to, Debtor for the purposes of manufacturing and disposing of Inventory after the occurrence of an Event of Default. All Inventory shall at least meet quality standards maintained by Debtor prior to such Event of Default.

13. MISCELLANEOUS.

13.1. PERFECTING THE SECURITY INTEREST; PROTECTING THE COLLATERAL.

Debtor hereby authorizes Secured Party to file such financing statements relating to the Collateral without Debtor's signature thereon as Secured Party may deem appropriate, and appoints Secured Party as Debtor's attorney-in-fact (without requiring Secured Party) to execute any such financing statement or statements in Debtor's name and to perform all other acts which Secured Party deems appropriate to perfect and continue the Security Interest and to protect, preserve, and realize upon the Collateral.

13.2. PERFORMANCE OF DEBTOR'S DUTIES.

Upon Debtor's failure to perform any of its duties under the Transaction Documents, including, without limitation, the duty to obtain insurance as specified in Section 9.11, Secured Party may, but shall not be obligated to, perform any or all such duties.

13.3. NOTICE OF SALE.

Without in any way requiring notice to be given in the following manner, Debtor agrees that any notice by Secured Party of sale, disposition, or other intended action hereunder, or in connection herewith, whether required by the Uniform Commercial Code as in effect in the State or otherwise, shall constitute reasonable notice to Debtor if such notice is mailed by regular or certified mail, postage prepaid, at least five (5) days prior to such action, to Debtor's address or addresses specified above or to any other address which Debtor has specified in writing to Secured Party as the address to which notices hereunder shall be given to Debtor.

13.4. WAIVER BY SECURED PARTY.

No course of dealing between Debtor and Secured Party and no delay or omission by Secured Party in exercising any right or remedy under the Transaction Documents or with respect to any Indebtedness shall operate as a waiver thereof or of any other right or remedy, and no single or partial exercise thereof shall preclude any other or further exercise thereof or the exercise of any other right or remedy. All rights and remedies of Secured Party are cumulative.

13.5. WAIVER BY DEBTOR.

Secured Party shall have no obligation to take, and Debtor shall have the sole responsibility for taking, any and all steps to preserve rights against any and all Account Debtors and against any and all prior parties to any note, Chattel Paper, draft, trade acceptance or other instrument for the payment of money covered by the Security Interest, whether or not in Secured Party's possession. Secured Party shall not be responsible to Debtor for loss or damage resulting from Secured Party's failure to enforce any Receivables or to collect any moneys due, or to become due, thereunder or other Proceeds constituting

Collateral hereunder. Debtor waives protest of any note, check, draft, trade acceptance, or other instrument for the payment of money constituting Collateral at any time held by Secured Party on which Debtor is in any way liable and waives notice of any other action taken by Secured Party, including, without limitation, notice of Secured Party's intent to accelerate the Indebtedness or any part thereof.

13.6 SETOFF. Without limiting any other right of Secured Party, whenever Secured Party has the right to declare any Indebtedness to be immediately due and payable (whether or not it has so declared), Secured Party, at its sole election, may setoff against the Indebtedness any and all monies then or thereafter owed to Debtor by Secured Party in any capacity, whether or not the Indebtedness or the obligation to pay such monies owed by Secured Party is then due, and Secured Party shall be deemed to have exercised such right of setoff immediately at the time of such election even though any charge therefor is made or entered on Secured Party's records subsequent thereto.

13.7. ASSIGNMENT. The rights and benefits of Secured Party hereunder shall, if Secured Party so agrees, inure to any party acquiring any interest in the Indebtedness or any part thereof. Prior to the occurrence of an Event of Default hereunder, Secured Party shall give Debtor ninety (90) days prior written notice of an assignment in full of its interest in the Indebtedness, with the exception of assignments of its interest in the Indebtedness due to acquisition, merger, consolidation, takeover or such other like activity.

13.8. SUCCESSORS AND ASSIGNS. Secured Party and Debtor, as used herein, shall include the successors or assigns of those parties, except that Debtor shall not have the right to assign its rights hereunder or any interest herein.

13.9. MODIFICATION. No modification, rescission, waiver, release, or amendment of any provision of this Agreement shall be made, except as may be provided in a written agreement signed by Debtor and a duly authorized officer of Secured Party.

13.10. COUNTERPARTS. This Agreement may be executed in any number of counterparts, and by Secured Party and Debtor on separate counterparts, each of which, when so executed and delivered, shall be an original, but all of which shall together constitute one and the same Agreement.

13.11. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. Any financial calculation to be made, all financial statements and other financial information to be provided, and all books and

records to be kept in connection with the provision of this Agreement, shall be in accordance with GAAP consistently applied during each interval and from interval to interval; provided, however, that in the event changes in GAAP shall be mandated by the Financial Accounting Standards Board or any similar accounting body of comparable standing, or should be recommended by Debtor's certified public accountants, to the extent such changes would affect any financial calculations to be made in connection herewith, such changes shall be implemented in making such calculations only from and after such date as Debtor and Secured Party shall have amended this Agreement to the extent necessary to reflect such changes in the financial and other covenants to which such calculations relate.

13.12. INDEMNIFICATION.

(a) If after receipt of any payment of all, or any part of, the Indebtedness, Secured Party is, for any reason, compelled to surrender such payment to any person or entity because such payment is determined to be void or voidable as a preference, an impermissible setoff, or a diversion of trust funds, or for any other reason, the Transaction Documents shall continue in full force and Debtor shall be liable, and shall indemnify and hold Secured Party harmless for, the amount of such payment surrendered. The provisions of this Section shall be and remain effective notwithstanding any contrary action which may have been taken by Secured Party in reliance upon such payment, and any such contrary action so taken shall be without prejudice to Secured Party's rights under the Transaction Documents and shall be deemed to have been conditioned upon such payment having become final and irrevocable. The provisions of this Section 13.12(a) shall survive the termination of this Agreement and the Transaction Documents.

