

TRI-S SECURITY CORP
Form 10-K
March 31, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2004

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

For the transition period from _____ to _____
Commission File Number 0-51148

Tri-S Security Corporation

(Exact Name of Registrant as Specified in Its Charter)

Georgia
*(State or Other Jurisdiction of
Incorporation or Organization)*

30-0016962
*(I.R.S. Employer
Identification No.)*

**3700 Mansell Road
Suite 220
Alpharetta, GA 30022**
(Address of Principal Executive Offices)

(770) 625-4945

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: units (each unit consisting of one share of common stock, par value \$0.001 per share, and a warrant to purchase one share of common stock); common stock, par value \$0.001 per share; and warrants to purchase common stock, par value \$0.001 per share

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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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.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

As of June 30, 2004, there was no public market for the registrant's common equity.

As of March 25, 2005, 3,285,000 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None.

PART I

Note Regarding Forward-Looking Statements

Tri-S Security Corporation, a Georgia corporation (the "Company", "Tri-S" or "we"), has made forward-looking statements in this Annual Report on Form 10-K for the year ended December 31, 2004 (the "Annual Report"), including, without limitation, in the sections herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts. Words such as "believes," "expects," "anticipates," "intends," "seeks," "could," "will," "predicts," "potential," "continue," "may," "plans," "estimates" and similar expressions, or the negative of these and similar expressions, are intended to identify such forward-looking statements.

Examples of forward-looking statements in this Annual Report include statements regarding: the impact of terrorist activity or breach of security on our business; our ability to retain and manage our guards; our plans for expansion and growth of our business; our ability to compete effectively in our industry; our expectations regarding the likelihood of introduction of new regulations that would adversely affect our business; our estimates of our capital requirements and needs for additional financing; risks related to Federal government contracts; Federal government audits and cost adjustments; differences between authorized amounts and amounts received by us under Federal government contracts; changes in Federal government (or other applicable) procurement laws, regulations, policies and budgets; our ability to retain contracts during re-bidding processes; and the other factors that we describe in this Annual Report under the section herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Factors." Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in these forward-looking statements. You should not put undue reliance on any forward-looking statement. You should understand that many important factors, in addition to those discussed in the sections herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business" and elsewhere in this Annual Report, could cause our results to differ materially from those expressed in forward-looking statements.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth in this Annual Report. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of these statements in light of new information or future events.

Item 1. Business

Introduction and History

Through our wholly-owned subsidiary, Paragon Systems, Inc., an Alabama corporation ("Paragon Systems"), we provide contract guard services to various Federal government agencies. We strive to provide cost-effective solutions to ensure the safety and security of the assets and personnel of our customers and to continually improve the protection we provide for their personnel, programs, resources and facilities. Our goal is to provide demonstrably superior contract guard services with the highest degree of integrity and responsiveness.

We were incorporated in Georgia in October 2001 under the name "Diversified Security Corporation." We changed our name to "Tri-S Security Corporation" on August 16, 2004. Our principal executive offices are located at 3700 Mansell Road, Suite 220, Alpharetta, Georgia 30022, and our telephone number at that address is (770) 625-4945.

We were formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. We intend to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We made our first acquisition (the "Acquisition") on February 27, 2004 when we acquired Paragon Systems, a contract guard services and logistics provider. At the closing of the Acquisition, we: (i) paid \$10 million, of which \$2.3 million was paid in cash and \$7.7 million was paid through issuance of promissory notes (referred to herein as the "Paragon Notes") to the former shareholders of Paragon Systems; and (ii) agreed to issue to the former shareholders an aggregate of 100 shares of our Series C Redeemable Preferred Stock, par value \$1.00 per share (the "Series C Redeemable Preferred Stock"), with an aggregate redemption value of \$6.0 million.

On February 8, 2005, pursuant to an Exchange and Recapitalization Agreement between the Company and all the holders of our common stock, par value \$0.001 per share, Series A Convertible Preferred Stock, par value \$1.00 per share (the "Series A Convertible Preferred Stock"), and Series B Convertible Preferred Stock, par value \$1.00 per share (the "Series B Convertible Preferred Stock"), and all holders of rights to acquire our common stock (the "Exchange and Recapitalization Agreement"), we effected an exchange and recapitalization of our outstanding common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock and rights to acquire our common stock. Pursuant to the Exchange and Recapitalization Agreement, all of our outstanding (i) common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock was exchanged for an aggregate of 1,200,000 shares of common stock and (ii) rights to acquire our common stock were exchanged for rights to purchase an aggregate of 113,269 shares of common stock. The transactions effected by the Exchange and Recapitalization agreement are referred to in this Annual Report as the "Exchange and Recapitalization."

On February 9, 2005, we commenced an underwritten initial public offering of 1,800,000 units (plus up to an additional 270,000 units subject to the exercise of the underwriters' over-allotment option), with each unit consisting of one share of our common stock and a warrant to purchase one share of our common stock, at an initial offering price per unit of \$6.00 (the "Initial Public Offering"). In connection with the Initial Public Offering, our units commenced trading on The Nasdaq SmallCap Stock Market under the symbol "TRISU" on February 9, 2005. The Initial Public Offering closed with respect to the initial 1,800,000 units on February 14, 2005 and with respect to the additional 270,000 units on March 17, 2005. We filed a Registration Statement on Form S-1 (No. 333-119737) with the Securities and Exchange Commission (the "SEC") registering pursuant to the Securities Act of 1933, as amended (the "Securities Act"), the securities to be sold in the Initial Public Offering (the "Registration Statement"). The SEC declared the Registration Statement effective on February 8, 2005.