(b) Debtor agrees to indemnify, defend and hold harmless Secured Party from, and against, any and all liabilities, claims, damages, penalties, expenditures, losses, or charges, including, but not limited to, all costs of investigation, monitoring, legal representations, remedial response, removal, restoration or permit acquisition, which may now, or in the future, be undertaken, suffered, paid, awarded, assessed, or otherwise incurred by Secured Party or any other person or entity as a result of the presence of, Release of, or threatened Release of Hazardous Substances on, in, under, or near the property owned, leased or operated by Debtor or any Consolidated Subsidiary. The liability of Debtor under the covenants of this Section 13.12(b) is not limited by any exculpatory provisions in this Agreement or any other documents securing the Indebtedness and shall survive repayment of the Indebtedness or any transfer or termination of this Agreement regardless of the means of such transfer or termination. Debtor agrees that Secured Party shall not be liable in any way for the

completeness or accuracy of any Environmental Report or the information contained therein. Debtor further agrees that Secured Party has no duty to warn Debtor or any other person or entity about any actual or potential environmental contamination or other problem that may have become apparent, or will become apparent, to Secured Party.

(c) Debtor agrees to pay, indemnify, and hold Secured Party harmless from, and against, any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses, or disbursements of any kind or nature whatsoever (including, without limitation, counsel and special counsel fees and disbursements in connection with any litigation, investigation, hearing, or other proceeding) with respect, or in any way related, to the existence, execution, delivery, enforcement, performance, and administration of this Agreement and any other Transaction Document (all of the foregoing, collectively, the "Indemnified Liabilities"). The agreements in this Section 13.12(c) shall survive repayment of the Indebtedness.

13.13. TERMINATION.

This Agreement is, and is intended to be, a continuing Agreement and shall remain in full force and effect for the Term and for any renewal term, if any; provided, however, that Secured Party may terminate this Agreement by giving Debtor notice to terminate in writing at least one hundred twenty (120) days prior to the end of the Term whereupon at the end of the Term all Indebtedness shall be due and payable in full without presentation, demand, or further notice of any kind, whether or not all or any part of such Indebtedness is otherwise due and payable pursuant to the agreement or instrument evidencing same. Notwithstanding the above, Secured Party may terminate this Agreement immediately and without further notice (except as specifically provided for herein or in the other Transaction Documents) upon the occurrence of an uncured or unremedied Event of Default herein or under any of the Transaction Documents. In addition, the one hundred twenty (120) day prior notice provision contained in this Section 13.13. does not apply and shall not be enforceable in the event that an uncured default has occurred and is continuing under the Transaction Documents with respect to payment covenants, bankruptcy covenants or bankruptcy events of default, financial covenants contained in Section 9.26. herein, the negative covenants contained in Sections 10.11, 10.15 and 10.16 herein, the cross-default with other creditors covenants, and the event of default specified in Section

11.1. (q). Notwithstanding the foregoing or anything in this Agreement or elsewhere to the contrary, the Security Interest, Secured Party's rights and remedies under the Transaction Documents and Debtor's obligations and liabilities under the Transaction Documents, shall survive any termination of this Agreement and shall remain in full force and effect until all of the Indebtedness outstanding, or contracted or committed for (whether or not outstanding), before the receipt of such notice by Secured Party, and any extensions or renewals thereof (whether made before or after receipt of such notice), together with interest accruing thereon after such notice, shall be finally and irrevocably paid in full. No Collateral shall be released or financing statement terminated until: (i) such final and irrevocable payment in full of the Indebtedness as described in the preceding sentence; and (ii) Debtor and Secured Party execute a mutual general release, subject to Section 13.12 of this Agreement, in form and substance satisfactory to the Secured Party and Debtor and their counsel.

13.14. FURTHER ASSURANCES. From time to time, Debtor shall take such action and execute and deliver to Secured Party such additional documents, instruments, certificates, and agreements as Secured Party may reasonably request to effectuate the purposes of the Transaction Documents.

13.15. HEADINGS. Article and Section headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

13.16. CUMULATIVE SECURITY INTEREST, ETC. The execution and delivery of this Agreement shall in no manner impair or affect any other security (by endorsement or otherwise) for payment or performance of the Indebtedness, and no security taken hereafter as security for payment or performance of the Indebtedness shall impair in any manner or affect this Agreement, or the security interest granted hereby, all such present and future additional security to be considered as cumulative security.

13.17. SECURED PARTY'S DUTIES. Without limiting any other provision of this Agreement: (a) the powers conferred on Secured Party hereunder are solely to protect its interests and shall not impose any duty to exercise any such powers; and (b) except as may be required by applicable law, Secured Party shall not have any duty as to any Collateral or as to the taking of any necessary steps to preserve rights against any parties or any other rights pertaining to any Collateral.

13.18. NOTICE GENERALLY. All notices and other communications hereunder shall be made by telegram, telex, electronic transmitter, overnight air courier, or certified or registered mail, return receipt requested, and shall be deemed to be received by the party

to whom sent one Business Day after sending, if sent by telegram, telex, electronic transmitter or overnight air courier, and three Business Days after mailing, if sent by certified or registered mail. All such notices and other communications to a party hereto shall be addressed to such party at the address set forth on the cover page hereof or to such other address as such party may designate for itself in a notice to the other party given in accordance with this Section 13.18. Notices to Debtor shall be sent to the attention of the Senior Vice President for Operations and Finance. As of this date the Senior Vice President for Operations and Finance is Kevin Buchel.

13.19. SEVERABILITY. The provisions of this Agreement are independent of, and separable from, each other, and no such provision shall be affected or rendered invalid or unenforceable by virtue of the fact that for any reason any other such provision may be invalid or unenforceable in whole or in part. If any provision of this Agreement is prohibited or unenforceable in any jurisdiction, such provision shall be ineffective in such jurisdiction only to the extent of such prohibition or unenforceability, and such prohibition or unenforceability shall not invalidate the balance of such provision to the extent it is not prohibited or unenforceable nor render prohibited or unenforceable such provision in any other jurisdiction.

13.20. INCONSISTENT PROVISIONS. The terms of this Agreement and the other Transaction Documents shall be cumulative except to the extent that they are specifically inconsistent with each other, in which case the terms of this Agreement shall prevail.

13.21. ENTIRE AGREEMENT. This Agreement and the other Transaction Documents constitute the entire agreement and understanding between the parties hereto with respect to the transactions contemplated hereby and supersede all prior negotiations, understandings, and agreements between such parties with respect to such transactions, including, without limitation, those expressed in any commitment letter delivered by Secured Party to Debtor.

13.22. APPLICABLE LAW. THIS AGREEMENT, AND THE TRANSACTIONS EVIDENCED HEREBY, SHALL BE GOVERNED BY, AND CONSTRUED UNDER, THE INTERNAL LAWS OF THE STATE, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW, AS THE SAME MAY FROM TIME TO TIME BE IN EFFECT, INCLUDING, WITHOUT LIMITATION, THE UNIFORM COMMERCIAL CODE AS IN EFFECT IN THE STATE.

13.23. CONSENT TO JURISDICTION. DEBTOR AND SECURED PARTY AGREE THAT ANY ACTION OR PROCEEDING TO ENFORCE, OR ARISING OUT OF, THE TRANSACTION DOCUMENTS MAY BE COMMENCED IN ANY COURT OF THE STATE IN ANY COUNTY, OR IN THE DISTRICT COURT OF THE UNITED STATES

IN ANY DISTRICT, IN WHICH SECURED PARTY HAS AN OFFICE, AND DEBTOR WAIVES PERSONAL SERVICE OF PROCESS AND AGREES THAT A SUMMONS AND COMPLAINT COMMENCING AN ACTION OR PROCEEDING IN ANY SUCH COURT SHALL BE PROPERLY SERVED AND SHALL CONFER PERSONAL JURISDICTION IF SERVED BY REGISTERED OR CERTIFIED MAIL TO DEBTOR, OR AS OTHERWISE PROVIDED BY THE LAWS OF THE STATE OR THE UNITED STATES.

13.24. JURY TRIAL WAIVER. DEBTOR AND SECURED PARTY HEREBY KNOWINGLY, VOLUNTARILY, AND INTENTIONALLY WAIVE ANY RIGHT TO TRIAL BY JURY DEBTOR OR SECURED PARTY MAY HAVE IN ANY ACTION OR PROCEEDING, IN LAW OR IN EQUITY, IN CONNECTION WITH THE TRANSACTION DOCUMENTS OR THE TRANSACTIONS RELATED THERETO. DEBTOR REPRESENTS AND WARRANTS THAT NO REPRESENTATIVE OR AGENT OF SECURED PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SECURED PARTY WILL NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THIS RIGHT TO JURY TRIAL WAIVER. DEBTOR ACKNOWLEDGES THAT SECURED PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE PROVISIONS OF THIS SECTION 13.24.

Accepted at Garden City, New York by:

MARINE MIDLAND BANK	NAPCO SECURITY SYSTEMS, INC.
By: /s/ _____	By: /s/ _____
John S. Wamboldt	Kevin Buchel
Vice President	Senior Vice President

STATE OF NEW YORK)
) SS:
COUNTY OF NASSAU)

On this 12th day of May, 1997, before me personally came KEVIN BUCHEL, to me known, who being by me duly sworn, did depose and say that he resides at _____; that he is the Senior Vice President of NAPCO SECURITY SYSTEMS, INC., the corporation described in and which executed the foregoing instrument; that he signed his name thereto by order of the Board of Directors of said corporation.

/s/ _____
NOTARY PUBLIC

STATE OF NEW YORK)
) SS:
COUNTY OF NASSAU)

On the 12th day of May, 1997, before me personally came JOHN S. WAMBOLDT, to me known, who, being by me duly sworn, did depose and say that he has an office at 534 Broad Hollow Road, Melville, New York; that he is a Vice President of MARINE MIDLAND BANK, the corporation described in and which executed the foregoing instrument; and that he signed his name thereto by order of the Board of Directors of said corporation.

/s/ _____
NOTARY PUBLIC

Amount of Note: \$1,000,000.00

Date of Note: As of May 12, 1997

Borrower: NAPCO Security Systems, Inc., the undersigned borrower, having its principal office at the place indicated beneath its name, and including its successors and/or assigns.

Default Rate: All overdue amounts shall bear interest, payable on demand, at a rate per annum equal to the Interest Rate, then in effect, plus three (3.0%) percent per annum.

Interest Rate: Interest is to be computed from the date hereof at a rate per annum equal to either (a) the Variable Rate Option, or (b) the Libor Rate Option for the Interest Period selected by the Borrower. In all instances, interest shall be payable in arrears and computed on an actual/360-day basis (i.e., interest for each day during which the indebtedness evidenced by this Note, or any portion thereof, is outstanding), all as more specifically described in the Loan Agreement, incorporated herein by this reference.

Interest Period: Interest Period, as the term "Interest Period" is defined in the Loan Agreement.

Lender: Marine Midland Bank, including its successors and/or assigns, with a place of business at 534 Broad Hollow Road, Melville, New York 11747.

Libor Rate Option: Libor Rate Option, as the term "Libor Rate Option" is defined in the Loan Agreement.

Loan Agreement: The Loan and Security Agreement dated as of even date hereof, including all exhibits hereto, by and between the Borrower and the Lender, as the same may be amended or otherwise modified from time to time.

Prime Rate: Prime Rate, as the term "Prime Rate" is defined in the Loan Agreement.

Note or Revolving
Credit Note or
Revolving Credit
Note # 1

This Revolving Credit Note # 1, including all exhibits thereto, as the same may be amended or otherwise modified from time to time; the terms "herein", "hereunder" and like terms shall be taken in its entirety and shall not be limited to any particular paragraph or provision hereof.

Termination

Date:

Termination Date, as the term "Termination Date is defined in the Loan Agreement.

Transaction

Documents:

Transaction Documents, as the term "Transaction Documents" is defined in the Loan Agreement.

Variable Rate

Option:

Variable Rate Option, as the term "Variable Rate Option" is defined in the Loan Agreement.

FOR VALUE RECEIVED, the Borrower does hereby covenant and promise to pay to the order of the Lender at its office at 534 Broad Hollow Road; Melville, New York 11747 or at such other place or places as the Lender may designate to the Borrower in writing from time to time, in check, coin or currency of the United States which is then legal tender for the payment of public or private debts, in immediately available funds, the lesser of (a) the principal amount of One Million (\$1,000,000.00) Dollars; or (b) the aggregate unpaid principal amount of all loans (or Advances) made by the Lender to the Borrower from time to time hereunder (collectively the "Loans", or if used in the singular, the "Loan").