Overview of Our Operations

Prior to the Acquisition, we had no operations. Currently, our operations consist only of the operations of Paragon Systems. Paragon Systems was incorporated in 1987 in Alabama and has provided contract guard services to Federal government agencies since 1994. Initially, Paragon Systems was established as an engineering company to service contracts with the Federal government agencies and with the U.S. Army Missile Command in both space and defense related areas of business. Paragon Systems has participated in high level engineering projects for the U.S. Army, the National Aeronautics and Space Administration ("NASA"), other government agencies and local industry.

While serving as an engineering company, Paragon Systems contracted with Lockheed Martin to furnish assistance in Federal contract administration for Lockheed Martin on a sub-contract for construction at the NASA missile plant located in Iuka, Mississippi. Paragon Systems also provided engineering and technical support for contract cost management to NASA's Orbital Maneuvering Vehicle program, which developed an orbital vehicle that would be carried aloft by the space shuttle and maintained in orbit to perform specific tasks for the International Space Station. Paragon Systems

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also performed a number of high level engineering projects for Control Dynamics Corporation, including conducting preliminary design tasks for development of a heavy launch lift vehicle, which was at that time planned to be a robotic successor for the space shuttle.

In 1994, Paragon Systems applied its engineering expertise and management skills to the security industry. Paragon Systems was awarded its first contract in 1994 to provide security services for the U.S. Army Corps of Engineers. Since such time, Paragon Systems has obtained contracts with various other Federal government agencies and has provided high-level, expert security services. Paragon Systems has, through the utilization of its systems engineering skills, developed contract guard security services as its core business. Paragon Systems no longer provides engineering services.

In 1991, Paragon Systems applied to be certified as a small and disadvantaged business (an "8(a) firm") by the U.S. Small Business Administration (the "SBA"). In 1993, Paragon Systems was certified as an 8(a) firm and, in 1994, was awarded its first guard contract to provide security guard services for the U.S. Army Corps of Engineers. Since such time, Paragon Systems has obtained contracts with various other Federal government agencies and has developed contract guard security services as its core business. Paragon Systems' certification as an 8(a) firm expired in September 2002, and its revenues from its security guard service business have grown to a level which makes it ineligible to qualify once again for certification as an 8(a) firm. Paragon Systems is now expanding its security guard service business by bidding on larger contracts than it was first awarded when certified as an 8(a) firm.

Through Paragon Systems, we employ over 700 persons in the course of providing contract guard services and maintain field offices located in Birmingham, Alabama, Mobile, Alabama, Montgomery, Alabama; Louisville, Kentucky; Baltimore, Maryland; Glynco, Georgia; Stennis Space Center, in Vicksburg, Mississippi; and Gulfport, Mississippi. At our offices in Huntsville, Alabama we maintain a full support staff to support all field operations, including human resources, accounting, payroll, quality control, logistics, computer services, training, and other supporting functions as needed.

In addition to our core business of providing contract guard services, we have two non-core business interests relating to logistics services. First, in 2000, Paragon Systems entered into a contract to provide logistics services by developing and executing plans for improved logistics systems in support of U.S. Army facilities located at Fort Bliss, Texas and Fort Sill, Oklahoma. This contract will expire in September 2005, and we have not determined whether we will pursue any additional logistics contracts. Second, through Paragon Systems, we own a 10% equity interest in Army Fleet Support, LLC ("Army Fleet Support" or the "joint venture"), which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama. As a minority equity holder, we do not participate in the management of, or have any operational authority with respect to, Army Fleet Support.

We currently have a total of ten customers and thirteen Federal government contracts. We provide contract guard services for eight of our customers and logistics services for the other two customers. Three of our contract guard customers have two contracts with us. The following table sets forth the number of our Federal government contracts during the time periods and in the revenue ranges indicated:

Annual Revenues	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
Less than \$1.0 Million per Contract	5	5	7
\$1.0 to \$2.0 Million per Contract	3	6	4
\$2.0 to \$3.0 Million per Contract	0	0	1
Greater than \$3.0 Million per Contract	5	4	1

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The Security Industry

The security industry encompasses a variety of high-tech and low-tech products and services. The service segment of the security industry includes contract guard services, armored car services, executive protection, fire suppression, alarm monitoring, closed circuit television ("CCTV"), access control, biometric, home automation and system integration services.

The global security industry has grown largely due to an increasing fear of crime and terrorism. In the United States, the demand for security related products and central station monitoring services also has grown steadily. We believe that there is continued heightened attention to and demand for security due to the events of September 11, 2001 and the ensuing threat, or perceived threat, of criminal and terrorist activities.

Despite the size and prospects for growth of the services segment of the security industry, the services segment, including the contract guard services and system integration services, remains highly fragmented. This high degree of fragmentation in the security industry makes it a prime candidate for future consolidation.

Contract Guard Service

The contract guard services segment of the security industry includes security and patrol services, as well as various types of investigation services, including background, undercover, insurance claims and financial fraud.

Contract guard services are provided under contracts in which the guard company agrees to recruit, hire, train, supervise, schedule and pay security guards deployed to certain specified sites, as well as to provide firearms, uniforms and equipment. Typical functions for security guards include patrolling the premises, checking identification for access control, staffing a security control center, monitoring activities on CCTV and responding to emergency requests for assistance.

Contract guard services are customarily charged to the customer at an hourly or monthly rate (which can be fixed or variable). A contract guard company's profit is based on the "spread" of the hourly or monthly rate over the cost of the guard.

Demand for guard services is dependent upon a number of factors, including demographic trends, general economic variables such as growth in the gross domestic product, unemployment rates, consumer spending levels, perceived and actual crime rates, government legislation and technology.