The Borrower agrees that each monthly or other statement of account mailed or delivered by the Lender to the Borrower pertaining to the outstanding balance of the Loans, the amount of interest due thereon, fees, and costs and expenses shall be final, conclusive, and binding on the Borrower and shall constitute an "account stated" with respect to the matters contained therein unless, within thirty (30) calendar days from when such statement is mailed or, if not mailed, delivered to the Borrower, the Borrower shall deliver to the Lender written notice of any objections which it may have as to such statement of account, and in such event, only the items to which objection is expressly made in such notice shall be considered to be disputed by the Borrower.

No legal proceedings or actions shall be brought by the Borrower against the Lender claiming any such error unless (a) the Borrower shall have given the written notice as provided hereinabove, and (b)

such legal proceeding or action shall be commenced within one (1) year of the date when such statement of account, notice or advice was delivered or mailed to the Borrower.

The Borrower also shall pay, in lawful money of the United States, and in immediately available funds, interest to the Lender on the unpaid principal balance of all Loans outstanding from time to time from the date hereof until fully paid at a rate per annum equal to at the election of Borrower the Libor Rate Option or the Variable Rate Option, subject to the provisions contained in the Loan Agreement and all as more specifically described in the Loan Agreement. All payments shall be credited, when collected, first to interest and then to principal.

Interest Rate and Interest Period selection shall be governed by the provisions contained in the Loan Agreement. All written notices of Interest Rate and/or Interest Period selection shall be in the form annexed hereto as Exhibit A, attached hereto and incorporated herein by this reference.

A late payment premium equal to five (5%) percent of any principal or interest payment made more than ten (10) days after the due date thereof shall be due with any such late payment (other than the final payment due on the Maturity Date).

This Note is secured by and the parties hereto are entitled to the benefits of that certain Second Mortgage and Security Agreement in the principal amount of \$1,000,000., of even date herewith (the "Mortgage"), made by the Borrower to the Lender, encumbering, among other things, certain real property and improvements now or hereafter located on said real property, situate at 333 Bayview Avenue, a/k/a 359 Bayview Avenue, Amityville, in the Town of Babylon, County of Suffolk, State of New York, as more particularly described in the Mortgage ("Mortgaged Premises" or "Mortgaged Property"), and is executed and delivered pursuant to the Loan Agreement, all of the covenants, conditions and agreements of the Mortgage and the Loan Agreement being made a part hereof by this reference. This Note also is secured by the Collateral of the Borrower described in the Loan Agreement, and the pledged collateral described in certain pledge agreements dated of even date hereof, and the collateral of the domestic Consolidated Subsidiaries described in the general security agreements executed and delivered to the Lender by each of the domestic Consolidated Subsidiaries on even date hereof, and the Lender is entitled to the benefits of all of the collateral described therein and the collateral described in the other Transaction Documents.

This Revolving Credit Note is the Note # 1 referred to in the Loan Agreement, and the Lender shall be entitled to the benefit of all of the provisions contained therein and in the other Transaction Documents. The Loan Agreement, among other things, contains

provisions for payment of principal, interest, fees and charges in connection with the Revolving Credit Facility as well as provisions for acceleration of this Note upon the happening of certain stated events. The Loan Agreement also contains representations, warranties, covenants and conditions precedent to Advances under the Revolving Credit Facility, all of which are hereby made part of this Revolving Credit Note to the same extent and with the same effect as if set forth herein at length.

It is expressly agreed that, upon the failure of the Borrower timely to make any payment due hereunder, or upon the happening of any "Event of Default" under the Mortgage, the Loan Agreement and/or the other Transaction Documents, the principal sum hereof, together with accrued interest and all other expenses, including, but not limited to reasonable attorneys' fees for legal services incurred by the Lender in connection with the collection of this Note and/or the enforcement of payment hereof whether or not suit is brought, and if suit is brought, then through all appellate actions, shall immediately become due and payable at the option of the Lender, notwithstanding the Termination Date set forth herein. In the Event of Default, whether the Lender exercises any of its rights and remedies contained herein, including the right to declare all Indebtedness hereunder to be immediately due and payable, the Borrower shall pay interest on the unpaid principal balance hereunder at a rate equal to the Default Rate. The unpaid principal balance under the Note shall bear the Default Rate of Interest until the first to occur of the following: (i) all Indebtedness under this Note are paid in full; (ii) Borrower has cured said Event of Default to the satisfaction of the Lender; or (iii) the Lender, in writing, has waived said Event of Default. Notwithstanding anything to the contrary contained in this Note, the Note is subject to the express condition that at no time shall Borrower be obligated to be required to pay interest on the principal balance of this Note at a rate which could subject the Lender either to civil or criminal penalty as a result of being in excess of the maximum rate which Borrower is permitted by law to contract or agree to pay. If by the terms of this Note, Borrower at any time are required or obligated to pay interest on the principal balance of this Note at a rate in excess of such maximum rate then the rate of interest under this Note shall be deemed to be immediately reduced to such maximum rate and interest payable hereunder shall be computed at such maximum rate and any prior interest payments made in excess of such maximum rate shall be applied and shall be deemed to have been payments made in reduction of the principal balance of such note.

The indebtedness evidenced by this Note shall be prepayable, in whole or in part, subject to the provisions contained in the Loan Agreement.

Should the indebtedness represented by this Note or any part thereof be collected at law or in equity, or in bankruptcy, receivership or any other court proceedings (whether at the trial or

appellate level), or should this Note be placed in the hands of attorneys for collection upon an Event of Default, the Borrower agrees to pay, in addition to the principal, premium, breakage costs, and interest due and payable hereon, all costs of collection or attempting to collect this Note, including reasonable attorneys' fees and expenses.

The Borrower hereby waives valuation and appraisal, demand, presentment for payment, notice of dishonor, protest and notice of protest of this Note.

Any notice, demand or request relating to any matter set forth herein shall be in writing and shall be deemed effective when mailed, postage prepaid, by registered or certified mail, return receipt requested, to any party hereto at its address stated herein or at such other address of which it shall have notified the party giving such notice in writing as aforesaid.

This Note, being drawn, executed and delivered in the State of New York, where all advances and repayments shall be made, shall be construed and enforced in accordance with the laws of the State of New York.

This Note may not be changed or terminated orally, but only by an agreement in writing signed by the party against whom enforcement of any waiver, change, modification or discharge is sought.

All capitalized terms used herein not specifically defined shall have the meanings assigned to such terms in the Loan Agreement.