Although we currently provide contract guard services only to Federal government agencies, the contract guard services segment of the security industry also includes state government and private sectors, with customer sites including residential and office buildings, wholesale and retail businesses, warehouses, industrial facilities, hospitals and all state-run properties and facilities. The Federal government, state government and private sectors present diverse operating environments and unique challenges for contract guard service providers operating in such sectors. We intend to expand our operations in the Federal government sector and introduce operations in the state government and private sectors.

The Federal government awards substantially all contracts for contract guard services through a competitive bidding process; however, certain agencies permit negotiated contracting through the U.S. General Services Administration ("the "GSA"). Contracts awarded through a competitive bidding process generally have lower profit margins than negotiated contracts because in a competitive bidding process bidders compete predominantly on price. The Federal government is the largest procurer of products and services in the world, and the Federal contract market provides significant business opportunities for contract guard service providers approved to contract for the Federal government. Contracting with the Federal government, however, poses certain risks including that the Federal

government may terminate the contract at its discretion, that funds to pay awarded contracts may not be appropriated by Congress, and that service providers to the Federal government may not be able to comply with complex procurement laws.

The private sector enterprises, however, generally do not obtain contract guard services through a competitive bid process, but privately negotiate contracts for such services, resulting in contracts with higher profit margins because price is not always the primary basis for competition for such contracts. The private sector provides an opportunity for contract guard service providers to grow through acquisitions.

Security System Integration

The term "integrated systems" refers to security systems which combine the features of security products like CCTV and intrusion control. The critical concept in system integration is that the components of the system communicate with one another in order to improve system performance. This communication among system components is accomplished through the use of specialized software. The most highly complex integrated systems utilize a common database, which is often managed and maintained by the systems integrator. Because of their complexity and reliance on software, integrated systems require a higher degree of proficiency than ordinary add-on type systems like CCTV or access control.

We currently do not operate in the system integration segment of the security industry; however, we intend to expand our business by selectively pursuing acquisition opportunities in this segment. We intend to target for acquisition existing organizations with established reputations for quality customer service. We will seek to identify and acquire organizations offering customized, integrated systems in the high-end commercial and high-end residential electronic security markets.

We believe that offering system integration services will complement, and create synergies with, the contract guard services we currently offer. In the course of providing contract guard services under our current Federal government contracts, for example, our security guards monitor and operate integrated systems sold and installed by providers of integrated systems. If we are able to sell integrated systems to our clients and install such systems for our clients, in addition to monitoring and operating such systems, then we will be able to offer products and services which complement our contract guard services. We also believe that offering system integration products and services will increase our profitability because contracts for system integration products and services generally have higher profit margins than contracts for guard services and the system integration segment is anticipated to grow more rapidly than the contract guard segment.

Our Strategy

Operations

Our objective is to increase our revenues, profitability and market position and that of the businesses we may acquire in the future, while maintaining the highest level of service to our customers. The key elements of our operations strategy include the following:

managing personnel costs by minimizing turnover through effective recruitment, training and supervision of guards;

retaining existing customers and engaging new customers by servicing clients with the highest degree of integrity and responsiveness;

developing cost-effective solutions for the security needs of our customers; and

capitalize on the growing trend among businesses and Federal government agencies to outsource non-core functions such as security officer services.

Federal Government Contracts

The majority of our current contracts for contract guard services were awarded by the Federal government through a competitive bid process. We intend to grow our business by obtaining new Federal government contracts through the competitive bidding process and providing additional services under our current Federal government contracts and by negotiated contracts. In March 2005, we engaged Proposal Solutions, Inc., a consulting firm located in the Washington, D.C. area, to assist us in preparing contract bids for contract guard services. We believe this consulting firm will provide valuable assistance to us in preparing our bids.

We intend to hire a full-time employee to provide business development and marketing services for the Company. This person's job responsibilities will focus on identifying new contract opportunities with Federal government agencies and preparing and submitting bids for such contracts.

We intend to bid on Federal government contracts for contract guard services valued between an aggregate of \$500,000 and \$50 million over a five-year period. Our ability to bid on larger contracts is constrained because we do not currently have sufficient capital to cover the substantial start-up costs we would incur if awarded a significant number of contracts with higher values.

Acquisitions

We intend to develop and expand our business by selectively pursuing acquisition opportunities in the contract guard services and system integration services segments of the security industry. We intend to target for acquisition existing companies with established reputations for quality customer service.

In the system integration market, we seek to identify and acquire organizations offering customized, integrated systems in the high-end commercial and high-end residential electronic security markets.

In the contract guard services market, we seek to acquire organizations which provide contract guard services to Federal government agencies and to the private sector. We are specifically looking to acquire larger organizations which provide contract guard services to Federal government agencies pursuant to negotiated contracts or which otherwise have contracts with higher profit margins. We are also looking to acquire organizations which provide contract guard services to the private sector, including residential and commercial facilities, and which have contracts with higher profit margins than our current Federal government contracts. Although we intend our initial acquisition activities to be concentrated in the Southeast, Midwest and Atlantic coastal portions of the United States, we have not placed any geographic restrictions on our future acquisition strategy. We believe we will have significantly more acquisition possibilities in the private sector than in the Federal government sector.

We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

Because the security industry is still very highly fragmented, we believe there will be no lack of opportunities for acquiring the type of companies that are the focus of our planned acquisition efforts. Both industry segments are marked by concentration by several of the well known larger providers of security services, such as Tyco International Ltd. on the electronic side of the business and Allied Security, Inc., Securitas Security Services USA and Rentokil Initial plc on the physical security side. While there is concentration among the larger providers, we believe there remains a host of quality, sizable regional and local providers that are available for acquisition.

Our Contract Guard Services Operations

Through Paragon Systems, we provide contract guard services to various Federal government agencies. Our contract guard services include providing uniformed and armed guards for access control, plant security, personnel security, theft prevention, surveillance, vehicular and foot patrol, crowd control and the prevention of sabotage, terrorist and criminal activities. We provide guards and other personnel who are, depending on the particular requirements of the customer, uniformed or plain-clothed, armed or unarmed, and who patrol in marked radio cars or stand duty on the premises at stationary posts. Our guards maintain contact with headquarters or supervisors via car radio or hand-held radios. In addition, our guards respond to emergency situations and report to appropriate authorities for fires, natural disasters, work accidents and medical crises.

In connection with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training and supervising the guards deployed to the Federal agencies we serve, as well as paying all guards and providing them with firearms, uniforms, fringe benefits, workers' compensation insurance and any required bonding. We are responsible for preventing the interruption of guard services as a consequence of illness, vacations or resignations.

We strive to provide cost-effective solutions to ensure the safety and security of the assets of our customers and to continually improve the protection we provide for their personnel, programs, resources and facilities. Our goal is to provide demonstrably superior contract guard services with the highest degree of integrity and responsiveness.

Our Logistics Contracts

In 2000, Paragon Systems entered into a contract to provide logistics services by developing and executing plans for improved logistics systems in support of U.S. Army facilities located at Fort Bliss, Texas and Fort Sill, Oklahoma. Pursuant to this contract, Paragon Systems provides expertise in support of the U.S. Army's Velocity Management initiatives, known as the Logistics Centers of Excellence ("LCOE") programs, by developing and executing plans for improved logistics systems in terms of readiness and cost reduction. Paragon Systems designs and operates LCOEs at Fort Bliss, Texas and Fort Sill, Oklahoma to support the Army's Material Command weapon programs. Paragon Systems provides the essential and critical interfaces and lines of technical communications between the various U.S. Army Aviation and Missile Command Project Offices, the end user and the weapons prime contractors. This contract, including extensions, expires pursuant to its terms in September 2005, and we have not determined whether we will pursue any additional logistics contracts.

Our Equity Interest in Army Fleet Support, LLC

Through Paragon Systems, we own a 10% equity interest in Army Fleet Support, which provides all logistics support for U.S. Army aviation training at Fort Rucker, Alabama. In providing this support, the joint venture provides personnel, management, material parts, supplies, transportation and equipment to perform aviation unit maintenance, aviation unit intermediate maintenance and approved depot maintenance.

L-3 Communications Integrated Systems and Vertex Aerospace LLC collectively own the majority equity interest in Army Fleet Support. L-3 Communications Integrated Systems provides comprehensive logistics support and services, including extensive rotary-wing aircraft systems integration, modification and maintenance. Vertex Aerospace LLC is an aviation and aerospace technical services company, managing and servicing rotary-wing air craft, as well as other equipment, primarily for government customers.

As a minority equity holder, we do not participate in the management of, or have any operational authority with respect to, Army Fleet Support. None of our management personnel or employees

provides any services to Army Fleet Support. In December 2003, Paragon Systems made an initial capital contribution to Army Fleet Support of \$715,000. Since such time through December 31, 2004, Paragon Systems has received approximately \$2.1 million in cash distributions with respect to its equity interest in Army Fleet Support.

Sales and Marketing

Our sales and marketing approach is designed to focus on Federal government agencies. We market our services through the offices of our subsidiary, Paragon Systems, located in Huntsville, Alabama. Currently, the executive officers of Paragon Systems conduct all of our sales and marketing efforts. We currently do not have a separately designated sales and marketing staff but intend to establish a separate sales and marketing department to identify opportunities in the Federal government and private sectors and to negotiate and bid on Federal government contracts. Our key marketing vehicles are our website, Federal government bulletin board sites on the Internet, word of mouth and customer referrals.

Employees

As of December 31, 2004, we employed approximately 760 individuals, consisting of more than 725 security guards, and 38 managerial and administrative employees. Two of the former shareholders of Paragon Systems served as the President and Executive Vice President of Paragon Systems during 2004 and were responsible for managing substantially all of Paragon Systems' operations relating to the provision of contract guard services. These two individuals were employed by Paragon Systems pursuant to employment agreements which expired in February 2005. We are currently conducting an executive search for a President of Paragon Systems.

Our business is labor intensive and, as a result, is affected by the availability of qualified personnel and the cost of labor. Although the contract guard services industry is characterized by high turnover, we believe our experience compares favorably with that of the industry. We have not experienced any material difficulty in employing suitable numbers of qualified guards, although when labor has been in short supply, we have been required to pay higher wages and incur overtime charges.

We believe that the quality of our guards is essential to our ability to offer effective and reliable service, and we believe diligence in their selection and training produces the level of performance required to maintain customer satisfaction and internal growth. Our policy requires that all selected applicants for a guard position with us undergo a detailed pre-employment interview and a background investigation covering such areas as employment, education, military service, medical history and, subject to applicable state laws and criminal record checks. Personnel are selected based upon physical fitness, maturity, experience, personality, stability and reliability. We treat all employees and applicants for employment without unlawful discrimination as to race, creed, color, national origin, sex, age, disability, marital status or sexual orientation in all employment-related decisions. However, all Federal guard service contracts require that guards be a minimum of 21 years of age.