THE BORROWER AND THE LENDER AGREE THAT ANY LITIGATION GROWING OUT OF ANY CONTROVERSY WITH RESPECT TO, IN CONNECTION WITH OR ARISING OUT OF THIS NOTE OR ANY INSTRUMENT OR DOCUMENT DELIVERED PURSUANT HERETO WILL BE TRIED BY A COURT BY A JUDGE SITTING WITHOUT A JURY. IN ADDITION, THE BORROWER WAIVES THE RIGHT TO INTERPOSE ANY DEFENSE BASED UPON ANY STATUTE OF LIMITATIONS OR ANY CLAIM OF LACHES AND ANY SET-OFF OR COUNTERCLAIM EXCEPT FOR COMPULSORY COUNTERCLAIMS OF ANY NATURE OR DESCRIPTION, EXCEPT FOR PAYMENT PROVIDED BORROWER MAY INSTITUTE A SEPARATE CLAUSE OF ACTION AS TO SUCH MATTERS. THE BORROWER AND THE LENDER CONFIRM THAT THE FOREGOING WAIVERS ARE INFORMED AND FREELY MADE.

IN WITNESS WHEREOF, the Borrower has duly executed this Note as of the Date of Note.

NAPCO SECURITY SYSTEMS, INC.

BY: /s/-----
KEVIN BUCHEL
SENIOR VICE PRESIDENT

with offices at 333 Bayview Avenue
Amityville, New York 11701

STATE OF NEW YORK)
COUNTY OF NASSAU) SS:

On this 12th day of May, 1997, before me personally came Kevin Buchel, to me known, who being by me duly sworn, did depose and say that he resides at , that he is the Senior Vice President of NAPCO Security Systems, Inc., the corporation described in and which executed the foregoing instrument; that he signed his name thereto by order of the Board of Directors of said corporation.

/s/-----
NOTARY PUBLIC

EXHIBIT "A"

REQUEST FOR ADVANCE AND
NOTICE OF INTEREST RATE SELECTION

TO: MARINE MIDLAND BANK
534 Broad Hollow Road
Melville, New York 11747
Attention: John S. Wamboldt
Fax No.: (516) 752-4340

This Request for Advance Notice of Interest Rate Selection is governed by the terms of the Loan and Security Agreement dated May 12, 1997 made by and between NAPCO Security Systems, Inc. ("Debtor") and MARINE MIDLAND BANK ("Secured Party") (the "Agreement").

The undersigned hereby GIVES THE SECURED PARTY IRREVOCABLE NOTICE that Debtor requests the following Interest Rate under the Agreement as follows:

1. Rate Option and Interest Period. The requested Interest Rate option and Interest Rate Period for the requested amount is ((a) or (b), checked as applicable):

☐ (a) The Libor Rate Option for an Interest Period of (one checked as applicable):

- ☐ one month;
- ☐ two months; or
- ☐ three months; or
- ☐ four months; or
- ☐ six months; or
- ☐ nine months; or
- ☐ twelve months; or

☐ (b) The Variable Rate Option.

2. The Interest Rate shall be in effect for a requested Advance equalling \$_____.

Dated: _____, 1997

NAPCO Security Systems, Inc.

By:

Kevin Buchel
Senior Vice President

Amount of Note: \$15,000,000.00

Date of Note: As of May 12, 1997

Borrower: NAPCO Security Systems, Inc., the undersigned borrower, having its principal office at the place indicated beneath its name, and including its successors and/or assigns.

Default Rate: All overdue amounts shall bear interest, payable on demand, at a rate per annum equal to the Interest Rate, then in effect, plus three (3.0%) percent per annum.

Interest Rate: Interest is to be computed from the date hereof at a rate per annum equal to either (a) the Variable Rate Option, or (b) the Libor Rate Option for the Interest Period selected by the Borrower. In all instances, interest shall be payable in arrears and computed on an actual/360-day basis (i.e., interest for each day during which the indebtedness evidenced by this Note, or any portion thereof, is outstanding), all as more specifically described in the Loan Agreement, incorporated herein by this reference.

Interest Period: Interest Period, as the term "Interest Period" is defined in the Loan Agreement.

Lender: Marine Midland Bank, including its successors and/or assigns, with a place of business at 534 Broad Hollow Road, Melville, New York 11747.

Libor Rate Option: Libor Rate Option, as the term "Libor Rate Option" is defined in the Loan Agreement.

Loan Agreement: The Loan and Security Agreement dated as of even date hereof, including all exhibits hereto, by and between the Borrower and the Lender, as the same may be amended or otherwise modified from time to time.

Prime Rate: Prime Rate, as the term "Prime Rate" is defined in the Loan Agreement.

Note or Revolving
Credit Note or
Revolving Credit
Note # 2

This Revolving Credit Note # 2, including all exhibits thereto, as the same may be amended or otherwise modified from time to time; the terms "herein", "hereunder" and like terms shall be taken in its entirety and shall not be limited to any particular paragraph or provision hereof.

Termination

Date:

Termination Date, as the term "Termination Date is defined in the Loan Agreement.

Transaction

Documents:

Transaction Documents, as the term "Transaction Documents" is defined in the Loan Agreement.

Variable Rate

Option:

Variable Rate Option, as the term "Variable Rate Option" is defined in the Loan Agreement.

FOR VALUE RECEIVED, the Borrower does hereby covenant and promise to pay to the order of the Lender at its office at 534 Broad Hollow Road; Melville, New York 11747 or at such other place or places as the Lender may designate to the Borrower in writing from time to time, in check, coin or currency of the United States which is then legal tender for the payment of public or private debts, in immediately available funds, the lesser of (a) the principal amount of Fifteen Million (\$15,000,000.00) Dollars; or (b) the aggregate unpaid principal amount of all loans (or Advances) made by the Lender to the Borrower from time to time hereunder (collectively the "Loans", or if used in the singular, the "Loan").

The Borrower agrees that each monthly or other statement of account mailed or delivered by the Lender to the Borrower pertaining to the outstanding balance of the Loans, the amount of interest due thereon, fees, and costs and expenses shall be final, conclusive, and binding on the Borrower and shall constitute an "account stated" with respect to the matters contained therein unless, within thirty (30) calendar days from when such statement is mailed or, if not mailed, delivered to the Borrower, the Borrower shall deliver to the Lender written notice of any objections which it may have as to such statement of account, and in such event, only the items to which objection is expressly made in such notice shall be considered to be disputed by the Borrower.

No legal proceedings or actions shall be brought by the Borrower against the Lender claiming any such error unless (a) the Borrower

shall have given the written notice as provided hereinabove, and (b) such legal proceeding or action shall be commenced within one (1) year of the date when such statement of account, notice or advice was delivered or mailed to the Borrower.

The Borrower also shall pay, in lawful money of the United States, and in immediately available funds, interest to the Lender on the unpaid principal balance of all Loans outstanding from time to time from the date hereof until fully paid at a rate per annum equal to at the election of Borrower the Libor Rate Option or the Variable Rate Option, subject to the provisions contained in the Loan Agreement and all as more specifically described in the Loan Agreement. All payments shall be credited, when collected, first to interest and then to principal.

Interest Rate and Interest Period selection shall be governed by the provisions contained in the Loan Agreement. All written notices of Interest Rate and/or Interest Period selection shall be in the form annexed hereto as Exhibit A, attached hereto and incorporated herein by this reference.

A late payment premium equal to five (5%) percent of any principal or interest payment made more than ten (10) days after the due date thereof shall be due with any such late payment (other than the final payment due on the Maturity Date).

This Note is executed and delivered pursuant to the Loan Agreement, all of the covenants, conditions and agreements of the Loan Agreement being made a part hereof by this reference. This Note also is secured by the Collateral of the Borrower described in the Loan Agreement, and the pledged collateral described in certain pledge agreements dated of even date hereof, and the collateral of the domestic Consolidated Subsidiaries described in the general security agreements executed and delivered to the Lender by each of the domestic Consolidated Subsidiaries on even date hereof, and the Lender is entitled to the benefits of all of the collateral described therein and the collateral described in the other Transaction Documents.

This Revolving Credit Note is the Note # 2 referred to in the Loan Agreement, and the Lender shall be entitled to the benefit of all of the provisions contained therein and in the other Transaction Documents. The Loan Agreement, among other things, contains provisions for payment of principal, interest, fees and charges in connection with the Revolving Credit Facility as well as provisions for acceleration of this Note upon the happening of certain stated events. The Loan Agreement also contains representations, warranties, covenants and conditions precedent to Advances under the Revolving Credit Facility, all of which are hereby made part of this Revolving Credit Note to the same extent and with the same effect as if set forth herein at length.

It is expressly agreed that, upon the failure of the Borrower timely to make any payment due hereunder, or upon the happening of any "Event of Default" under the Loan Agreement and/or the other Transaction Documents, the principal sum hereof, together with accrued interest and all other expenses, including, but not limited to reasonable attorneys' fees for legal services incurred by the Lender in connection with the collection of this Note and/or the enforcement of payment hereof whether or not suit is brought, and if suit is brought, then through all appellate actions, shall immediately become due and payable at the option of the Lender, notwithstanding the Termination Date set forth herein. In the Event of Default, whether the Lender exercises any of its rights and remedies contained herein, including the right to declare all Indebtedness hereunder to be immediately due and payable, the Borrower shall pay interest on the unpaid principal balance hereunder at a rate equal to the Default Rate. The unpaid principal balance under the Note shall bear the Default Rate of Interest until the first to occur of the following: (i) all Indebtedness under this Note are paid in full; (ii) Borrower has cured said Event of Default to the satisfaction of the Lender; or (iii) the Lender, in writing, has waived said Event of Default. Notwithstanding anything to the contrary contained in this Note, the Note is subject to the express condition that at no time shall Borrower be obligated to be required to pay interest on the principal balance of this Note at a rate which could subject the Lender either to civil or criminal penalty as a result of being in excess of the maximum rate which Borrower is permitted by law to contract or agree to pay. If by the terms of this Note, Borrower at any time are required or obligated to pay interest on the principal balance of this Note at a rate in excess of such maximum rate then the rate of interest under this Note shall be deemed to be immediately reduced to such maximum rate and interest payable hereunder shall be computed at such maximum rate and any prior interest payments made in excess of such maximum rate shall be applied and shall be deemed to have been payments made in reduction of the principal balance of such note.

The indebtedness evidenced by this Note shall be prepayable, in whole or in part, subject to the provisions contained in the Loan Agreement.

Should the indebtedness represented by this Note or any part thereof be collected at law or in equity, or in bankruptcy, receivership or any other court proceedings (whether at the trial or appellate level), or should this Note be placed in the hands of attorneys for collection upon an Event of Default, the Borrower agrees to pay, in addition to the principal, premium, breakage costs, and interest due and payable hereon, all costs of collection or attempting to collect this Note, including reasonable attorneys' fees and expenses.

The Borrower hereby waives valuation and appraisal, demand, presentment for payment, notice of dishonor, protest and notice of protest of this Note.

Any notice, demand or request relating to any matter set forth herein shall be in writing and shall be deemed effective when mailed, postage prepaid, by registered or certified mail, return receipt requested, to any party hereto at its address stated herein or at such other address of which it shall have notified the party giving such notice in writing as aforesaid.

This Note, being drawn, executed and delivered in the State of New York, where all advances and repayments shall be made, shall be construed and enforced in accordance with the laws of the State of New York.

This Note may not be changed or terminated orally, but only by an agreement in writing signed by the party against whom enforcement of any waiver, change, modification or discharge is sought.

All capitalized terms used herein not specifically defined shall have the meanings assigned to such terms in the Loan Agreement.

THE BORROWER AND THE LENDER AGREE THAT ANY LITIGATION GROWING OUT OF ANY CONTROVERSY WITH RESPECT TO, IN CONNECTION WITH OR ARISING OUT OF THIS NOTE OR ANY INSTRUMENT OR DOCUMENT DELIVERED PURSUANT HERETO WILL BE TRIED BY A COURT BY A JUDGE SITTING WITHOUT A JURY. IN ADDITION, THE BORROWER WAIVES THE RIGHT TO INTERPOSE ANY DEFENSE BASED UPON ANY STATUTE OF LIMITATIONS OR ANY CLAIM OF LACHES AND ANY SET-OFF OR COUNTERCLAIM EXCEPT FOR COMPULSORY COUNTERCLAIMS OF ANY NATURE OR DESCRIPTION, EXCEPT FOR PAYMENT, PROVIDED BORROWER MAY INSTITUTE A SEPARATE CAUSE OF ACTION AS TO SUCH MATTERS. THE BORROWER AND THE LENDER CONFIRM THAT THE FOREGOING WAIVERS ARE INFORMED AND FREELY MADE.