Our comprehensive training programs for our guards include pre-assignment training, on-the-job assignment training and refresher training. Pre-assignment training explains the duties and powers of a guard, report preparation, emergency procedures, ethics and professionalism, grounds for discharge, general orders, uniforms and personal appearance, and basic post responsibilities. It also includes jurisdiction and legal responsibilities, use of force, arrest authority and procedures, search and seizure procedures, crime scene protection, rules of evidence, hostage situations, bomb threats and incidents, workplace violence, sabotage and espionage, terrorism/anti-terrorism, and weapons of mass destruction. On-the-job assignment training covers specific duties as required by the post and job orders. Ongoing refresher training is given on an annual basis as the need arises as determined by the local area supervisor and manager, or quality control personnel.

Unionized employees account for approximately 60% of our employees and work under collective bargaining agreements with the following unions: the United Union of Security Guards; the Industrial, Technical and Professional Employees Union; and the Security Police and Fire Professionals of America. These collective bargaining agreements do not permit work stoppages, and we have experienced no work stoppages attributable to labor disputes. Our relations with our employees have generally been satisfactory. Guards and other personnel supplied by us to its customers are our employees, even though they may be stationed regularly at the customer's premises.

Insurance

We maintain all appropriate forms of insurance, including comprehensive general liability, performance and crime bonding, professional liability and automobile coverage. Special coverage is sometimes added in response to unique customer requirements. We also maintain compliance with all state workers' compensation laws. A certificate of insurance, which meets individual contract specifications, is made available to every customer.

Generally, our Federal government contracts do not require that we obtain a performance bond; however, one of our current contracts does require a performance bond in the amount equal to 20% of the current year's contract price of \$3.0 million or \$600,000. The fee to obtain this bond is 1% of the bond amount. The bond does not cover losses incurred by our failure to perform due to acts of terrorism.

Customers

Since February 27, 2004, when we acquired Paragon Systems, we have provided our contract guard services to eight customers in eight states. We provide contract guard services for the following Federal government agencies (i) the Department of Homeland Security; (ii) the Social Security Administration; (iii) the Corps of Engineers; (iv) the U.S. Coast Guard; (v) the Federal Law Enforcement Training Center; (vi) the NASA John C. Stennis Space Center; (vii) the U.S. Food and Drug Administration; and (viii) the U.S. Army Armed Forces Retirement Home.

Our typical customer contract may provide for an hourly or monthly billing rate used for all security guards at a site or variable hourly billing rates for different guards. Our contracts are usually multi-year contracts with renewal options. For the twelve months ended December 31, 2004, five contracts represented more than 80% of our revenues.

For the year ended December 31, 2004, our contracts with the Social Security Administration, the Department of Homeland Security, the Federal Law Enforcement Training Center and the Stennis Space Center each accounted for more than 10% of our revenue.

Competition in Contract Guard Services

The contract guard services segment of the security industry is highly competitive but fragmented. Contract guard services generally compete with each other on price and the quality of service provided; the scope of the services performed; name recognition; the extent and quality of the guard supervision, recruiting, selection and training; and the ability to handle multiple worksites nationwide.

We provide contract guard services to Federal government agencies located exclusively in the southeastern United States. On any given contract for which we bid, there are generally five to ten other bidders. We compete primarily on price, the quality of our service and our history of providing contract guard services in the Southeast for over a decade.

Our largest competitors in the contract guard services market include contract security service providers such as Coastal International Security and Wackenhut/Alletug. These competitors are much larger than we are and have significantly greater resources with which to target our markets, including

name recognition. The guard industry also contains a large number of smaller regional and local security service providers in the United States in addition to those listed above which also directly compete with us, including Alpha Protective Services and Security Consultants Group.

We believe that we have highly skilled accounting and cost management personnel and an excellent reputation for providing services to our customers on time and within budget. These competitive advantages contribute to our ability to obtain Federal government contracts through the competitive bidding process. Our primary competitive disadvantage results from our centralized management. Although we maintain field offices at certain contract sites, certain primary support functions for all of our contracts are provided out of our office located in Huntsville, Alabama, which is a competitive disadvantage when we are bidding for contracts against firms willing to establish full-blown support offices at the contract site.

Because of the contract guard services industry's low barriers to entry, other competitors are also likely to enter the industry. Furthermore, traditional guard companies will increasingly compete with the electronics side of the security industry, as customers increase their level of automation and replace guards with more sophisticated electronic hardware.

Government Regulation

We are subject to city, county and state firearm and occupational licensing laws that apply to security guards and private investigators. In addition, many states have laws or regulations requiring training and registration of security guards, regulating the use of badges and uniforms, prescribing the use of identification cards or badges, and imposing minimum bond, surety or insurance standards. We may be subjected to penalties or fines as the result of licensing irregularities or the misconduct of one of our guards from time to time in the ordinary course of our business.

We are also subject to certain Federal regulations, including regulations concerning the use and distribution of firearms. Violations of these regulations may result in criminal penalties. Furthermore, we are subject to Federal laws and regulations relating to the formation, administration and performance of Federal government contracts, including the Federal Acquisition Regulations and supplemental GSA regulations, the Truth in Negotiations Act and the Cost Accounting Standards.

Item 2. Properties

Our corporate headquarters and principal executive offices are located in Alpharetta, Georgia, and our contract guard services operations are located at the offices of our wholly-owned subsidiary, Paragon Systems, in Huntsville, Alabama. We lease space at both locations. We are obligated to pay rent on the Alpharetta, Georgia facility of \$1,930 per month. This lease may be terminated upon 30 days' notice. We are obligated to pay rent on the Huntsville, Alabama facility of \$3,850 per month, plus a share of operating expenses, through October 2005.

We lease two additional facilities in Huntsville, Alabama. We use one these facilities to support our guard services contract with the State of Alabama and to house our quality control department, and we are obligated to pay rent on this facility of \$1,250 per month through October 2005. We use the other facility to support our logistics services business, and we are obligated to pay rent on this facility of \$2,013 per month through November 2005. Paragon Systems also maintains an off-site facility used for office space located in Baltimore, Maryland on which we are obligated to pay rent of \$2,275 through December 2006.

We believe our leased facilities are adequate to meet our needs and that additional facilities are available to us to meet our expansion needs for the foreseeable future on commercially reasonable terms. We have leased our office locations at market rates prevailing at the time the leases for such facilities were executed.

Item 3. Legal Proceedings

Based on currently known facts, we believe there are no claims or litigation pending against us the disposition of which would materially affect our financial position or future operating results, although we cannot be certain as to the ultimate outcome of any such claim or litigation. In addition, exposure to litigation is inherent in our ongoing business and may harm our business in the future.

Item 4. Submission of Matters to a Vote of Security Holders

On October 13, 2004, the Company's shareholders took the following actions by written consent in lieu of a 2004 annual meeting of the Company's shareholders:

- (i) approved and adopted the Company's amended and restated articles of incorporation in the form filed as Exhibit 3.1 to this Annual Report;
- (ii) approved and adopted the Company's amended and restated bylaws in the form filed as Exhibit 3.2 to this Annual Report;
- (iii) approved and adopted the Company's 2004 Stock Incentive Plan in the form filed as Exhibit 10.42 to this Annual Report; and
- (iv) elected James M. Logsdon to serve as a Class I director of the Company, James A. Verbrugge to serve as a Class II director of the Company, and Ronald G. Farrell and Lee K. Toole to each serve as a Class III director of the Company, with each Class I, Class II and Class III director to serve commencing on the completion of the Initial Public Offering and until the date of the annual meeting of the Company's shareholders held in 2005, 2006 and 2007, respectively, and until such director's successor has been duly elected and qualified or until such director's earlier death, resignation or removal.

The actions of the Company's shareholders taken by written consent on October 13, 2004 were taken by shareholders holding 2,500,000 shares of common stock, which constituted a majority of the outstanding shares of common stock entitled to take such actions.

On January 22, 2005, the Company held its 2005 annual meeting of shareholders (the "Meeting") at which the Company's shareholders took the following actions to adjust the terms of office of the directors of the Company as approved by the Company's shareholders on October 13, 2004:

- (i) elected Mr. Logsdon to serve as a Class I director of the Company, commencing upon the date on which the Registration Statement is declared effective by the SEC and until the date of the Company's 2006 annual meeting of shareholders and until his successor is elected and qualified or until his earlier death, resignation or removal;
- (ii) elected Dr. Verbrugge to serve as a Class II director of the Company, commencing upon the date on which the Registration Statement is declared effective by the SEC and until the date of the Company's 2007 annual meeting of shareholders and until his successor is elected and qualified or until his earlier death, resignation or removal; and
- (iii) elected each of Messrs. Farrell and Toole to serve as a Class III director of the Company, commencing upon the date on which the Registration Statement is declared effective by the SEC and until the date of the Company's 2008 annual meeting of shareholders and until their successors are elected and qualified or until their earlier death, resignation or removal.

The election of each of the directors at the Meeting received the approval of shareholders holding 2,500,000 shares of common stock, which constituted a majority of the outstanding shares of common stock entitled to vote. No votes were withheld or abstained with respect to the

election of directors at the Meeting.

Item 4.5 Executive Officers of the Registrant

Pursuant to General Instruction G (3) of Form 10-K under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the information regarding the Company's executive officers required by Item 401 of Regulation S-K is hereby included in Part I of this Annual Report.

The following table sets forth the name of each executive officer of the Company, the office held by such officer and the age, as of March 25, 2005, of such officer:

Name	Age	Position
Ronald G. Farrell	61	Chairman of the Board, President and Chief Executive Officer of the Company
E. Wayne Stallings	59	Chief Financial Officer of the Company
Carla Cilyok	38	Chief Financial Officer of Paragon Systems

Certain additional information concerning the individuals named above is set forth below:

Ronald G. Farrell is the Company's founder and has served as a director and the President and Chief Executive Officer of the Company since the Company was formed in October 2001. From December 1998 to December 2001, Mr. Farrell served as Chairman of the Board and Chief Executive Officer of Golf Entertainment, Inc. At various times from 1986 through 1998, Mr. Farrell served as Chairman of the Board and Chief Executive Officer of Computer Integration Corporation, Sports Leisure, Inc., Automotive Industries, Inc. and Builders Design, Inc.

E. Wayne Stallings has served as the Company's Chief Financial Officer since October 2004. From 1992 to September 2004, Mr. Stallings served in various executive capacities, including Senior Vice President and Chief Financial Officer, with Wellington Leisure Products, Inc., a manufacturer of rope and outdoor products. In February 2003, Wellington Leisure Products, Inc. filed for protection under Chapter 11 of the United States Bankruptcy Code. Mr. Stallings was Chief Financial Officer of Wellington Leisure Products, Inc. from November 1992 to January 2003. Prior to 1992, Mr. Stallings served in various executive capacities for over 10 years in the United States corporate office of Grand Metropolitan, PLC, a United Kingdom public company.

Carla Cilyok has served as the Chief Financial Officer and controller of Paragon Systems since 1997. Prior to 1997, Ms. Cilyok served as the Business Manager for Paragon Systems.