IN WITNESS WHEREOF, the Borrower has duly executed this Note as of the Date of Note.

NAPCO SECURITY SYSTEMS, INC.

BY: /s/ _____
KEVIN BUCHEL
SENIOR VICE PRESIDENT

with offices at 333 Bayview Avenue
Amityville, New York 11701

STATE OF NEW YORK)
) SS:
COUNTY OF NASSAU)

On this 12th day of May, 1997, before me personally came Kevin Buchel, to me known, who being by me duly sworn, did depose and say that he resides at _____, that he is the Senior Vice President of NAPCO Security Systems, Inc., the corporation described in and which executed the foregoing instrument; that he signed his name thereto by order of the Board of Directors of said corporation.

/s/ _____
NOTARY PUBLIC

EXHIBIT "A"

REQUEST FOR ADVANCE AND
NOTICE OF INTEREST RATE SELECTION

TO: MARINE MIDLAND BANK
534 Broad Hollow Road
Melville, New York 11747
Attention: John S. Wamboldt
Fax No.: (516) 752-4340

This Request for Advance Notice of Interest Rate Selection is governed by the terms of the Loan and Security Agreement dated May 12, 1997 made by and between NAPCO Security Systems, Inc. ("Debtor") and MARINE MIDLAND BANK ("Secured Party") (the "Agreement").

The undersigned hereby GIVES THE SECURED PARTY IRREVOCABLE NOTICE that Debtor requests the following Interest Rate under the Agreement as follows:

1. Rate Option and Interest Period. The requested Interest Rate option and Interest Rate Period for the requested amount is ((a) or (b), checked as applicable):

☐ (a) The Libor Rate Option for an Interest Period of (one checked as applicable):

- ☐ one month;
- ☐ two months; or
- ☐ three months; or
- ☐ four months; or
- ☐ six months; or
- ☐ nine months; or
- ☐ twelve months; or

☐ (b) The Variable Rate Option.

2. The Interest Rate shall be in effect for a requested Advance equalling \$_____.

Dated: _____, 1997

NAPCO Security Systems, Inc.

By:

Kevin Buchel
Senior Vice President

PROMISSORY NOTE

Dated: May 12, 1997

ON DEMAND, FOR VALUE RECEIVED, the undersigned, NAPCO Security Systems, Inc. (the "Company"), a corporation formed under the laws of the State of Delaware, having its principal office located at 333 Bayview Avenue, Amityville, New York 11701, hereby promises to pay to the order of MARINE MIDLAND BANK (the "Bank") at its office at 534 Broad Hollow Road, Melville, New York 11747, or at such other place as the holder of this Promissory Note may from time to time designate in writing, in lawful money of the United States and in immediately available funds, the principal sum of TWO MILLION FIVE HUNDRED THOUSAND AND 00/100 (\$2,500,000) DOLLARS, or so much as may be drawn on the Letter of Credit (as defined in the Reimbursement Agreement [hereinafter defined]) and such other amounts as may be owed to the Bank pursuant to the Loan Documents (as defined in the Reimbursement Agreement) including, but not limited to, the Bank's reasonable attorney's fees upon the occurrence of an Event of Default under the Reimbursement Agreement together with interest on the principal amount remaining unpaid hereunder from time to time from the date of any draw on the Letter of Credit until such principal amount has been paid in full. Any amount owed the Bank pursuant to this Promissory Note shall bear interest at a rate per annum equal to the Prime Rate plus three (3%) percent per annum in accordance with the terms herein and as set forth in the Reimbursement Agreement.

The interest rate shall be adjusted, without notice, as of the effective date of any change in the Prime Rate and shall be computed hereunder on the basis of a 360 day year for the actual number of days elapsed. "Prime Rate" shall mean that floating rate of interest per annum announced by the Bank from time to time as being the Bank's prime rate, which is a base for calculating interest on certain loans.

In no event shall the interest rate and charges herein or in the Reimbursement Agreement or other Loan Documents, exceed the highest rate permissible under any law which a court of competent jurisdiction shall, in a final determination, deem applicable hereto. In the event that a court determines that the Bank has received interest and other charges in excess of the highest rate applicable hereto, such excess shall be deemed received on account of, and shall automatically be applied to reduce the obligations arising under or in connection with this Promissory Note other than interest, and the provisions hereof shall be deemed amended to provide for the highest permissible rate. If there is no indebtedness outstanding, the Bank shall refund such excess to the Borrower.

Capitalized words and phrases not otherwise defined herein shall have the meanings ascribed to such terms in the standby letter of credit application and reimbursement agreement by and between the Company and the Bank dated as of May 12, 1997 (the "Reimbursement Agreement").

Notwithstanding the foregoing, this Promissory Note is also intended to evidence the Letter of Credit fees, commissions and expenses of the Company to the Bank and any and all charges and expenses which the Bank may pay or incur relative to the draw on the Letter of Credit.

This Promissory Note is the Promissory Note (or Note) referred to in the Reimbursement Agreement and shall be entitled to the benefit of all security granted in the Loan Documents and all benefits thereof. The Loan Documents, among other things, contain provisions for payment of fees, charges and expenses and regarding the remedies of the Bank upon the occurrence of an Event of Default. The Loan Documents also contain representations, warranties, covenants and conditions, all of which are hereby made part of this Promissory Note to the same extent and with the same effect as if set forth herein at length. Without limiting the foregoing, this Promissory Note is secured by and the parties hereto are entitled to the benefits of that certain mortgage and security agreement, dated of even date herewith (the "Mortgage"), made by the Company to the Bank, encumbering, among other things, certain real property and improvements now or hereafter located on said real property, situate at 359 Bayview Avenue, a\k\ 333 Bayview Avenue, Amityville, New York 11701 in the Town of Babylon, County of Suffolk, State of New York, as more particularly described in the Mortgage ("Mortgaged Premises" or "Mortgaged Property"), and is executed and delivered pursuant to the Reimbursement Agreement, all of the covenants, conditions and agreements of the Mortgage and the Reimbursement Agreement being made a part hereof by this reference.