There are no family relationships among any of our executive officers or directors. Except as disclosed in the section of this Annual Report titled "Executive Compensation Employment Agreements", no arrangement or understanding exists between any executive officer and any other person pursuant to which any executive officer was selected to serve as an executive officer. To the best of our knowledge, (i) there are no material proceedings to which any executive officer of the Company is a party, or has a material interest, adverse to the Company; and (ii) there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions that are material to the evaluation of the ability or integrity of any executive officer during the past five years. Our executive officers of the Company are elected or appointed by our board of directors and hold office until their successors are elected and qualified, or until their death, resignation or removal, subject to the terms of applicable employment agreements.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issue Purchases of Equity Securities

Market for Common Equity

Our units commenced trading on The Nasdaq SmallCap Market under the symbol "TRISU" on February 9, 2005. Prior to February 9, 2005, there was no established public trading market or reported quotations of any nature for our units, common stock or warrants.

The units will cease trading on The Nasdaq SmallCap Market at the market's close on April 8, 2005. Commencing on April 11, 2005, our common stock and warrants will trade separately on The Nasdaq SmallCap Market under the symbols "TRIS" and "TRISW", respectively.

As of March 25, 2005, there were approximately 13 holders of record of our common stock.

We have never declared or paid cash dividends on our common stock. We currently intend to retain any earnings for use in our operations and do not anticipate paying cash dividends on our common stock in the foreseeable future.

Sales of Unregistered Securities

During the year ended December 31, 2004, we issued unregistered securities to a limited number of individuals, as described below. None of these transactions involved any underwriters, underwriting discounts or commissions, or any public offering, and we believe that each transaction was exempt from the registration requirements of the Securities Act by virtue of Section 4(2) thereof and Regulation D promulgated thereunder ("Regulation D"). The recipients of securities in each such transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof. In each instance, the recipients were accredited investors, as that term is defined in Rule 501 of Regulation D. All recipients had adequate access, through their relationships with us, to information about us. Set forth below is a description of the issuances of unregistered securities made by us during the year ended December 31, 2004.

On March 3, 2004, we issued 10,000 shares of Series B Convertible Preferred Stock to Michael Bennett, an accredited investor and a beneficial holder of greater than 5% of our common stock, for a purchase price of \$5.00 per share.

On March 3, 2004, we issued 15,000 shares of common stock to Mr. Bennett in exchange for consulting services rendered by him on our behalf.

On February 27, 2004, we issued an aggregate of 100 shares of our Series C Redeemable Preferred Stock to the former shareholders of Paragon Systems in connection with the Acquisition of Paragon Systems. The shares have an aggregate redemption value of \$6.0 million.

In July 2004, we issued a warrant to purchase 50,000 shares of common stock with an exercise price of \$1.00 per share to BRE LLC in connection with entering into our credit agreement. This warrant was exchanged in the Exchange and Recapitalization for a warrant to purchase 16,181 shares of common stock at an exercise price of \$3.09 per share.

Use of Proceeds of Initial Public Offering

In connection with our Initial Public Offering, on February 8, 2005, the SEC declared effective our Registration Statement (No. 333-119737). Pursuant to the Registration Statement we registered under the Securities Act the sale and issuance of 1,800,000 units, plus an additional 270,000 units underlying the underwriters' over-allotment option. Each unit consists of one share of common stock and one warrant to purchase one share of common stock. The initial public offering price of the units was \$6.00

per unit. The managing underwriters of the offering were Capital Growth Financial, LLC and Bathgate Capital Partners LLC.

Our Initial Public Offering commenced on February 9, 2005. The initial 1,800,000 units were sold to underwriters at a unit price of \$5.52 per unit at the closing of the offering on February 14, 2005. On March 15, 2005, the underwriters exercised their over-allotment option to purchase the additional 270,000 units. The additional 270,000 units were sold to the underwriters at a unit price of \$5.52 per unit at the closing of the over-allotment option on March 17, 2005. All of the units were sold by us. There were no selling shareholders in the offering.

The aggregate gross proceeds from the units sold, including the units sold pursuant to the exercise of the underwriters' over-allotment option, were approximately \$12.4 million. The aggregate net proceeds to us were approximately \$10.3 million after deducting approximately \$2.1 million in underwriting discounts and commissions, offering expenses and consulting fees.

We used approximately \$8.1 million of the net proceeds in repayment of the Paragon Notes, \$300,000 in payment of accrued interest due on our Series C Redeemable Preferred Stock and \$1.1 million for working capital needs.

Item 6. Selected Financial Data

We did not have an operating business before our acquisition of Paragon Systems. The financial statements of Paragon Systems, as an operating entity, provide the more relevant information available for time periods prior to the Acquisition. Consequently, the selected financial data set forth below presents the selected financial data of Paragon Systems prior to the Acquisition and the consolidated selected financial data of the Company for the year ended December 31, 2004, which includes the operations of Paragon Systems after the Acquisition. The historical results are not necessarily indicative of future results.

Basic income (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period after giving effect to the Exchange and Recapitalization. Diluted earnings per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Paragon Systems was formerly a subchapter S corporation and, consequently, pro forma income tax expense, pro forma net income and pro forma income per share are presented on the face of the summary of selected financial data for the periods presented prior to February 27, 2004. The necessary adjustments include only taxes at a statutory rate of 38% for each period presented. The pro forma income per share calculation of operations prior to February 27, 2004 is based on the weighted average number of common shares outstanding of Tri-S.

Tri-S was incorporated during the fourth quarter of 2001. For purposes of calculating the weighted average shares outstanding for the pro forma income per share calculation for periods prior to the Acquisition, it is assumed that the Company was incorporated on January 1, 2000.

The operations of Tri-S prior to February 27, 2004 consisted primarily of expenditures relating to the identification and pursuit of acquisition opportunities. For 2003, 2002 and 2001, such expenditures amounted to \$347,000, \$216,000 and \$100,000, respectively. Tri-S recognized deferred income tax benefits on these expenditures of \$130,000, \$80,000 and \$40,000 for 2003, 2002 and 2001, respectively. The loss per share (basic and diluted) for Tri-S for 2003, 2002 and 2001 was \$0.26, \$0.16 and \$0.08, respectively.

The selected financial data should be read in conjunction with our consolidated financial statements, related notes and other financial information set forth in Item 15 hereof, and

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"Management's Discussion and Analysis of Financial Condition and Results of Operations," set forth in Item 7 hereof.

Selected Financial Data	Paragon Systems, Inc.					
	Tri-S Security Corporation and Subsidiary Consolidated	Jan. 1, 2004 to Feb. 27, 2004	2003	2002	2001	2000
	2004					
(In thousands, except per share data)						
Statement of Operations Data:						
Revenues	\$ 25,425	\$ 4,705	\$ 29,395	\$ 21,364	\$ 16,491	\$ 7,698
Direct labor	13,810	2,481	16,070	11,983	9,092	3,076
% of revenues	54.32%	52.73%	54.67%	56.09%	55.13%	39.96%
Indirect labor and other contract support costs	10,223	2,113	11,151	7,615	6,000	3,417
% of revenues	40.21%	44.91%	37.94%	35.64%	36.38%	44.39%
Amortization of government contracts	298					
% of revenues	1.17%					
Gross profit	1,094	111	2,174	1,766	1,399	1,205
% of revenues	4.30%	2.36%	7.40%	8.27%	8.48%	15.65%
Selling, general and administrative expenses	2,115	230	1,466	1,179	896	652
% of revenues	8.32%	4.89%	4.99%	5.52%	5.43%	8.47%
Amortization expense	462					
Operating income (loss)	(1,021)	(119)	708	587	503	553
% of revenues	-4.02%	-2.53%	2.41%	2.74%	3.05%	7.18%
Depreciation expense	155	28	175	68	88	62
Interest income	3		12	23	28	
Interest expense	(1,380)	(11)	(30)	(7)	(11)	(14)
Interest on redeemable preferred stock	(250)					
Income (loss) before income taxes	(2,648)	(130)	690	603	520	539
Income tax expense (benefit)	(1,008)					
Pro forma income tax expense (benefit)		(49)	262	229	198	205
Net income (loss)	(1,640)					
Pro forma net income (loss)		(81)	428	374	322	334
Basic net income (loss) per common share	(1.98)					
Pro forma basic net income (loss) per common share		(0.10)	0.52	0.46	0.40	0.41
Diluted net income (loss) per common share	(1.98)					
Pro forma diluted net income (loss) per common share		(0.10)	0.39	0.40	0.40	0.41
Balance Sheet Data (at Period End):						
Cash	\$ 313	\$ 275	\$ 846	\$ 877	\$ 647	\$ 239
Current assets	6,636	6,803	5,713	5,911	5,003	3,005
Total assets	22,981	7,230	6,883	6,114	5,147	3,201
Long term obligations	9,822	175	185			
Total liabilities	24,262	3,720	3,243	3,124	2,760	1,207
Cash dividends						

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The results of operations set forth below are presented on a historical basis for the Company. Historical amounts for the years ended December 31, 2004, 2003 and 2002, are derived from audited financial statements for Paragon Systems and Tri-S and represent the mathematical addition of the results of operations for Paragon Systems and Tri-S for such years. The results of operations set forth below include the administrative expenses of Tri-S for all years presented.

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Paragon Systems was formerly a subchapter S corporation and, consequently, pro forma income tax expense and pro forma net income are presented on the face of the historical statements of operations for all periods presented. The adjustments include only taxes at a statutory rate of 38% for each period presented.

In accordance with requirements of purchase accounting, the assets and liabilities of Paragon Systems were adjusted to their estimated fair values and the resulting goodwill computed for the Acquisition. The application of purchase accounting generally results in higher depreciation and amortization expense in periods subsequent to the Acquisition. Accordingly, the results discussed for the year ended December 31, 2004 are not comparable with prior years.

Overview

We operate in a single reportable segment offering contract guard services to various Federal government agencies pursuant to long-term contracts. These guard services include providing uniformed and armed guards for access control, personnel protection, plant security, theft prevention, surveillance, vehicular and foot patrol, crowd control and the prevention of sabotage, terrorist and criminal activities. In connection with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training, arming and supervising guards deployed to the Federal government agencies we serve as well as paying all guards and providing them with uniforms, fringe benefits and workers' compensation insurance.

We were incorporated in Georgia in October 2001 for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. We currently intend to pursue acquisition opportunities in the contract guard services and systems integration services segments of the security industry. To this end, we acquired Paragon Systems in February 2004. Paragon Systems has been providing contract guard services to Federal government agencies since 1994.

We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

During the year ended December 31, 2004, the Federal government exercised option renewals for eleven of our existing contracts and a six month extension on one of our contracts for providing contract guard and logistics services, which contracts generate aggregate annual revenue of approximately \$30.0 million. Paragon Systems also obtained one new contract for providing contract guard services, which contract generates annual revenue of approximately \$250,000.

During the year ended December 31, 2003, the Federal government exercised option renewals for seven of our existing contracts for providing contract guard and logistics services, which contracts generate aggregate annual revenue of approximately \$9.8 million. Paragon Systems also obtained four new contracts for providing contract guard services, which contracts generate aggregate annual revenue of approximately \$17.7 million. One contract for providing contract guard services which expired on December 31, 2002 was renewed for an additional five-year period and generates aggregate annual revenue of approximately \$1.3 million.

During 2005, all of our existin