The holder of this Promissory Note at its option may extend the time for payment of this Promissory Note, postpone the enforcement hereof, or grant any other indulgences, without affecting or diminishing the holder's right to recourse against the Company or any endorsers, sureties or guarantors, which right is expressly reserved.

The Company and any endorsers, sureties and guarantors of this Promissory Note waive presentment for payment, demand, protest, notice of protest and notice of dishonor hereof, and, except as expressly set forth in the other Bank Documents, all other notices to which they may be entitled.

The terms and provisions hereof shall inure to the benefit of the Bank, and its successors and assigns and shall be binding upon the respective successors and assigns of the Company.

In the event the Bank, for any reason whatsoever, shall deem it necessary to refer this Promissory Note to an attorney for the enforcement thereof or any rights thereunder, by suit or

otherwise or for the protection or preservation of any rights hereunder, there shall be due and owing reasonable attorneys' fees, together with all costs and expenses of any such action, and the Bank may take judgment for all such amounts.

This Promissory Note and the rights and obligations of the parties hereunder shall be governed and construed in accordance with the laws of the State of New York.

The Company agrees that any action or proceeding to enforce this Promissory Note or arising out of or related to this Promissory Note may be commenced in any State court of competent jurisdiction in Nassau, Suffolk or Kings County, New York, or in the United States District Court for the Eastern District of New York, and the Company consents and submits in advance to such jurisdiction and agrees that venue shall be proper in such courts on any such matter.

The Company acknowledges that this Promissory Note is and shall be effective upon its execution by the Company and delivery hereof to the Bank and it shall not be necessary for the Bank to execute any acceptance hereto or to otherwise signify or express its acceptance hereof.

THE COMPANY AGREES THAT ANY LITIGATION GROWING OUT OF ANY CONTROVERSY WITH RESPECT TO, IN CONNECTION WITH OR ARISING OUT OF THIS PROMISSORY NOTE, THE AGREEMENT OR ANY INSTRUMENT OR DOCUMENT DELIVERED PURSUANT HERETO AND THERETO WILL BE TRIED BY A COURT BY A JUDGE SITTING WITHOUT A JURY. THE COMPANY CONFIRMS THAT THE FOREGOING WAIVER OF A TRIAL BY JURY IS INFORMED AND FREELY MADE.

IN WITNESS WHEREOF, the Company has caused this Promissory Note to be executed by it by its officer on the date first written above.

NAPCO Security Systems, Inc.

By: /s/

Kevin Buchel
Senior Vice President

EXHIBIT 11

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

COMPUTATION OF EARNINGS PER SHARE

	1997 ----	1996 ----	1995 ----	1994 ----	1993 ----
Weighted average number of shares outstanding	4,368,727	4,367,727	4,367,727	4,367,577	4,366,827
Add common stock equivalents	14,222 -----	5,396 -----	21,904 -----	27,053 -----	39,077 -----
Adjusted weighted average shares outstanding	4,382,949 =====	4,373,123 =====	4,389,631 =====	4,394,630 =====	4,405,904 =====
Net Income:	\$1,639,000 =====	\$1,014,000 =====	\$512,000 =====	\$1,254,000 =====	\$2,317,000 =====
Earnings per share: primary and fully diluted:	\$.37 =====	\$.23 =====	\$.12 =====	\$.29 =====	\$.53 =====

Earnings per common and common equivalent shares are based upon the weighted average number of shares of common stock and common stock equivalents outstanding during the respective periods. Stock options have been considered to be the equivalent of common stock. Shares issuable upon exercise of stock options, to the extent appropriate, have been added to the average common shares actually outstanding for purposes of this computation, and shares assumed to be purchased at the average market price during the respective periods, with proceeds from the exercise of such options, have been deducted from the average shares outstanding.

NAPCO SECURITY SYSTEMS, INC. AND SUBSIDIARIES

COMPUTATION OF RATIOS

	1997 ----	1996 ----	1995 ----
	(In thousands, except for ratios)		
A. Current Assets	\$42,021	\$41,529	\$39,916
B. Current Liabilities	11,885	12,853	11,256
Current Ratio (Line A / Line B)	3.5 to 1	3.2 to 1	3.5 to 1
C. Net Sales	\$53,302	\$49,088	\$48,078
D. Receivables	13,937	13,759	13,647
Ratio (Line C / Line D)	3.8 to 1	3.6 to 1	3.5 to 1
E. Total Current Liabilities	\$11,885	\$12,853	\$11,256
F. Long Term Debt	13,313	14,150	15,275
G. Deferred Income Taxes	828	742	648
H. Total Liabilities	26,026	27,745	27,179
I. Equity	31,218	29,574	28,560
Ratio (Line H / Line I)	.8 to 1	.9 to 1	1 to 1

SUBSIDIARIES OF THE COMPANY

The following are the Company's subsidiaries as of the close of the fiscal year ended June 30, 1997. All beneficial interests are wholly-owned, directly or indirectly, by the Company and are included in the Company's consolidated financial statements.

Name -----	State or Jurisdiction of Organization -----
Alarm Lock Systems, Inc.	Delaware
Derringer Security Systems, Inc.	New York
E.E. Electronic Components Inc.	New York
Napco Security Systems International, Inc.	New York
Napco/Alarm Lock Grupo Internacional, S.A. (formerly known as NSS Caribe, S.A.)	Dominican Republic
Napco Group Europe Limited	England
Raltech Logic, Inc.	New York
UMI Manufacturing Corp.	New York

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report included in this Form 10-K, into the Company's previously filed Registration Statement No. 333-1743 on Form S-8 relating to common stock of Napco Security Systems, Inc. issuable under the 1992 Incentive Stock Option Plan.

/s/ Arthur Andersen LLP

New York, New York
October 10, 1997

YEAR	
JUN-30-1997	
JUL-01-1996	
JUN-30-1997	1,006
	0
	14,742
	805
	25,702
	42,021
	12,088
	10,344
	57,244
11,885	
	13,313
0	
	0
	59
	31,159
57,244	
	53,302
	53,302
	40,524
	9,133
	320
	0
	1,081
	2,244
	605
1,639	
	0
	0
	0
	1,639
	.37
	.37